

D R A F T
FOR APPROVAL

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

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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

WITH PREFATORY NOTE AND REPORTER’S NOTES

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

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

3 **PREFATORY NOTE**

4 **I. Introduction**

5 From its inception, the Article 1 Drafting Committee performed two related,
6 but distinct, tasks – revision of the current text of Uniform Commercial Code Article
7 1 and harmonization of ongoing UCC projects. This draft represents the product of
8 one of those tasks – revision of the provisions of Article 1. The other task entailed
9 the Drafting Committee serving as a harmonization committee for the purpose of
10 seeking to insure that the Uniform Commercial Code speaks with a single voice to
11 the extent appropriate.

12 After lengthy analysis and discussion, the Drafting Committee decided to
13 recommend a relatively small number of substantive changes to the law as it is
14 currently set forth in Article 1. Those changes, concerning scope of the Article,
15 applicability of supplemental principles of law, the concept of good faith, choice of
16 law, the relevance of course of performance between the parties, and the existence
17 of an independent statute of frauds, are described in some detail in Part II below.
18 The changes with respect to choice of law are probably the most important changes
19 in this draft and were the subject of more extensive Drafting Committee analysis and
20 deliberation than any other topic.

21 In addition to these substantive changes, the Drafting Committee decided to
22 make some structural changes to Article 1. These structural changes, intended to
23 make this Article more closely fit with the drafting conventions of the more recently
24 addressed Articles and to lessen some difficulties in interpretation, are described in
25 Part III below. Other than these structural changes, the Drafting Committee
26 generally decided to resist the temptation to make non-substantive changes to
27 provisions that have not been a source of serious problems in the nearly four
28 decades since the widespread enactment of the UCC. A few such changes should be
29 noted, however. First, as in all of the other UCC Articles promulgated in the last
30 decade, provisions have been reformulated in a gender-neutral fashion. Second, in a
31 very small number of cases, minor changes in wording have been made when the
32 current wording has proven confusing. Those changes are noted in the Preliminary
33 Comments following each section but are not otherwise described in this Prefatory
34 Note.

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II. Substantive Issues

The following are significant substantive issues raised by changes from current Article 1, in the order of their appearance in the draft:

A. Scope

Article 1 contains a relatively small number of substantive rules, but those rules are of fundamental importance. Occasionally courts and commentators have expressed uncertainty as to which transactions are governed by the substantive rules. Section 1-102 expresses a point that is implicit in current Article 1 – namely, that the substantive rules in Article 1 apply only to transactions within the scope of the other Articles.

B. Applicability of Supplemental Principles of Law

This draft merges subsections (1) and (2) of current Section 1-102 (concerning the underlying purposes and policies of the UCC) and current Section 1-103 (concerning the applicability of supplemental principles of law) into a revised Section 1-103. The provisions have been combined in this section to reflect the interrelationship between the Code’s purposes and policies and the extent to which other law is available to supplement it. Except for changing the form of reference to the Uniform Commercial Code, subsection (b) of this section is identical to current Section 1-103. The Preliminary Comments to this section, though, give more helpful guidance as to the distinction between situations in which Code provisions preempt the application of other law and those in which such supplementation is permissible.

C. Good Faith

Section 1-201(19) replaces the current definition of “good faith” (“honesty in fact in the conduct or transaction concerned”) with the definition adopted by all but one of the recently revised UCC Articles as well as drafts of Revised Articles 2 and 2A – “honesty in fact *and the observance of reasonable commercial standards of fair dealing.*” The section explicitly provides, however, that its definition of “good faith” does not displace the narrower definition in UCC Article 5. In addition to centralizing the developments already taking place in other Articles, the new definition resolves any ambiguity as to the proper definition to apply to the general duty of good faith imposed by Article 1.

D. Choice of Law

Section 1-301 represents a significant rethinking of choice of law issues addressed in current UCC Section 1-105. The new section reexamines both the

1 power of parties to select the jurisdiction whose law will govern their transaction
2 and the determination of the governing law in the absence of such selection by the
3 parties. With respect to the power to select governing law, the draft affords greater
4 party autonomy, but with important safeguards protecting consumer interests and
5 fundamental policies. While the Drafting Committee considered also addressing the
6 related topic of forum selection clauses, it ultimately decided that it was not
7 workable for the Uniform Commercial Code to govern such clauses.

8 **1. Contractual Designation of Governing Law**

9 Revised UCC Section 1-301 addresses contractual designation of governing
10 law somewhat differently than does current Section 1-105. Current law allows the
11 parties to any transaction to designate a jurisdiction whose law governs if the
12 transaction bears a “reasonable relation” to that jurisdiction. Revised Article 1
13 deviates from this unified approach by providing different rules for consumer
14 transactions than for “business to business” transactions.

15 In the context of consumer transactions, revised Article 1, unlike current
16 law, protects consumers against the possibility of losing the protection of consumer
17 protection laws of their home jurisdiction.

18 In the context of business-to-business transactions, revised Article 1
19 generally provides the parties with greater autonomy to designate a jurisdiction
20 whose law will govern than does current Article 1, but also provides some
21 safeguards against abuse that do not appear in current Article 1. Following
22 emerging international norms, greater autonomy is provided in subsections (b) and
23 (c) by deleting the requirement that the transaction bear a “reasonable relation” to
24 the jurisdiction designated in this non-consumer context. It should be noted in this
25 regard that in the case of wholly domestic transactions the jurisdiction designated
26 must be a State. An important safeguard not present in current law is provided in
27 subsection (e). Subsection (e) indicates that the designation of a jurisdiction’s law is
28 not effective (even if the transaction bears a reasonable relation to that jurisdiction)
29 to the extent that application of that law would be contrary to a fundamental policy
30 of the jurisdiction whose law would govern in the absence of contractual
31 designation. Application of the law designated may be contrary to a fundamental
32 policy of the State or country whose law would otherwise govern either because of
33 the nature of the law designated or because of the “mandatory” nature of the law
34 that would otherwise apply.

2. Choice of Law in the Absence of Contractual Designation of Governing Law

In the absence of an effective contractual designation of governing law, current UCC Section 1-105(1) directs the forum to apply its own law if the transaction bears “an appropriate relation to this state.” This provision, however, is frequently ignored by courts. Revised UCC Section 1-301(b) provides simply that, in the absence of contractual designation, the court should apply the forum’s choice of law principles.

E. Course of Performance

Section 1-304 adds the concept of “course of performance,” currently utilized only in Articles 2 and 2A, to course of dealing and usage of trade as the contextual clues that a court may use to interpret a contract.

F. Statute of Frauds

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

III. Structural Issues

A. General Organization

Current Article 1 is divided into two parts. Part 1 is entitled “Short Title, Construction, Application and Subject Matter of Act.” Part 2 is entitled “General Definitions and Principles of Interpretation.” The rationale for placement of particular sections in one part or the other is occasionally obscure. This draft reorganizes Article 1 into three parts. Part 1 – “General Provisions” – contains general rules about the UCC as a whole. Part 2 – “General Definitions and Principles of Interpretation” – contains the Code’s major definitional section as well as additional rules of interpretation. Part 3 – “Territorial Applicability and General Rules” – contains substantive rules that apply to all transactions that are within the scope of the Code.

B. Relocation of Substantive Rules Embedded in Definitions

1 The Drafting Committee identified four cases in which definitions in Section
2 1-201 were made unnecessarily complicated by substantive rules embedded within
3 them. Extracting those substantive rules and placing them in separate sections
4 enables those rules to be presented more effectively and is more consistent with
5 current drafting principles in many States.

6 **1. Notice and knowledge**

7 The rules concerning notice and knowledge have been moved from their
8 current location in three subsections of Section 1-201 to a separate substantive
9 section. The Drafting Committee believes that, with this reorganization, the
10 concepts are more clearly articulated and more easily found.

11 **2. Distinguishing leases from security interests**

12 In current Article 1, the definition of “security interest” consists of a short
13 paragraph elucidating a basic principle that resolves almost every issue, followed by
14 over 50 lines of clarification and qualification that serve only one function –
15 distinguishing “true leases” from transactions that are leases in form but security
16 interests in substance. This extended rule even contains a nested definition of the
17 term “present value,” which it uses as part of drawing the distinction between true
18 leases and security interests. The portion of the definition of “security interest” that
19 distinguishes true leases from security interests has been moved to a separate
20 substantive section. As a result, the remaining portion of the definition of “security
21 interest” is shorter and clearer. The definition of “present value” is moved to its
22 own definitional subsection.

23 **3. Value**

24 Whether a person acquires rights “for value” is at present the subject of a
25 definitional provision in current Section 1-201(44). Yet, as the NCCUSL
26 Committee on Style correctly noted to the Drafting Committee, the provision is
27 more appropriately articulated as a free-standing rule. It has been moved to Section
28 1-204.

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

3 **PART 1**
4 **GENERAL PROVISIONS**

5 **SECTION 1-101. SHORT TITLES.**

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

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

9 **Preliminary Comments**

10 **Source:** Former Section 1-101.

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

14 1. Each other Article of the Uniform Commercial Code (except Articles 10
15 and 11) may also be cited by its own short title. See Sections 2-101, 2A-101,
16 3-101, 4-101, 4A-101, 5-101, 6-101, 7-101, 8-101, and 9-101.

17 **SECTION 1-102. SCOPE OF ARTICLE.** This article applies to a
18 transaction to the extent that it is governed by another article of [the Uniform
19 Commercial Code].

20 **Preliminary Comments**

21 **Source:** New.

22 1. This section is intended to resolve confusion that has occasionally arisen
23 as to the applicability of the substantive rules in this article. As this section makes
24 clear, the rules in article 1 apply to transactions to the extent that those transactions

1 are governed by one of the other articles of the Uniform Commercial Code. This
2 article does not apply to transactions to the extent that they are governed by other
3 law. See Preliminary Comment 1 to Section 1-301.

4 **SECTION 1-103. CONSTRUCTION OF [ACT] TO PROMOTE ITS**
5 **PURPOSES AND POLICIES; APPLICABILITY OF SUPPLEMENTAL**
6 **PRINCIPLES OF LAW.**

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

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

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

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

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

19 **Preliminary Comments**

20 **Source:** Former Section 1-102 (1)-(2); Former Section 1-103.

21 **Changes from former law:** This section is derived from subsections (1)
22 and (2) of former Section 1-102 and from former Section 1-103. Subsection (a) of
23 this section combines subsections (1) and (2) of former Section 1-102. Except for
24 changing the form of reference to the Uniform Commercial Code and minor stylistic
25 changes, its language is the same as subsections (1) and (2) of former Section 1-102.

1 Except for changing the form of reference to the Uniform Commercial Code,
2 subsection (b) of this section is identical to former Section 1-103. The provisions
3 have been combined in this section to reflect the interrelationship between them.

4 1. The Uniform Commercial Code is drawn to provide flexibility so that,
5 since it is intended to be a semi-permanent piece of legislation, it will provide its
6 own machinery for expansion of commercial practices. It is intended to make it
7 possible for the law embodied in the Uniform Commercial Code to be developed by
8 the courts in the light of unforeseen and new circumstances and practices.
9 However, the proper construction of the Uniform Commercial Code requires that its
10 interpretation and application be limited to its reason.

11 Even prior to the enactment of the Uniform Commercial Code, courts were
12 careful to keep broad acts from being hampered in their effects by later acts of
13 limited scope. [*Pacific Wool Growers v. Draper & Co.*, 158 Or. 1, 73 P.2d 1391
14 (1937), and] compare Section 1-104. The courts recognized the policies embodied
15 in an act as applicable in reason to subject-matter that was not expressly included in
16 the language of the act, [*Commercial Nat. Bank of New Orleans v. Canal-Louisiana*
17 *Bank & Trust Co.*, 239 U.S. 520, 36 S.Ct. 194, 60 L.Ed. 417 (1916) (bona fide
18 purchase policy of Uniform Warehouse Receipts Act extended to case not covered
19 but of equivalent nature)] and did the same where reason and policy so required,
20 even where the subject-matter had been intentionally excluded from the act in
21 general. [*Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479 (1934) (Uniform Sales Act
22 change in seller's remedies applied to contract for sale of choses in action even
23 though the general coverage of that Act was intentionally limited to goods "other
24 than things in action.")] They implemented a statutory policy with liberal and useful
25 remedies not provided in the statutory text. They disregarded a statutory limitation
26 of remedy where the reason of the limitation did not apply. [*Fiterman v. J. N.*
27 *Johnson & Co.*, 156 Minn. 201, 194 N.W. 399 (1923) (requirement of return of the
28 goods as a condition to rescission for breach of warranty; also, partial rescission
29 allowed).] Nothing in the Uniform Commercial Code stands in the way of the
30 continuance of such action by the courts.

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

37 2. **Applicability of supplemental principles of law.** Subsection (b) states
38 the basic relationship of the Uniform Commercial Code to supplemental bodies of
39 law. The Uniform Commercial Code was drafted against the backdrop of existing

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

The language of subsection (b) is intended to reflect both the concept of supplementation and the concept of preemption. Some courts, however, had difficulty in applying the identical language of former Section 1-103 to determine when other law appropriately may be applied to supplement the Code, and when that law has been displaced by the Code. Some decisions applied other law in situations in which that application, while not inconsistent with the text of any particular provision of the Code, clearly was inconsistent with the underlying purposes and policies reflected in the relevant Code provisions. *See, e.g., Sheerbonnet, Ltd. v. American Express Bank, Ltd.*, 951 F. Supp. 403 (S.D.N.Y. 1995). In part, this difficulty arose from Comment 1 to former Section 1-103, which stated that “this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act.” The “explicitly displaced” language of that Comment does not accurately reflect the proper scope of Code preemption, which extends to displacement of other law that is inconsistent with its purposes and policies as well as its text.

3. Application of subsection (b) to statutes. The primary focus of Section 1-103 is on the relationship between the Uniform Commercial Code and principles of common law and equity as developed by the courts. State law, however, increasingly is statutory. Not only are there a growing number of state statutes addressing specific issues that come within the scope of the Uniform Commercial Code, but in some States many general principles of common law and equity have been codified. When the other law relating to a matter within the scope of the Uniform Commercial Code is a statute, the principles of subsection (b) remain relevant to the court’s analysis of the relationship between that statute and the Uniform Commercial Code, but will be supplemented by other principles of statutory interpretation that specifically address the interrelationship between statutes. In some situations, the principles of subsection (b) still will be determinative. For example, the mere fact that an equitable principle is stated in statutory form rather than in judicial decisions should not change the court’s analysis

of whether the principle can be used to supplement the Uniform Commercial Code – under subsection (b), equitable principles may supplement provisions of the Uniform Commercial Code only if they are consistent with the purposes and policies of the Uniform Commercial Code as well as its text. In other situations, however, other interpretive principles addressing the interrelationship between statutes may lead the court to conclude that the other statute is controlling, even though it conflicts with the Uniform Commercial Code. This, for example, would be the result in a situation where the other statute was specifically intended to provide additional protection to a class of individuals engaging in transactions covered by the Uniform Commercial Code.

4. **Listing not exclusive.** The list of sources of supplemental law in subsection (b) is intended to be merely illustrative of the other law that may supplement the Uniform Commercial Code, and is not exclusive. No listing could be exhaustive. Further, the fact that a particular section of the Uniform Commercial Code makes express reference to other law is not intended to suggest the negation of the general application of the principles of subsection (b). Note also that the word “bankruptcy” in subsection (b), continuing the use of that word from former Section 1-103, should be understood not as a specific reference to federal bankruptcy law but, rather as a reference to general principles of insolvency, whether under federal or state law.

SECTION 1-104. CONSTRUCTION AGAINST IMPLIED REPEAL.

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

Preliminary Comments

Source: Former Section 1-104.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former UCC Section 1-104.

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

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

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

Preliminary Comments

Source: Former Section 1-108.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former UCC Section 1-108.

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

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

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

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

Preliminary Comments

Source: Former Section 1-102(5). See also 1 U.S.C. § 1.

Changes from former law: Other than minor stylistic changes, this section is identical to former UCC Section 1-102(5).

1. This section makes it clear that the use of singular or plural in the text of the Uniform Commercial Code is generally only a matter of drafting style – singular words may be applied in the plural, and plural words may be applied in the singular. Only when it is clear from the statutory context that the use of the singular or plural does not include the other is this rule inapplicable. *See, e.g.*, Section 9-322.

SECTION 1-107. SECTION CAPTIONS. Section captions are part of [the Uniform Commercial Code].

Preliminary Comments

Source: Former Section 1-109.

Changes from former law: None.

1. Section captions are a part of the text of the Uniform Commercial Code, and not mere surplusage. This is not the case, however, with respect to subsection headings appearing in Article 9. See Preliminary Comment 3 to Section 9-101 (“subsection headings are not a part of the official text itself and have not been approved by the sponsors.”).

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PART 2
GENERAL DEFINITIONS AND
PRINCIPLES OF INTERPRETATION

SECTION 1-201. GENERAL DEFINITIONS.

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

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

(1) “Action”, in the sense of a judicial proceeding, includes recoupment, counterclaim, set-off, suit in equity, and any other proceeding in which rights are determined.

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

(3) “Agreement” means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in Section 1-303.
(Compare “Contract.”)

(3a) “Authenticate” *[The standard NCCUSL definition will be inserted.]*

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

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

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

10 (7) “Branch” includes a separately incorporated foreign branch of a
11 bank.

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

14 (9) “Buyer in ordinary course of business” means a person that buys
15 goods in good faith, without knowledge that the sale violates the rights of another
16 person in the goods, and in the ordinary course from a person, other than a
17 pawnbroker, in the business of selling goods of that kind. A person buys goods in
18 the ordinary course if the sale to the person comports with the usual or customary
19 practices in the kind of business in which the seller is engaged or with the seller’s
20 own usual or customary practices. A person that sells oil, gas, or other minerals at
21 the wellhead or minehead is a person in the business of selling goods of that kind. A
22 buyer in ordinary course of business may buy for cash, by exchange of other

1 property, or on secured or unsecured credit, and may acquire goods or documents
2 of title under a pre-existing contract for sale. Only a buyer that takes possession of
3 the goods or has a right to recover the goods from the seller under Article 2 may be
4 a buyer in ordinary course of business. A person that acquires goods in a transfer in
5 bulk or as security for or in total or partial satisfaction of a money debt is not a
6 buyer in ordinary course of business.

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

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

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

18 (10a) “Consumer” means an individual who enters into a transaction
19 primarily for personal, family, or household purposes

20 (11) “Contract” means the total legal obligation that results from the
21 parties’ agreement as determined by [the Uniform Commercial Code] as
22 supplemented by any other applicable laws. (Compare “Agreement.”)

1 (12) “Creditor” includes a general creditor, a secured creditor, a lien
2 creditor, and any representative of creditors, including an assignee for the benefit of
3 creditors, a trustee in bankruptcy, a receiver in equity, and an executor or
4 administrator of an insolvent debtor’s or assignor’s estate.

5 (13) “Defendant” includes a person in the position of defendant in a
6 counterclaim or third party claim.

7 (14) “Delivery”, with respect to an instrument, document of title, or
8 chattel paper, means voluntary transfer of possession.

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

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

18 (17) “Fungible goods” means:

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

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

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

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

4 (20) “Holder” means:

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

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

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

12 (23) “Insolvent” means:

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

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

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

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

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

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

4 (30) “Person” means an individual, corporation, business trust, estate,
5 trust, partnership, limited liability company, association, joint venture, government,
6 governmental subdivision, agency, or instrumentality, public corporation, or any
7 other legal or commercial entity.

8 (30a) “Present value” means the amount as of a date certain of one or
9 more sums payable in the future, discounted to the date certain by use of either an
10 interest rate specified by the parties if that rate is not manifestly unreasonable at the
11 time the transaction is entered into or, if an interest rate is not so specified, a
12 commercially reasonable rate that takes into account the facts and circumstances at
13 the time the transaction is entered into.

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

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

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

1 (33a) “Record” means information that is inscribed on a tangible
2 medium or that is stored in an electronic or other medium and is retrievable in
3 perceivable form.

4 (34) “Remedy” means any remedial right to which an aggrieved party is
5 entitled with or without resort to a tribunal.

6 (35) “Representative” means any person empowered to act for another,
7 including an agent, an officer of a corporation or association, and a trustee,
8 executor, or administrator of an estate.

9 (36) “Right” includes remedy.

10 (37) “Security interest” means an interest in personal property or
11 fixtures which secures payment or performance of an obligation. The term also
12 includes any interest of a consignor and a buyer of accounts, chattel paper, a
13 payment intangible, or a promissory note in a transaction that is subject to Article 9.
14 The special property interest of a buyer of goods on identification of those goods to
15 a contract for sale under Section 2- 401 is not a “security interest”, but a buyer may
16 also acquire a “security interest” by complying with Article 9. Except as otherwise
17 provided in Section 2-505, the right of a seller or lessor of goods under Article 2 or
18 2A to retain or acquire possession of the goods is not a “security interest”, but a
19 seller or lessor may also acquire a “security interest” by complying with Article 9.
20 The retention or reservation of title by a seller of goods notwithstanding shipment or
21 delivery to the buyer (Section 2-401) is limited in effect to a reservation of a

1 “security interest.” Whether a transaction in the form of a lease creates a “security
2 interest” is determined pursuant to Section 1-203.

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

4 (A) to deposit in the mail or deliver for transmission by any other
5 usual means of communication with postage or cost of transmission provided for
6 and properly addressed and, in the case of an instrument, to an address specified
7 thereon or otherwise agreed, or if there be none to any address reasonable under the
8 circumstances; or

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

11 (39) “Signed” includes any symbol executed or adopted with present
12 intention to adopt or accept a writing.

13 (39a) “State” means a State of the United States, the District of
14 Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular
15 possession subject to the jurisdiction of the United States.

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

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

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

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

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

3 **Preliminary Comments**

4 **Source:** Former Section 1-201.

5 **Changes from former law:** In order to make it clear that all definitions in
6 the Uniform Commercial Code – not just those in Article 1 – do not apply if the
7 context otherwise requires, a new subsection (a) to that effect has been added. The
8 reference to the “context” is intended to refer to the context in which the defined
9 term is used in the UCC. In other words, the definition applies whenever the
10 defined term is used unless the context in which the defined term is used in the
11 statute indicates that the term was not used in its defined sense. Consider, for
12 example, UCC §§ 3-103(a)(9) (defining “promise,” in relevant part, as “a written
13 undertaking to pay money signed by the person undertaking to pay”) and
14 3-303(a)(1) (indicating that an instrument is issued or transferred for value if “the
15 instrument is issued or transferred for a promise of performance, to the extent that
16 the promise has been performed.” It is clear from the statutory context of the use of
17 the word “promise” in Section 3-303(a)(1) that the term was not used in the sense
18 of its definition in Section 3-103(a)(9). Thus, the Section 3-103(a)(9) definition
19 should not be used to give meaning to the word “promise” in Section 3-303(a). The
20 remainder of former Section 1-201, as revised, now appears as subsection (b).

21 Other than minor stylistic changes, the definitions in this draft are as in
22 former Article 1 (as amended, most recently, in conjunction with revisions to Article
23 9) except as noted below. It should be noted that numbering of existing definitions
24 has been left constant even though some new definitions have been added to this
25 section and some others have been moved to other sections.

26 1. “Action.” Unchanged from former Section 1-201, which was derived
27 from similar definitions in Section 191, Uniform Negotiable Instruments Law;
28 Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act;
29 Section 53, Uniform Bills of Lading Act.

30 2. “Aggrieved party.” Unchanged from former Section 1-201.

31 3. “Agreement.” Derived from former Section 1-201. As used in the
32 Uniform Commercial Code the word is intended to include full recognition of usage
33 of trade, course of dealing, course of performance and the surrounding
34 circumstances as effective parts thereof, and of any agreement permitted under the
35 provisions of the Uniform Commercial Code to displace a stated rule of law.
36 Whether an agreement has legal consequences is determined by applicable

1 provisions of the Uniform Commercial Code and, to the extent provided in Section
2 1-103, by the law of contracts.

3 3a. “Authenticate.” This is the standard definition of the term used in acts
4 prepared by the National Conference of Commissioners on Uniform State Laws.

5 4. “Bank.” Derived from Section 4A-104.

6 5. “Bearer.” Unchanged from former Section 1-201, which was derived
7 from Section 191, Uniform Negotiable Instruments Law.

8 6. “Bill of Lading.” Derived from former Section 1-201. The reference to
9 airbills has been deleted as no longer necessary.

10 7. “Branch.” Unchanged from former Section 1-201.

11 8. “Burden of establishing a fact.” Unchanged from former Section 1-201.

12 9. “Buyer in ordinary course of business.” Unchanged from former Section
13 1-201 (as amended in conjunction with the 1999 revisions to Article 9). The major
14 significance of the phrase lies in Section 2-403 and in the Article on Secured
15 Transactions (Article 9).

16 The first sentence of paragraph (9) makes clear that a buyer from a
17 pawnbroker cannot be a buyer in ordinary course of business. The second sentence
18 tracks Section 6-102(1)(m). It explains what it means to buy “in the ordinary
19 course.” The penultimate sentence prevents a buyer that does not have the right to
20 possession as against the seller from being a buyer in ordinary course of business.
21 Concerning when a buyer obtains possessory rights, see Sections 2-502 and 2-716.
22 However, the penultimate sentence is not intended to affect a buyer’s status as a
23 buyer in ordinary course of business in cases (such as a “drop shipment”) involving
24 delivery by the seller to a person buying from the buyer or a donee from the buyer.
25 The requirement relates to whether *as against the seller* the buyer or one taking
26 through the buyer has possessory rights.

27 10. “Conspicuous.” Derived from Section 2-103(a)(10). It states the
28 general standard that to be conspicuous a term ought to be noticed by a reasonable
29 person. Whether a term is conspicuous is an issue for the court. Subparagraphs (A)
30 and (B) set out several methods for making a term conspicuous. Requiring that a
31 term be conspicuous blends a notice function (the term ought to be noticed) and a
32 planning function (giving guidance to the party relying on the term regarding how
33 that result can be achieved). Although these paragraphs indicate some of the
34 methods for making a term attention-calling, the test is whether attention can

1 reasonably be expected to be called to it. The statutory language should not be
2 construed to permit a result that is inconsistent with that test.

3 11. "Contract." Unchanged from former Section 1-201.

4 11a. "Consumer." Derived from Section 9-102(a)(25).

5 12. "Creditor." Unchanged from former Section 1-201.

6 13. "Defendant." Unchanged from former Section 1-201, which was
7 derived from Section 76, Uniform Sales Act.

8 14. "Delivery." Derived from former Section 1-201. The reference to
9 certificated securities has been deleted in light of the more specific treatment of the
10 matter in Section 8-301.

11 15. "Document of title." Unchanged from former Section 1-201, which was
12 derived from Section 76, Uniform Sales Act. By making it explicit that the
13 obligation or designation of a third party as "bailee" is essential to a document of
14 title, this definition clearly rejects any such result as obtained in *Hixson v. Ward*, 254
15 Ill.App. 505 (1929), which treated a conditional sales contract as a document of
16 title. Also the definition is left open so that new types of documents may be
17 included. It is unforeseeable what documents may one day serve the essential
18 purpose now filled by warehouse receipts and bills of lading. Truck transport has
19 already opened up problems which do not fit the patterns of practice resting upon
20 the assumption that a draft can move through banking channels faster than the
21 goods themselves can reach their destination. There lie ahead air transport and such
22 probabilities as teletype transmission of what may some day be regarded
23 commercially as "Documents of Title." The definition is stated in terms of the
24 function of the documents with the intention that any document which gains
25 commercial recognition as accomplishing the desired result shall be included within
26 its scope. Fungible goods are adequately identified within the language of the
27 definition by identification of the mass of which they are a part.

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

1 obligation undertaken by the shipping company, then it is a warehouse receipt within
2 this section regardless of the name given to the instrument.

3 The goods must be “described,” but the description may be by marks or
4 labels and may be qualified in such a way as to disclaim personal knowledge of the
5 issuer regarding contents or condition. However, baggage and parcel checks and
6 similar “tokens” of storage which identify stored goods only as those received in
7 exchange for the token are not covered by this Article.

8 The definition is broad enough to include an airway bill.

9 16. “Fault.” Derived from former Section 1-201. “Default” has been added
10 to the list events constituting fault.

11 17. “Fungible.” Derived from former Section 1-201. The definition has
12 been reorganized and references to securities have been deleted because Article 8 no
13 longer uses the term “fungible” to describe securities.

14 18. “Genuine.” Unchanged from former Section 1-201.

15 19. “Good faith.” Former Section 1-201(19) defined “good faith” simply as
16 honesty in fact; the definition contained no element of commercial reasonableness.
17 Initially, that definition applied throughout the Code with only one exception.
18 Former Section 2-103(1)(b) provided that “*in this Article . . . good faith* in the case
19 of a merchant means honesty in fact and the observance of reasonable commercial
20 standards of fair dealing in the trade.” This alternative definition was limited in
21 applicability in three ways. First, it applied only to transactions within the scope of
22 Article 2. Second, it applied only to merchants. Third, strictly construed it applied
23 only to uses of the phrase “good faith” *in Article 2*; thus, so construed it would not
24 define “good faith” for its most important use – the obligation of good faith imposed
25 by former UCC Section 1-203.

26 Over time, however, amendments to the UCC brought the Article 2
27 merchant concept of good faith (subjective honesty and objective reasonableness)
28 into other Articles. First, Article 2A explicitly incorporated the Article 2 standard.
29 See current UCC Section 2A-103(7). Then, other Articles broadened the
30 applicability of that standard by adopting it for all parties rather than just for
31 merchants. *See, e.g.*, UCC Sections 3-103(a)(4), 4A-105(a)(6), 8-102(a)(10), and
32 9-102(a)(43). *See also* Draft of Revised Article 2. All of these definitions are
33 comprised of two elements – honesty in fact *and* the observance of reasonable
34 commercial standards of fair dealing. Only revised Article 5 defines “good faith”
35 solely in terms of subjective honesty, and only Article 6 and Article 7 are without
36 definitions of good faith. (It should be noted that, while revised Article 6 did not

1 define good faith, Comment 2 to revised UCC Section 6-102 states that “this Article
2 adopts the definition of ‘good faith’ in Article 1 in all cases, even when the buyer is
3 a merchant.”) Given this near unanimity, it is appropriate to move the broader
4 definition of “good faith” to Article 1. Of course, this definition is subject to the
5 applicability of the narrower definition in revised Article 5.

6 20. “Holder.” Derived from former Section 1-201. The definition has been
7 reorganized for clarity.

8 22. “Insolvency proceedings.” Unchanged from former Section 1-201.

9 23. “Insolvent.” Derived from former Section 1-201. The three tests of
10 insolvency – “generally ceased to pay debts in the ordinary course of business other
11 than as a result of a bona fide dispute as to them,” “unable to pay debts as they
12 become due,” and “insolvent within the meaning of the federal bankruptcy law” –
13 are expressly set up as alternative tests and must be approached from a commercial
14 standpoint.

15 24. “Money.” Unchanged from former Section 1-201. The test is that of
16 sanction of government, whether by authorization before issue or adoption
17 afterward, which recognizes the circulating medium as a part of the official currency
18 of that government. The narrow view that money is limited to legal tender is
19 rejected.

20 28. “Organization.” The former definition of this word has been replaced
21 with the standard definition used in acts prepared by the National Conference of
22 Commissioners on Uniform State Laws.

23 29. “Party.” Substantively identical to former Section 1-201. Mention of a
24 party includes, of course, a person acting through an agent. However, where an
25 agent comes into opposition or contrast to the principal, particular account is taken
26 of that situation.

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

30 30a. “Present value.” This definition was formerly contained within the
31 definition of “security interest” in former Section 1-201(37).

32 31. “Presumption.” Unchanged from former Section 1-201.

1 32. “Purchase.” Derived from former UCC Section 1-201. The form of
2 definition has been changed from “includes” to “means.”

3 33. “Purchaser.” Unchanged from former Section 1-201.

4 33a. “Record.” Derived from Section 9-102(a)(69).

5 34. “Remedy.” Unchanged from former Section 1-201. The purpose is to
6 make it clear that both remedy and right (as defined) include those remedial rights of
7 “self help” which are among the most important bodies of rights under the Uniform
8 Commercial Code, remedial rights being those to which an aggrieved party can
9 resort on its own motion.

10 35. “Representative.” Derived from former Section 1-201. Reorganized,
11 and form changed from “includes” to “means.”

12 36. “Right.” Unchanged from former Section 1-201.

13 37. “Security Interest.” The definition is the first paragraph of the definition
14 of “security interest” in former Section 1-201. The remaining portion has been
15 moved to Section 1-203. Notice that in view of Article 9 the term includes the
16 interest of certain outright buyers of certain kinds of property.

17 38. “Send.” New. Compare “notifies”.

18 39. “Signed.” Derived from former Section 1-201. Former Section 1-201
19 referred to “intention to authenticate”; because authenticate is now a defined term,
20 the language has been changed to “intention to adopt or accept.” The latter
21 formulation is derived from the definition of “authenticate.” The definition of
22 “signed” is to make clear that, as the term is used in the Uniform Commercial Code,
23 a complete signature is not necessary. The symbol may be printed, stamped or
24 written; it may be by initials or by thumbprint. It may be on any part of the
25 document and in appropriate cases may be found in a billhead or letterhead. No
26 catalog of possible situations can be complete and the court must use common sense
27 and commercial experience in passing upon these matters. The question always is
28 whether the symbol was executed or adopted by the party with present intention to
29 adopt or accept the writing.

30 39a. “State.” This is the standard definition of the term used in acts
31 prepared by the National Conference of Commissioners on Uniform State Laws.

32 40. “Surety.” This definition makes it clear that “surety” includes all
33 secondary obligors, not just those whose obligation refers to them person obligated

1 as a surety. As to the nature of secondary obligations generally, see Restatement of
2 Suretyship and Guaranty § 1.

3 42. “Term.” Unchanged from former Section 1-201.

4 43. “Unauthorized signature.” Unchanged from former Section 1-201.

5 45. “Warehouse receipt.” Unchanged from former Section 1-201, which
6 was derived from Section 76(1), Uniform Sales Act; Section 1, Uniform Warehouse
7 Receipts Act. Receipts issued by a field warehouse are included, provided the
8 warehouseman and the depositor of the goods are different persons.

9 46. “Written” or “writing.” Unchanged from former Section 1-201.

10 **SECTION 1-202. NOTICE; KNOWLEDGE.**

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

12 (1) has actual knowledge of it;

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

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

16 (b) “Knowledge” means actual knowledge.

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

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

22 (e) Subject to subsection (f), a person “receives” a notice or notification
23 when:

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

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

16 **Preliminary Comments**

17 **Source:** Derived from former Section 1-201(25)-(27).

18 **Changes from former law:** These provisions are substantive rather than
19 purely definitional. Accordingly, they have been relocated from Section 1-201 to
20 this section.

21 1. Under subsection (a), a person has notice when, *inter alia*, the person has
22 received a notification of the fact in question. The subsection leaves open the time
23 and circumstances under which notice or notification may cease to be effective.
24 Therefore such cases as *Graham v. White-Phillips Co.*, 296 U.S. 27, 56 S.Ct. 21, 80
25 L.Ed. 20 (1935), are not overruled.

1 2. As shown in subsection (d), the word “notifies” is used when the essential
2 fact is the proper dispatch of the notice, not its receipt. Compare “Send.” When the
3 essential fact is the other party’s receipt of the notice, that is stated. Subsection (e)
4 states when a notification is received.

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

10 **SECTION 1-203. LEASE DISTINGUISHED FROM SECURITY**
11 **INTEREST.**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Preliminary Comments

Source: Former Section 1-201(37).

Changes from former law: This section is substantively identical to those portions of former UCC Section 1-201(37) that distinguished “true” leases from security interests, except that the definition of “present value” formerly embedded in Section 1-201(37) has been placed in UCC Section 1-201(30a).

1. An interest in personal property or fixtures which secures payment or performance of an obligation is a “security interest.” See Section 1-201(37). Security interests are sometimes created by transactions in the form of leases. Because it can be difficult to distinguish leases that create security interests from those that do not, this section provides rules that govern the determination of whether a transaction in the form of a lease creates a security interest.

2. One of the reasons it was decided to codify the law with respect to leases was to resolve an issue that created considerable confusion in the courts: what is a lease? The confusion existed, in part, due to the last two sentences of the definition of security interest in the 1978 Official Text of the Act, Section 1-201(37). The confusion was compounded by the rather considerable change in the federal, state and local tax laws and accounting rules as they relate to leases of goods. The answer is important because the definition of lease determines not only the rights and remedies of the parties to the lease but also those of third parties. If a

1 transaction creates a lease and not a security interest, the lessee's interest in the
2 goods is limited to its leasehold estate; the residual interest in the goods belongs to
3 the lessor. This has significant implications to the lessee's creditors. "On common
4 law theory, the lessor, since he has not parted with title, is entitled to full protection
5 against the lessee's creditors and trustee in bankruptcy" 1 G. Gilmore,
6 *Security Interests in Personal Property* § 3.6, at 76 (1965).

7 Under pre-UCC chattel security law there was generally no requirement that
8 the lessor file the lease, a financing statement, or the like, to enforce the lease
9 agreement against the lessee or any third party; the Article on Secured Transactions
10 (Article 9) did not change the common law in that respect. Coogan, *Leasing and the*
11 *Uniform Commercial Code*, in *Equipment Leasing—Leveraged Leasing* 681, 700
12 n.25, 729 n.80 (2d ed.1980). The Article on Leases (Article 2A) did not change the
13 law in that respect, except for leases of fixtures. Section 2A-309. An examination
14 of the common law will not provide an adequate answer to the question of what is a
15 lease. The definition of security interest in Section 1-201(37) of the 1978 Official
16 Text of the Act provided that the Article on Secured Transactions (Article 9)
17 governs security interests disguised as leases, *i.e.*, leases intended as security;
18 however, the definition became vague and outmoded.

19 Lease is defined in Article 2A as a transfer of the right to possession and use
20 of goods for a term, in return for consideration. Section 2A-103(1)(j). The
21 definition continues by stating that the retention or creation of a security interest is
22 not a lease. Thus, the task of sharpening the line between true leases and security
23 interests disguised as leases continues to be a function of this Article.

24 This section begins where Section 1-201(37) leaves off. It draws a sharper
25 line between leases and security interests disguised as leases to create greater
26 certainty in commercial transactions.

27 Prior to enactment of the rules in this section, the 1978 text of Section
28 1-201(37) provided that whether a lease was intended as security (*i.e.*, a security
29 interest disguised as a lease) was to be determined from the facts of each case;
30 however, (a) the inclusion of an option to purchase did not itself make the lease one
31 intended for security, and (b) an agreement that upon compliance with the terms of
32 the lease the lessee would become, or had the option to become, the owner of the
33 property for no additional consideration, or for a nominal consideration, did make
34 the lease one intended for security.

35 Reference to the intent of the parties to create a lease or security interest led
36 to unfortunate results. In discovering intent, courts relied upon factors that were
37 thought to be more consistent with sales or loans than leases. Most of these criteria,
38 however, were as applicable to true leases as to security interests. Examples include

1 the typical net lease provisions, a purported lessor's lack of storage facilities or its
2 character as a financing party rather than a dealer in goods. Accordingly, this
3 section contains no reference to the parties' intent.

4 Subsections (a) and (b) are taken from Section 1(2) of the Uniform
5 Conditional Sales Act (act withdrawn 1943), modified to reflect current leasing
6 practice. Thus, reference to the case law prior to this Act will provide a useful
7 source of precedent. Gilmore, *Security Law, Formalism and Article 9*, 47
8 Neb.L.Rev. 659, 671 (1968). Whether a transaction creates a lease or a security
9 interest continues to be determined by the facts of each case. Subsection (b) further
10 provides that a transaction creates a security interest if the lessee has an obligation
11 to continue paying consideration for the term of the lease, if the obligation is not
12 terminable by the lessee (thus correcting early statutory gloss, e.g., *In re Royer's*
13 *Bakery, Inc.*, 1 U.C.C. Rep.Serv. (Callaghan) 342 (Bankr.E.D.Pa.1963)) and if one
14 of four additional tests is met. The first of these four tests, subparagraph (1), is that
15 the original lease term is equal to or greater than the remaining economic life of the
16 goods. The second of these tests, subparagraph (2), is that the lessee is either bound
17 to renew the lease for the remaining economic life of the goods or to become the
18 owner of the goods. *In re Gehrke Enters.*, 1 Bankr. 647, 651-52
19 (Bankr.W.D.Wis.1979). The third of these tests, subparagraph (3), is whether the
20 lessee has an option to renew the lease for the remaining economic life or the goods
21 for no additional consideration or for nominal additional consideration, which is
22 defined later in this section. *In re Celeryvale Transp.*, 44 Bankr. 1007, 1014-15
23 (Bankr.E.D.Tenn.1984). The fourth of these tests, subparagraph (4), is whether the
24 lessee has an option to become the owner of the goods for no additional
25 consideration or for nominal additional consideration. All of these tests focus on
26 economics, not the intent of the parties. *In re Berge*, 32 Bankr. 370, 371-73
27 (Bankr.W.D.Wis.1983).

28 The focus on economics is reinforced by subsection (c). It states that a
29 transaction does not create a security interest merely because the transaction has
30 certain characteristics listed therein. Subparagraph (1) has no statutory derivative;
31 it states that a full payout lease does not *per se* create a security interest. *Rushton v.*
32 *Shea*, 419 F.Supp. 1349, 1365 (D.Del.1976). Subparagraph (2) provides the same
33 regarding the provisions of the typical net lease. *Compare All-States Leasing Co. v.*
34 *Ochs*, 42 Or.App. 319, 600 P.2d 899 (Ct.App.1979) *with In re Tillery*, 571 F.2d
35 1361 (5th Cir.1978). Subparagraph (3) restates and expands the provisions of
36 former Section 1-201(37) to make clear that the option can be to buy or renew.
37 Subparagraphs (4) and (5) treat fixed price options and provide that fair market
38 value must be determined at the time the transaction is entered into. *Compare*
39 *Arnold Mach. Co. v. Balls*, 624 P.2d 678 (Utah 1981), *with Aoki v. Shepherd*
40 *Mach. Co.*, 665 F.2d 941 (9th Cir.1982).

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

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

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

SECTION 1-204. VALUE. Except as otherwise provided in Articles 3, 4, [and] 5, [and 6], a person gives value for rights if the person acquires them:

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

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

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

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

Preliminary Comments

Source: Former Section 1-201(44).

Changes from former law: Unchanged from former Section 1-201, which was derived from Sections 25, 26, 27, 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 58, Uniform Warehouse Receipts Act; Section 22(1), Uniform Stock Transfer Act;

1 Section 1, Uniform Trust Receipts Act. These provisions are substantive rather than
2 purely definitional. Accordingly, they have been relocated from former Section
3 1-201 to this section.

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

12 This definition is not applicable to Articles 3 and 4, but the express inclusion
13 of immediately available credit as value follows the separate definitions in those
14 Articles. See Sections 4-208, 4-209, 3-303. A bank or other financing agency
15 which in good faith makes advances against property held as collateral becomes a
16 bona fide purchaser of that property even though provision may be made for
17 charge-back in case of trouble. Checking credit is “immediately available” within
18 the meaning of this section if the bank would be subject to an action for slander of
19 credit in case checks drawn against the credit were dishonored, and when a
20 charge-back is not discretionary with the bank, but may only be made when
21 difficulties in collection arise in connection with the specific transaction involved.

22 **SECTION 1-205. REASONABLE TIME; SEASONABLENESS.**

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

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

28 **Preliminary Comments**

29 **Source:** Former Section 1-204(2)-(3).

30 **Changes from former law:** This section is derived from subsections (2)
31 and (3) of former Section 1-204. Subsection (1) of that section is now incorporated
32 in Section 1-302(b).

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

4 2. Under subsection (b), the agreement that fixes the time need not be part
5 of the main agreement, but may occur separately. Notice also that under the
6 definition of “agreement” (Section 1-201) the circumstances of the transaction,
7 including course of dealing or usages of trade or course of performance may be
8 material. On the question what is a reasonable time these matters will often be
9 important.

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PART 3

TERRITORIAL APPLICABILITY AND GENERAL RULES

SECTION 1-301. TERRITORIAL APPLICABILITY; PARTIES’

POWER TO CHOOSE APPLICABLE LAW.

(a) In this section:

(1) “Domestic transaction” means a transaction other than an international transaction; and

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

(b) Except as otherwise provided in this section:

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

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

(c) In the absence of an agreement effective under subsection (b), and except as provided in subsections (d) and (f), the rights and obligations of the parties are determined by the law that would be selected by application of this State’s conflict of laws principles.

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

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

5 (2) Application of the law of the State or country determined pursuant
6 to subsection (b) or (c) may not deprive the consumer of the protection of any rule
7 of law, that both is protective of consumers and may not be varied by agreement, of
8 the State or country:

9 (A) in which the consumer habitually resides, unless subparagraph
10 (B) applies; or

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

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

18 (f) To the extent that [the Uniform Commercial Code] governs a
19 transaction, where one of the following provisions of [the Uniform Commercial
20 Code] specifies the applicable law, that provision governs and a contrary agreement
21 is effective only to the extent permitted by the law (including the conflict of law
22 rules) so specified:

- 1 (1) Section 2-402;
- 2 (2) Sections 2A-105 and 2A-106;
- 3 (3) Section 4-102;
- 4 (4) Section 4A-507;
- 5 (5) Section 5-116;
- 6 [(6) Section 6-103;]
- 7 (7) Section 8-110;
- 8 (8) Sections 9-301 through 9-307.

9 **Preliminary Comments**

10 **Source:** Former Section 1-105.

11 **Summary of changes from former law:** Section 1-301, which replaces
12 former UCC Section 1-105, represents a significant rethinking of choice of law
13 issues addressed in that section. The new section reexamines both the power of
14 parties to select the jurisdiction whose law will govern their transaction and the
15 determination of the governing law in the absence of such selection by the parties.
16 With respect to the power to select governing law, the draft affords greater party
17 autonomy than former Section 1-105, but with important safeguards protecting
18 consumer interests and fundamental policies. While the Drafting Committee
19 considered addressing the related topic of forum selection clauses, it ultimately
20 decided that Article 1 of the Uniform Commercial Code is not an appropriate
21 vehicle for addressing this issue.

22 Revised UCC Section 1-301 addresses contractual designation of governing
23 law somewhat differently than does former Section 1-105. Former law allows the
24 parties to any transaction to designate a jurisdiction whose law governs if the
25 transaction bears a “reasonable relation” to that jurisdiction. Revised Article 1
26 deviates from this unified approach by providing different rules for consumer
27 transactions than for “business to business” transactions.

28 In the context of consumer transactions, revised Article 1, unlike former law,
29 generally protects consumers against the possibility of losing the protection of
30 consumer protection laws of their home jurisdiction.

1 In the context of business-to-business transactions, revised Article 1
2 generally provides the parties with greater autonomy to designate a jurisdiction
3 whose law will govern than does former Article 1, but also provides some
4 safeguards against abuse that do not appear in former Article 1. Following
5 emerging international norms, greater autonomy is provided in subsections (b) and
6 (c) by deleting the requirement that the transaction bear a “reasonable relation” to
7 the jurisdiction designated in this non-consumer context. It should be noted in this
8 regard that in the case of wholly domestic transactions the jurisdiction designated
9 must be a State. An important safeguard not present in former law is provided in
10 subsection (e). Subsection (e) indicates that the designation of a jurisdiction’s law is
11 not effective (even if the transaction bears a reasonable relation to that jurisdiction)
12 to the extent that application of that law would be contrary to a fundamental policy
13 of the jurisdiction whose law would govern in the absence of contractual
14 designation. Application of the law designated may be contrary to a fundamental
15 policy of the State or country whose law would otherwise govern either because of
16 the nature of the law designated or because of the “mandatory” nature of the law
17 that would otherwise apply.

18 In the absence of an effective contractual designation of governing law,
19 former UCC Section 1-105(1) directs the forum to apply its own law if the
20 transaction bears “an appropriate relation to this state.” This provision, however, is
21 frequently ignored by courts. Revised UCC Section 1-301(c) provides simply that,
22 in the absence of contractual designation, the court should apply the forum’s choice
23 of law principles.

24 **1. Applicability of section.** This section is neither a full Restatement of
25 choice of law principles nor a free-standing choice of law statute. Rather, it is a
26 provision of Article 1 of the Uniform Commercial Code. As such, it is subject to
27 Section 1-102, which states the scope of Article 1. As that section indicates, Article
28 1, and the rules contained therein, apply to transactions to the extent that they are
29 governed by one of the other Articles of the Uniform Commercial Code. Thus, this
30 section does not apply to a transaction outside the scope of the Uniform
31 Commercial Code such as a services contract or a contract for the sale of real estate.
32 On the other hand, if the transaction is within the scope of a substantive Article of
33 the Uniform Commercial Code, such as in the case of a sale or lease of goods, this
34 section does apply.

35 In some cases, a transaction is neither completely within the scope of the
36 Uniform Commercial Code (as in the case of a sale or lease of goods) nor
37 completely outside the scope of the Uniform Commercial Code (as in the case of a
38 contract for the sale of real estate). Rather, some aspects of the transaction are
39 within the substantive scope of the Uniform Commercial Code while other aspects
40 are not. One example of this phenomenon is an agreement to loan money in which

1 the borrower's obligation to repay the loan is secured by a security interest in
2 personal property. The security agreement, and the security interest created
3 thereby, are clearly within the scope of Article 9. The loan agreement, on the other
4 hand, is governed not by the Uniform Commercial Code but by the general law of
5 contracts. Another example is provided by a real estate lease in which the lessee's
6 obligation to pay the stated rent is backed by a standby letter of credit issued by a
7 bank. The lease is governed by realty law outside the Uniform Commercial Code,
8 while the letter of credit is governed by Article 5. While this section, by its terms,
9 only applies to the UCC aspect of such a "mixed transaction," it is within a court's
10 discretion to decide in a particular case that bifurcation of the choice of law
11 principles applicable to the transaction is inadvisable and, accordingly, to apply
12 principles of this section to the non-UCC aspects of the transaction in order to have
13 the law of the same State or country apply to the entire transaction. When the UCC
14 aspects of such a "mixed transaction" predominate, such a decision may be
15 particularly appropriate.

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

27 There are three important limitations on this party autonomy to select
28 governing law. First, a different, and more protective, rule applies in the context of
29 consumer transactions (see note *c*). Second, in an entirely domestic transaction, this
30 section does not validate the selection of foreign law. (See note *d*.) Third,
31 contractual choice of law will not be given effect to the extent that application of the
32 law designated would be contrary to a fundamental policy of the State or country
33 whose law would be applied in the absence of such contractual designation (see
34 Comment 5).

35 The Drafting Committee considered whether this section should expressly
36 provide for the ability of parties to designate non-legal codes such as trade codes as
37 the set of rules governing their transaction, but decided that the principles of Section
38 1-302 allowing parties broad freedom of contract to structure their relation are
39 adequate for this purpose. A similar decision was made with respect to the ability of
40 the parties to designate recognized bodies of rules or principles applicable to

1 commercial transactions that are promulgated by intergovernmental authorities such
2 as UNCITRAL or UNIDROIT. *See, e.g.,* UNIDROIT Principles of International
3 Commercial Contracts.

4 **3. Consumer transactions.** If one of the parties is a consumer (as defined
5 in Section 1-201(11a)), subsection (d) provides the parties less autonomy to
6 designate the State or country whose law will govern. First, in a consumer
7 transaction subsection (d)(1) provides that the transaction must bear a reasonable
8 relation to the State or country designated. Second, except as noted below,
9 subsection (d)(2) provides that a designation of the law of a State or country other
10 than that of the consumer's habitual residence, even if the transaction bears a
11 reasonable relation to that State or country, will not deprive the consumer of the
12 protection of any rules of law of the consumer's habitual residence which are
13 protective of consumers and are not variable by agreement. (It should be noted that
14 the phrase "rule of law" is intended to refer to case law as well as statutes and
15 administrative regulations.) Thus, for example, in the case of a sale of goods by a
16 seller in Indiana to a consumer buyer in New York, in which transaction the contract
17 designates Indiana law as governing, the New York buyer will retain the protection
18 of nonwaivable New York rules of law that are protective of consumers.

19 There is one exception to this principle. In the case of a sale of goods to a
20 consumer in which the consumer makes the contract and takes possession of the
21 goods in a State or country other than the consumer's habitual residence, subsection
22 (d)(2)(B) provides that it is the consumer protection rules of law of that State or
23 country that cannot be eliminated by choice of law. Thus, for example, if a New
24 York consumer, while on vacation in Indiana, buys goods and takes delivery of them
25 at an Indiana branch of an Ohio retailer, and the contract designates Ohio law as
26 governing, this choice of law may not deprive the New York consumer buyer of
27 nonwaivable Indiana rules of law that are protective of consumers, but may deprive
28 that buyer of analogous New York rules. This exception, adapted from UCC
29 Section 2A-106 and Article 5 of the EC Convention on the Law Applicable to
30 Contractual Obligations, enables a seller that engages in only face-to-face
31 transactions to ascertain in advance which consumer protection law it is subject to.
32 The reference in subsection (d)(2)(B) to the State or country in which the consumer
33 makes the contract should not be read to incorporate formalistic concepts of where
34 the last event necessary to conclude the contract took place; rather, the intent is to
35 identify the State in which all material steps were taken by the consumer to enter
36 into the contract.

37 In the absence of a contractual designation of governing law, application of
38 the choice of law rules of the forum, as mandated by subsection (c), could lead to
39 application of the laws of a State or country other than that of the consumer's
40 habitual residence. In such a case, subsection (d)(2) still applies to preserve

1 consumer protection rules for the benefit of the consumer as described in the
2 preceding paragraph.

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

11 **5. International transactions.** This section provides greater autonomy in
12 the context of international transactions. As defined in subsection (a)(2), a
13 transaction is an “international transaction” if it bears a reasonable relation to a
14 country other than the United States. In a non-consumer international transaction,
15 subsection (b)(2) provides that a designation of the law of any State or country is
16 effective (subject, of course, to the limitations set out in subsections (e) and (f)). It
17 is important to note that the transaction need not bear a relation to the State or
18 country designated so long as the transaction is international. Thus, for example, in
19 a non-consumer lease of goods in which the lessor is located in Mexico and the
20 lessee is located in Louisiana, a designation of the law of Ireland to govern the
21 transaction would be given effect under this section even though the transaction may
22 bear no relation to Ireland. The ability to designate the law of any country in non-
23 consumer international transactions is important in light of the common practice in
24 many commercial contexts of designating the law of a “neutral” jurisdiction whose
25 law is well-developed.

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

36 Under the fundamental policy doctrine, a court should not refrain from
37 applying the designated law merely because this would lead to a result different than
38 would be obtained under the local law of the State or country whose law would
39 otherwise govern. Rather, the difference must be contrary to a public policy that is

1 so substantial that it justifies overriding the concerns for certainty and predictability
2 underlying modern commercial law as well as concerns for judicial economy
3 generally. Thus, application of the designated law will rarely be found to be
4 contrary to a fundamental policy of the State or country whose law would otherwise
5 govern when the difference between the two concerns a requirement, such as a
6 statute of frauds, that relates to formalities, or general rules of contract law, such as
7 those concerned with the need for consideration.

8 The opinion of Judge Cardozo in *Loucks v. Standard Oil Co. of New York*,
9 120 N.E. 198 (1918), regarding the related issue of when a state court may decline
10 to apply the law of another State, is a helpful touchstone here:

11 Our own scheme of legislation may be different. We may even have no
12 legislation on the subject. That is not enough to show that public policy forbids
13 us to enforce the foreign right. A right of action is property. If a foreign statute
14 gives the right, the mere fact that we do not give a like right is no reason for
15 refusing to help the plaintiff in getting what belongs to him. We are not so
16 provincial as to say that every solution of a problem is wrong because we deal
17 with it otherwise at home. Similarity of legislation has indeed this importance;
18 its presence shows beyond question that the foreign statute does not offend the
19 local policy. But its absence does not prove the contrary. It is not to be exalted
20 into an indispensable condition. The misleading word ‘comity’ has been
21 responsible for much of the trouble. It has been fertile in suggesting a discretion
22 unregulated by general principles.

23 * * *

24 The courts are not free to refuse to enforce a foreign right at the pleasure of the
25 judges, to suit the individual notion of expediency or fairness. They do not close
26 their doors, unless help would violate some fundamental principle of justice,
27 some prevalent conception of good morals, some deep-rooted tradition of the
28 common weal.

29 120 N.E. at 201-02 (citations to authorities omitted).

30 Analytically, one might conclude that application of the designated law is
31 contrary to a fundamental policy of the State or country whose law would otherwise
32 govern either (i) because the substance of the designated law violates a fundamental
33 principle of justice of that State or country or (ii) because it differs from a rule of
34 that State or country that is “mandatory” in that it *must* be applied in the courts of
35 that State or country without regard to otherwise-applicable choice of law rules of
36 that State or country and without regard to whether the designated law is otherwise
37 offensive. This distinction, which may have more theoretical than practical
38 significance, has been suggested in some international conventions in this area,

1 although in some cases the concept is applied to authorize the *forum* State to apply
2 *its* mandatory rules, rather than those of the State or country whose law would
3 otherwise govern. The latter situation is not addressed by this section. See
4 Comment 9.

5 In any event, it is obvious that a rule that is freely changeable by agreement
6 of the parties under the law of the State or country whose law would otherwise
7 govern can hardly be construed as a mandatory rule of that State or country. This
8 does not mean, however, that rules that cannot be changed by agreement under that
9 law are, for that reason alone, mandatory rules. Otherwise, contractual choice of
10 law in the UCC context would be illusory and redundant; the parties would be able
11 to accomplish by choice of law no more than can be accomplished under Section
12 1-302 (by agreeing to vary the rules that would otherwise govern their transaction
13 by substituting for those rules the rules that would apply if the transaction were
14 governed by the designated State or country) without designation of governing law.
15 Indeed, other than cases in which a mandatory choice of law rule is established by
16 statute (*see, e.g.*, UCC Sections 9-301 through 9-307, explicitly preserved in
17 subsection (f)), cases in which courts have declined to follow the designated law
18 solely because a rule of the State or country whose law would otherwise govern is
19 mandatory are rare.

20 **7. Choice of law in the absence of contractual designation.** Subsection
21 (c), which replaces the second sentence of former UCC Section 1-105(1),
22 determines which jurisdiction's law governs a transaction in the absence of an
23 effective contractual choice by the parties. Former Section 1-105(1), provided that
24 the law of the forum (*i.e.*, the Uniform Commercial Code) applies if the transaction
25 bears "an appropriate relation to this state." By using an "appropriate relation" test,
26 rather than, say, requiring that the forum be the location of the "most significant"
27 contact, Section 1-105(1) expressed a bias in favor of applying the forum's law.
28 This bias, while not universally respected by the courts, was justifiable in light of the
29 uncertainty that existed at the time of drafting as to whether the Uniform
30 Commercial Code would be adopted by all the States; the pro-forum bias would
31 assure that the Uniform Commercial Code would be applied so long as the
32 transaction bore an "appropriate" relation to the forum. Inasmuch as the Uniform
33 Commercial Code has been adopted, at least in part, in all U.S. jurisdictions, the
34 vitality of this point is minimal in the domestic context, and international comity
35 concerns militate against continuing the pro-forum, pro-UCC bias in transnational
36 transactions. When the choice is between the law of two jurisdictions that have
37 adopted the Uniform Commercial Code, but whose law differs (whether because of
38 differences in enacted language or differing judicial interpretations), there is no
39 strong justification for directing a court to apply different choice of law rules to its
40 determination than it would apply if the matter were not governed by the Uniform
41 Commercial Code. Similarly, given the wide variety of choice of law principles

1 applied by the States, it would not be prudent to designate only one such principle
2 as the proper one for transactions governed by the Uniform Commercial Code.
3 Accordingly, in cases in which the parties have not made an effective choice of law,
4 Section 1-301(a) simply directs the forum to apply its ordinary choice of law
5 principles to determine which jurisdiction's law governs.

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

9 **9. Matters not addressed by this section.** As noted in Comment 1, this
10 section is not a complete statement of conflict of laws doctrines applicable in
11 commercial cases. In particular, this section does not address, and leaves to other
12 law, two issues that relate to the forum and its law. First, a forum will occasionally
13 decline to apply the law of a different jurisdiction selected by the parties when
14 application of that law would be contrary to a fundamental policy of the forum
15 jurisdiction, even if it would not be contrary to a fundamental policy of the State or
16 country whose law would govern in the absence of contractual designation.
17 Standards for application of this doctrine relate primarily to concepts of sovereignty
18 rather than commercial law and are thus left to the courts. Second, in determining
19 whether to give effect to the parties' agreement that the law of a particular State or
20 country will govern their relationship, courts must, of necessity, address some issues
21 as to the basic validity of that agreement. These issues might relate, for example, to
22 capacity to contract and absence of duress. This section does not address these
23 issues.

24 **SECTION 1-302. VARIATION BY AGREEMENT.**

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

28 (b) The obligations of good faith, diligence, reasonableness, and care
29 prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement.
30 The parties, by agreement, may determine the standards by which the performance
31 of those obligations is to be measured if those standards are not manifestly

1 unreasonable. Whenever [the Uniform Commercial Code] requires any action to be
2 taken within a reasonable time, any time which is not manifestly unreasonable may
3 be fixed by agreement.

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

8 Preliminary Comments

9 **Source:** Former Sections 1-102(3)-(4) and 1-204(1).

10 **Changes:** This section combines the rules from subsections (3) and (4) of
11 former Section 1-102 and subsection (1) of former Section 1-204. No substantive
12 changes are made.

13 1. Subsection (a) states affirmatively at the outset that freedom of contract
14 is a principle of the Uniform Commercial Code: “the effect” of its provisions may be
15 varied by “agreement.” The meaning of the statute itself must be found in its text,
16 including its definitions, and in appropriate extrinsic aids; it cannot be varied by
17 agreement. But the Uniform Commercial Code seeks to avoid the type of
18 interference with evolutionary growth found in pre-Code cases such as *Manhattan*
19 *Co. v. Morgan*, 242 N.Y. 38, 150 N.E. 594 (1926). Thus private parties cannot
20 make an instrument negotiable within the meaning of Article 3 except as provided in
21 Section 3-104; nor can they change the meaning of such terms as “bona fide
22 purchaser,” “holder in due course,” or “due negotiation,” as used in the Uniform
23 Commercial Code. But an agreement can change the legal consequences that would
24 otherwise flow from the provisions of the Uniform Commercial Code. “Agreement”
25 here includes the effect given to course of dealing, usage of trade and course of
26 performance by Sections 1-201 and 1-303; the effect of an agreement on the rights
27 of third parties is left to specific provisions of the Uniform Commercial Code and to
28 supplementary principles applicable under Section 1-103. The rights of third parties
29 under Section 9-317 when a security interest is unperfected, for example, cannot be
30 destroyed by a clause in the security agreement.

31 This principle of freedom of contract is subject to specific exceptions found
32 elsewhere in the Uniform Commercial Code and to the general exception stated
33 here. The specific exceptions vary in explicitness: the statute of frauds found in

1 Section 2-201, for example, does not explicitly preclude oral waiver of the
2 requirement of a writing, but a fair reading denies enforcement to such a waiver as
3 part of the “contract” made unenforceable; Section 9-602, on the other hand, is a
4 quite explicit limitation on freedom of contract. Under the exception for “the
5 obligations of good faith, diligence, reasonableness and care prescribed by [the
6 Uniform Commercial Code],” provisions of the Uniform Commercial Code
7 prescribing such obligations are not to be disclaimed. However, the section also
8 recognizes the prevailing practice of having agreements set forth standards by which
9 due diligence is measured and explicitly provides that, in the absence of a showing
10 that the standards manifestly are unreasonable, the agreement controls. In this
11 connection, Section 1-303 incorporating into the agreement prior course of dealing
12 and usages of trade is of particular importance.

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

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

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

1 **SECTION 1-303. COURSE OF PERFORMANCE, COURSE OF**
2 **DEALING, AND USAGE OF TRADE.**

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

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

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

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

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

20 (d) A course of performance or course of dealing between the parties or
21 usage of trade in the vocation or trade in which they are engaged or of which they
22 are or should be aware is relevant in ascertaining the meaning of the parties’

1 agreement, may give particular meaning to specific terms of the agreement, and may
2 supplement or qualify the terms of the agreement. A usage of trade applicable in the
3 place in which part of the performance under the agreement is to occur may be so
4 utilized as to that part of the performance.

5 (e) Except as otherwise provided in subsection (f), the express terms of an
6 agreement and any applicable course of performance, course of dealing, or usage of
7 trade must be construed whenever reasonable as consistent with each other. If such
8 a construction is unreasonable:

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

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

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

14 (f) Subject to Section [2-209], a course of performance is relevant to show
15 a waiver or modification of any term inconsistent with the course of performance.

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

19 Preliminary Comments

20 **Source:** Former Sections 1-205, 2-208, and Section 2A-207.

21 **Changes from former law:** This section integrates the “course of
22 performance” concept from Articles 2 and 2A into the principles of former Section
23 1-205, which deals with course of dealing and usage of trade. In so doing, the
24 section slightly modifies the articulation of the course of performance rules to fit

1 more comfortably with the approach and structure of former UCC Section 1-205.
2 There are also slight modifications to be more consistent with the definition of
3 “agreement” in former Section 1-201(3). It should be noted that a course of
4 performance that might otherwise establish a defense to the obligation of a party to
5 a negotiable instrument is not available as a defense against a holder in due course
6 who took the instrument without notice of that course of performance.

7 1. The Uniform Commercial Code rejects both the “lay-dictionary” and the
8 “conveyancer’s” reading of a commercial agreement. Instead the meaning of the
9 agreement of the parties is to be determined by the language used by them and by
10 their action, read and interpreted in the light of commercial practices and other
11 surrounding circumstances. The measure and background for interpretation are set
12 by the commercial context, which may explain and supplement even the language of
13 a formal or final writing.

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

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

37 4. A usage of trade under subsection (c) must have the “regularity of
38 observance” specified. The ancient English tests for “custom” are abandoned in this
39 connection. Therefore, it is not required that a usage of trade be “ancient or

1 immemorial.” “universal,” or the like. Under the requirement of subsection (c) full
2 recognition is thus available for new usages and for usages currently observed by the
3 great majority of decent dealers, even though dissidents ready to cut corners do not
4 agree. There is room also for proper recognition of usage agreed upon by
5 merchants in trade codes.

6 5. The policies of the Uniform Commercial Code controlling explicit
7 unconscionable contracts and clauses (Sections 1-304, 2-302) apply to implicit
8 clauses that rest on usage of trade and carry forward the policy underlying the
9 ancient requirement that a custom or usage must be “reasonable.” However, the
10 emphasis is shifted. The very fact of commercial acceptance makes out a *prima*
11 *facie* case that the usage is reasonable, and the burden is no longer on the usage to
12 establish itself as being reasonable. But the anciently established policing of usage
13 by the courts is continued to the extent necessary to cope with the situation arising if
14 an unconscionable or dishonest practice should become standard.

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

20 7. Although the definition of “agreement” in Section 1-201 includes the
21 elements of course of performance, course of dealing, and usage of trade, the fact
22 that express reference is made in some sections to those elements is not to be
23 construed as carrying a contrary intent or implication elsewhere. Compare Section
24 1-302(c).

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

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

SECTION 1-304. OBLIGATION OF GOOD FAITH. Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.

Preliminary Comments

Source: Former Section 1-203.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former UCC Section 1-203. A Comment will make it clear that this section applies to the exercise of rights granted by the Uniform Commercial Code.

1. This section sets forth a basic principle running throughout the Uniform Commercial Code. The principle is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. While this duty is explicitly stated in some provisions of the Uniform Commercial Code, the applicability of the duty is broader than merely these situations and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within this Act. It is further implemented by Section 1-303 on course of dealing, course of performance, and usage of trade. This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, this section means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached.

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

SECTION 1-305. REMEDIES TO BE LIBERALLY ADMINISTERED.

(a) The remedies provided by [the Uniform Commercial Code] must be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special

1 damages nor penal damages may be had except as specifically provided in [the
2 Uniform Commercial Code] or by other rule of law.

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

6 Preliminary Comments

7 **Source:** Former Section 1-106.

8 **Changes from former law:** Other than changes in the form of reference to
9 the Uniform Commercial Code, this section is identical to former UCC Section
10 1-106.

11 1. Subsection (a) is intended to effect three propositions. The first is to
12 negate the possibility of unduly narrow or technical interpretation of remedial
13 provisions by providing that the remedies in the Uniform Commercial Code are to
14 be liberally administered to the end stated in this section. The second is to make it
15 clear that compensatory damages are limited to compensation. They do not include
16 consequential or special damages, or penal damages; and the Uniform Commercial
17 Code elsewhere makes it clear that damages must be minimized. Cf. Sections
18 1-203, 2-706(1), and 2-712(2). The third purpose of subsection (a) is to reject any
19 doctrine that damages must be calculable with mathematical accuracy.
20 Compensatory damages are often at best approximate: they have to be proved with
21 whatever definiteness and accuracy the facts permit, but no more. Cf. Section
22 2-204(3).

23 2. Under subsection (b), any right or obligation described in the Uniform
24 Commercial Code is enforceable by action, even though no remedy may be expressly
25 provided, unless a particular provision specifies a different and limited effect.
26 Whether specific performance or other equitable relief is available is determined not
27 by this section but by specific provisions and by supplementary principles. Cf.
28 Sections 1-103, 2-716.

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

SECTION 1-306. WAIVER OR RENUNCIATION OF CLAIM OR

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

Preliminary Comments

Source: Former Section 1-107.

Changes from former law: This section changes former law in two respects. First, former Section 1-107, requiring the “delivery” of a “written waiver or renunciation” merges the separate concepts of the aggrieved party’s agreement to forego rights and the manifestation of that agreement. This section separates those concepts, and explicitly requires *agreement* of the aggrieved party. Second, the revised section reflects developments in electronic commerce by providing for memorialization in an authenticated record.

1. This section makes consideration unnecessary to the effective renunciation or waiver of rights or claims arising out of an alleged breach of a commercial contract where the agreement effecting such renunciation is memorialized in a record authenticated by the aggrieved party. Its provisions, however, must be read in conjunction with the section imposing an obligation of good faith. (Section 1-304).

SECTION 1-307. PRIMA FACIE EVIDENCE BY THIRD PARTY

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

Preliminary Comments

Source: Former Section 1-202.

1 **Changes from former law:** No changes.

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

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

9 3. The provisions of this section go no further than establishing the
10 documents in question as prima facie evidence and leave to the court the ultimate
11 determination of the facts where the accuracy or authenticity of the documents is
12 questioned. In this connection the section calls for a commercially reasonable
13 interpretation.

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

16 **SECTION 1-308. PERFORMANCE OR ACCEPTANCE UNDER**
17 **RESERVATION OF RIGHTS.**

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

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

23 **Preliminary Comments**

24 **Source:** Former Section 1-207.

25 **Changes from former law:** This section is identical to former UCC Section
26 1-207.

27 1. This section provides machinery for the continuation of performance
28 along the lines contemplated by the contract despite a pending dispute, by adopting

1 the mercantile device of going ahead with delivery, acceptance, or payment “without
2 prejudice,” “under protest,” “under reserve,” “with reservation of all our rights,”
3 and the like. All of these phrases completely reserve all rights within the meaning of
4 this section. The section therefore contemplates that limited as well as general
5 reservations and acceptance by a party may be made “subject to satisfaction of our
6 purchaser,” “subject to acceptance by our customers,” or the like.

7 2. This section does not add any new requirement of language of reservation
8 where not already required by law, but merely provides a specific measure on which
9 a party can rely as that party makes or concurs in any interim adjustment in the
10 course of performance. It does not affect or impair the provisions of this Act such
11 as those under which the buyer’s remedies for defect survive acceptance without
12 being expressly claimed if notice of the defects is given within a reasonable time.
13 Nor does it disturb the policy of those cases which restrict the effect of a waiver of a
14 defect to reasonable limits under the circumstances, even though no such reservation
15 is expressed.

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

19 3. Subsection (b) states that this section does not apply to an accord and
20 satisfaction. Section 3-311 governs if an accord and satisfaction is attempted by
21 tender of a negotiable instrument as stated in that section. If Section 3-311 does not
22 apply, the issue of whether an accord and satisfaction has been effected is
23 determined by the law of contract. Whether or not Section 3-311 applies, this
24 section has no application to an accord and satisfaction.

25 **SECTION 1-309. OPTION TO ACCELERATE AT WILL.** A term
26 providing that one party or that party’s successor in interest may accelerate payment
27 or performance or require collateral or additional collateral “at will” or when the
28 party “deems itself insecure,” or words of similar import, means that the party has
29 power to do so only if that party in good faith believes that the prospect of payment
30 or performance is impaired. The burden of establishing lack of good faith is on the
31 party against which the power has been exercised.

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Preliminary Comments

Source: Former Section 1-208.

Changes from former law: Except for minor stylistic changes, this section is identical to former UCC Section 1-208.

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

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

SECTION 1-310. SUBORDINATED OBLIGATIONS. An obligation may

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

Preliminary Comments

Source: Former Section 1-209.

Changes from former law: This section is substantively identical to former Section 1-209. The language in that section stating that it “shall be construed as declaring the law as it existed prior to the enactment of this section and not as modifying it” has been deleted.

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

11 2. Subordination agreements are enforceable between the parties as
12 contracts; and in the bankruptcy of the common debtor dividends otherwise payable
13 to the subordinated creditor are turned over to the superior creditor. This
14 “turn-over” practice has on occasion been explained in terms of “equitable lien,”
15 “equitable assignment,” or “constructive trust,” but whatever the label the practice is
16 essentially an equitable remedy and does not mean that there is a transaction “that
17 creates a security interest in personal property . . . by contract” or a “sale of
18 accounts, chattel paper, payment intangibles, or promissory notes” within the
19 meaning of Section 9-109. On the other hand, nothing in this section prevents one
20 creditor from assigning his rights to another creditor of the same debtor in such a
21 way as to create a security interest within Article 9, where the parties so intend.

22 3. The enforcement of subordination agreements is largely left to
23 supplementary principles under Section 1-103. If the subordinated debt is evidenced
24 by a certificated security, Section 8-202(a) authorizes enforcement against
25 purchasers on terms stated or referred to on the security certificate. If the fact of
26 subordination is noted on a negotiable instrument, a holder under Sections 3-302
27 and 3-306 is subject to the term because notice precludes him from taking free of
28 the subordination. Sections 3-302(3)(a), 3-306, and 8-317 severely limit the rights
29 of levying creditors of a subordinated creditor in such cases.