

D R A F T
FOR DISCUSSION ONLY

UNIFORM COMMERCIAL CODE
REVISED ARTICLE 1 – GENERAL PROVISIONS (199__)

September 1999 Draft

THE AMERICAN LAW INSTITUTE
NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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UNIFORM COMMERCIAL CODE

REVISED ARTICLE 1 — GENERAL PROVISIONS

PREFATORY NOTE TO SEPTEMBER 1999 DRAFT

The September 1999 draft of Revised Article 1 reflects changes agreed to at the October 1997 and subsequent Drafting Committee meetings and updates to reflect decisions made by other Drafting Committees with respect to matters in Article 1. Sections requiring Drafting Committee attention on issues of substance include Revised sections 1-102, 1-302, and 1-306.

Revised section 1-102 articulates both the general rules of construction of the Uniform Commercial Code and the relationship between the Uniform Commercial Code and other sources of law. This second function of the section, which appears in Section 1-103 in current Article 1, is of particular importance and this draft reflects shadings of the principle discussed at previous meetings.

Revised section 1-302 determines which jurisdiction's law governs a transaction. The Drafting Committee has devoted considerable time to the rules in this section that determine the extent to which parties may, by agreement, choose which law governs their transaction. The section provides for greater party autonomy on this issue than does current Section 1-105, but limits that autonomy in important respects. This draft is the latest step in the evolution of these principles. While several revised Articles of the Uniform Commercial Code contain their own choice of law rules, this section, if enacted, would provide greater autonomy and certainty in a wide variety of commercial transactions.

Revised section 1-306, which appears in brackets, would apply the unconscionability principles of Articles 2 and 2A across the commercial spectrum with the exception of Article 5. Articulation of these principles has proven controversial in the context of revisions to Articles 2 and 2A. The section appears in brackets because the Drafting Committee has not yet decided whether to include this section in the final draft of this Article. This draft reflects the articulation of those principles in current Article 2.

PREFATORY NOTE TO SEPTEMBER 1997 DRAFT

I. Introduction

The September 1997 draft of Revised Article 1 does not differ substantially from the 1997 Annual Meeting Draft. This draft reflects suggestions for improvement received since the last meeting of the Drafting Committee. Many of these suggestions were supplied by Commissioners

at the Annual Meeting of NCCUSL. Others were suggested by persons following the progress of this project. For the benefit of members of the American Law Institute Members Consultative Group and others for whom this may be the first draft received, this draft includes Revision Notes and other material contained in the 1997 Annual Meeting Draft as well as explanations of changes made since that draft.

II. Important Issues in This Draft

A. Preemptive Nature of Uniform Commercial Code

Revised section 1-102(b), which incorporates the concept contained in current UCC section 1-103, has been criticized by some as not adequately setting out the relationship between the UCC and non-Code law. This draft provides some alternative formulations.

B. Choice of Law

Revised section 1-302, dealing with choice of law issues, is somewhat complex. This draft reorganizes the section in a way that the Reporter believes is clearer. Also, the draft provides alternate formulations of a number of substantive issues including (i) the scope of the rules in the section, (ii) the special rules governing transactions involving consumers, and (iii) the “fundamental public policy” exception to party autonomy. In addition, the draft again presents for Drafting Committee decision the bracketed subsection concerning cases in which the forum’s choice of law rules would result in the application of the law of a different jurisdiction that would invalidate the parties’ transaction.

C. Variation by Agreement

It has been noted that revised section 1-303, like current Article 1, does not make it clear *which* parties must agree in order to vary the effect of Code sections. An alternate formulation of the section is provided to address this point. In addition, at the suggestion of one commentator, explicit recognition of trade codes is provided for the Drafting Committee’s consideration.

D. Unconscionability

Revised section 1-306, which appears in brackets, would provide an unconscionability principle for transactions throughout the Code (except Article 5). At present, only Articles 2 and 2A have such provisions. The Drafting Committee should consider whether to make a decision about this section at this meeting, or to continue it as a bracketed section for the time being.

UNIFORM COMMERCIAL CODE

REVISED ARTICLE 1 — GENERAL PROVISIONS

PREFATORY NOTE TO 1997 ANNUAL MEETING DRAFT

I. Introduction

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

II. Important Issues in This Draft

A. Organization

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

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

B. Applicability of Supplemental Principles of Law

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

C. “Opting In”

Revised Section 1-103 articulates a rule that allows parties to a transaction not governed by the Uniform Commercial Code (or governed by it only in part) to agree that provisions of the UCC will supply the rules governing their relationship. There is no parallel articulation in Section

1-103 of a right to “opt out” of the Code’s rules because such an agreement is governed by Section 1-303.

D. Electronic Writings and Notices

The definitions in Section 1-201 reflect the work of the Drafting Committees revising Articles 2 and 2A and preparing Article 2B, and of the Working Group on Electronic Writings and Notices of the Committee on the Law of Commerce in Cyberspace and the Uniform Commercial Code Committee of the Section on Business Law of the American Bar Association, in attempting to make the various terms defined in this Section reflect modern concepts of “writings”, “signatures”, and “notices.”

E. Definition of Good Faith

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

F. Notice and Knowledge

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

G. Definition of Security Interest

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

H. Scope of Application of Substantive Rules in Article 1

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

I. Choice of Law

Section 1-302 represents a significant rethinking of choice of law issues addressed in current UCC Section 1-105. The new section reexamines both the power of parties to select the jurisdiction whose law will govern their transaction and the determination of the governing law in the absence of such selection by the parties. It does not, however, as suggested by some, address the effectiveness of forum selection clauses.

J. Course of Performance

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

K. Unconscionability

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

L. Statute of Frauds

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

PART 1

GENERAL PROVISIONS

SECTION 1–101. SHORT TITLES.

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

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

Changes Since September 1997 Draft

None.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

**SECTION 1–102. CONSTRUCTION OF ACT TO PROMOTE ITS PURPOSES AND
POLICIES; APPLICABILITY OF SUPPLEMENTAL PRINCIPLES OF LAW.**

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

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

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

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

(b) Principles of law and equity, **including the law merchant [and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause]**, may be used to supplement [the Uniform Commercial Code], except to the extent that those principles are inconsistent with ~~(1)~~ either the **terms provisions** ~~[Alternative A — or the purposes and policies of] [Alternative B — of, or the principles embodied by, ‡ a particular provision of [the Uniform Commercial Code]; or,~~

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

Changes Since September 1997 Draft

This draft reflects decisions made at the April-May 1999 meeting with respect to the preemptive nature of the Uniform Commercial Code. “Underlying” added to subsection (a) to conform more closely to current Section 1-102(1).

Changes Since 1997 Annual Meeting Draft

The drafting of subsection (b), which incorporates the concept of current UCC section 1-103, has been criticized by some. This draft responds to two of those criticisms. First, in subsection (b)(1) it provides an alternate formulation for preemption of principles of law and equity by particular terms of the UCC; this alternate formulation (marked as Alternative B) replaces the reference to the “purposes and policies” of a particular provision with a reference to “the

principles embodied by” the provision. The Drafting Committee should decide whether Alternative B represents an improvement. Second, some observed that the reference in subsection (b)(2) to “the purposes and policies identified in subsection (a)” might be interpreted so broadly as to keep out virtually all principles of law and equity or to make introducing them unduly difficult. Accordingly, this draft places subsection (b)(2) in brackets for the Drafting Committee’s reconsideration.

Revision Notes (1997 Annual Meeting Draft)

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

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

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

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

Changes Since September 1997 Draft

Deleted by Drafting Committee action.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

SECTION 1-104. CONSTRUCTION AGAINST IMPLIED REPEAL. [The Uniform Commercial Code] is being a general act intended as a unified coverage of its subject matter. ~~No~~ no provision part of it shall be deemed to be impliedly repealed ~~may be construed as having been repealed by implication~~ by subsequent legislation if ~~this~~ such construction can reasonably ~~can~~ be avoided.

Changes Since September 1997 Draft

Conformed to current Section 1-104.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

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

Changes Since September 1997 Draft

None.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

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

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

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

1 **Changes Since September 1997 Draft**

2 None.

3 **Changes Since 1997 Annual Meeting Draft**

4 None.

5 **Revision Notes (1997 Annual Meeting Draft)**

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

PART 2

GENERAL DEFINITIONS AND PRINCIPLES OF INTERPRETATION

SECTION 1-201. GENERAL DEFINITIONS.

~~Subject to~~ **(a) Unless the statutory 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, ~~and unless the context otherwise requires, in~~ **have the meanings stated.**

(b) Subject to additional 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 1-304. **(Compare “Contract.”)**

(4) “Authenticate” means:

(A) to sign, or

(B) otherwise to execute or adopt a symbol, ~~or encrypt a record in whole or in part with present intent to identify the authenticating party, or to adopt or accept a record or term, or to establish the authenticity of a record or term that contains the authentication- **or**~~

sound, or to use encryption or another process with respect to a record, with intent of the authenticating person to:

(i) identify that person; or

(ii) adopt or accept the terms or a particular term of a record that

includes or is logically associated with, or linked to, the authentication, or to which a record containing the authentication refers.

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

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

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

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

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

(10)* “Buyer in ordinary course of business” means a person ~~who that buys goods in good faith, and without knowledge that the sale to him is in violation of~~ violates the rights of ~~ownership rights or security interest of a third party~~ another person in the goods, and ~~buys in the ordinary course from a person, other than a pawnbroker,~~ in the business of selling goods of that kind: ~~but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons~~ A person

*Reflecting changes made in conjunction with Revised Article 9.

1 buys goods in the ordinary course if the sale to the person comports with the usual or customary
2 practices in the kind of business in which the seller is engaged or with the seller's own usual or
3 customary practices. A person that sells ~~minerals or the like, including oil and gas,~~ **oil, gas, or**
4 **other minerals** at the wellhead or minehead is a person in the business of selling goods of that
5 kind. **"Buying"** A buyer in ordinary course of business may ~~be~~ buy for cash, ~~or~~ by exchange of
6 other property, or on secured or unsecured credit, and ~~includes receiving~~ may acquire goods or
7 documents of title under a pre-existing contract for sale **but does not include a transfer in bulk**
8 **or as security for or in total or partial satisfaction of a money debt.** Only a buyer that takes
9 possession of the goods or has a right to recover the goods from the seller (~~Section [2-xxx]~~)
10 **under Article 2** may be a buyer in ordinary course of business. A person that acquires goods in a
11 transfer in bulk or as security for or in total or partial satisfaction of a money debt is not a buyer in
12 ordinary course of business.

13 (11) "Conspicuous", **with reference to a term,** means so **written,** displayed, or
14 **otherwise** presented that a reasonable person against whom **which** it is to operate ~~would likely~~
15 **ought to** have noticed it, ~~or, in the case of.~~ **A term in** an electronic ~~message~~ **record** intended to
16 evoke a response ~~without the need for review by an individual,~~ **by an electronic agent is**
17 **conspicuous if it is presented** in a form that would enable ~~the recipient or the recipient's~~
18 ~~computer~~ **a reasonably configured electronic agent** to take it into account or react to it without
19 review of the message by an individual: **record by an individual. Conspicuous terms include**
20 **the following:**

21 **(A) with respect to a person:**

1 (i) a heading in capitals equal to or greater in size than the
2 surrounding lower case text, or in contrasting type, font, or color to, the surrounding text
3 of the same size;

4 (ii) language in the body of a record or display in larger type than the
5 surrounding text, or in contrasting type, font, or color to surrounding text of the same size,
6 or set off from surrounding text of the same size by symbols or other marks that call
7 attention to the language; and

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

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

13 (12) “Contract” means the total legal obligation that results from the parties’ agreement
14 as determined by [the Uniform Commercial Code] as supplemented by any other applicable laws.

15 Compare “Agreement.”)

16 (13) “Creditor” includes a general creditor, a secured party or other secured creditor, a
17 lien creditor, and any representative of creditors, including an assignee for the benefit of creditors,
18 a trustee in bankruptcy, a receiver in equity, and an executor or administrator of an insolvent
19 debtor’s or assignor’s estate.

20 (14) “Defendant” includes a person in the position of defendant in a counterclaim or
21 third party claim.

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

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

(17) "Electronic agent" means a computer program or ~~other~~ electronic or other automated means used, ~~selected, or programmed by a party~~ to initiate an action or respond to electronic messages or performances without ~~review~~ intervention by an individual at the time of the action or response.

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

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

(20) "Fungible goods" means either:

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

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

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

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

(23) “Holder” means:

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

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

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

(25) ~~An “Insolvent”~~ **person is a person who** means:

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

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

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

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

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

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

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

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

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

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

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

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

(35) “Remedy” means ~~relief~~ **any remedial right** to which an aggrieved party is entitled with or without resort to a tribunal.

** Reflecting changes made in conjunction with Revised Article 9.

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

(37) “Right” includes remedy.

(38)*** “Security interest” means an interest in personal property or fixtures that **which** secures payment or performance of an obligation. ~~The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2-401) is limited in effect to a reservation of a “security interest”.~~ The term also includes any interest of a consignor and a buyer of accounts, or chattel paper, or ~~which~~ a payment intangible, or a promissory note in a transaction that is subject to Article 9. The special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 2-~~xxx~~ **401** is not a “security interest”, but a buyer may also acquire a “security interest” by complying with Article 9. ~~Unless a consignment is intended as security, reservation of title thereunder is not a “security interest”, but a consignment in any event is subject to the provisions on consignment sales (Section 2-326). Except as otherwise provided in Section 2-505, the right of a seller or lessor of goods under Article 2 or 2A to retain or acquire possession of the goods is not a “security interest”, but a seller or lessor may also acquire a “security interest” by complying with Article 9.~~ The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2 -~~xxx~~-**401**) is limited in effect to a reservation of a “security interest: ”.

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

*** Reflecting changes made in conjunction with Revised Article 9.

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

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

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

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

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

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

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

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

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

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

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

Changes Since September 1997 Draft

In order to make it clear that all definitions in the Uniform Commercial Code — not just those in Article 1 — do not apply if the statutory context otherwise requires, a new subsection (a) to that effect has been added. The remainder of this section now appears in subsection (b).

Definitions relating to electronic commerce and communication have been updated to reflect actions taken by the Article 2 Drafting Committee through the 1999 Annual Meeting Draft.

Amendments to Article 1 promulgated as conforming amendments to Revised Article 9 have been incorporated.

Cross-references between definitions of “agreement” and “contract” appearing in current Article 1 restored.

Definition of “insolvent” changed to somewhat more closely conform to current Article 1.

Definition of “remedy” changed to conform to current Article 1.

Definition of “sign” adjusted, at direction of Drafting Committee, to conform more closely to current Article 1. As a result, it no longer conforms to definition in Uniform Limited Liability Company Act.

Changes Since 1997 Annual Meeting Draft

Document of title. The definition has been slightly reordered for clarity.

Revision Notes (1997 Annual Meeting Draft)

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

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

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

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

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

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

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

10 Many of the revisions to the definition of “buyer in ordinary course of business” in
11 subsection [(10)] are for clarification and style. The second sentence of the subsection is
12 new. It provides that the “ordinary course” requirement is met only if the sale is in the
13 ordinary course of the seller's business. The third sentence, which tracks Section
14 6-102(1)(m), explains when a sale is in the ordinary course of the seller's business.

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

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

1 *Conspicuous.* Identical to UCC Section 2-102(a)(7) (May 1997 Draft). It should be noted
2 that there are differences that remain to be resolved between this formulation and that in Article
3 2B.

4 *Consumer.* This section does not contain a definition of “consumer” or “consumer
5 transaction.” Revised Articles 2, 2A, 2B, and 9 contain definitions that are similar but differ in
6 light of their differing contexts. This draft defines those terms in Section 1-302 solely for
7 purposes of that section. Consideration should be given to placing a uniform definition in Section
8 1-201.

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

11 *Document of title.* The definition of “document of title” is identical to current UCC Section
12 1-201(15), except that “document” is replaced with “record.”

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

14 *Fungible.* The reference to securities has been deleted because Article 8 no longer uses the
15 term “fungible” to describe securities.

16 *Good faith.* Current UCC Section 1-201(19) defines “good faith” simply as honesty in fact;
17 the definition contains no element of commercial reasonableness. Initially, that definition applied
18 throughout the Code with only one exception. UCC section 2-103(1)(b) provided that “*in this*
19 *Article . . . good faith* in the case of a merchant means honesty in fact and the observance of
20 reasonable commercial standards of fair dealing in the trade.” This alternative definition was
21 limited in applicability in three ways. First, it only applied to transactions within the scope of
22 Article 2. Second, it applied only to merchants. Third, strictly construed it applied only to uses

1 of the phrase “good faith” *in Article 2*; thus, so construed it would not define “good faith” for its
2 most important use — the obligation of good faith imposed by current UCC Section 1-203.

3 Over time, however, amendments to the UCC brought the Article 2 concept of good faith
4 (subjective honesty and objective reasonableness) into other Articles. First, Article 2A explicitly
5 incorporated the Article 2 standard. See current UCC Section 2A-103(7). Then, other Articles
6 broadened the applicability of that standard by adopting it for all parties rather than just for
7 merchants. See, e.g., UCC Sections 3-103(a)(4), 4A-105(a)(6), 8-102(a)(10). See also drafts of
8 Article 2B and revised Articles 2 and 2A. All of these definitions are comprised of two elements
9 — honesty in fact *and* the observance of reasonable commercial standards of fair dealing. Only
10 revised Article 5 defines “good faith” solely in terms of subjective honesty, and if the revisions
11 currently in progress are promulgated, only Article 6 and Article 7 will be without definitions of
12 good faith. (It should be noted that, while revised Article 6 did not define good faith, Comment 2
13 to revised UCC section 6-102 states that “this Article adopts the definition of ‘good faith’ in
14 [current] Article 1 in all cases, even when the buyer is a merchant.”) Given this near unanimity, it
15 is appropriate to move the definition of “good faith” to Article 1. The section will, of course,
16 clearly indicate that this definition is subject to the applicability of the narrower definition in
17 revised Article 5.

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

21 There is a small risk that the augmented definition of “good faith” could be misinterpreted by
22 courts as a floating commission to avoid the effects of UCC provisions perceived as being utilized

1 in a commercially unreasonable way. For example, is it “commercially unreasonable” for a
2 secured party to assert priority under Article 9 over an prior unperfected security interest of which
3 the subsequent secured party was aware? The duty and definition of good faith should not
4 inappropriately encourage courts to so revise substantive decisions made elsewhere in the Code.
5 Comments to Sections 1-201 and 1-305 should make this point, elaborating along the lines of
6 PEB Commentary No. 10.

7 *Holder.* Reorganized for clarity.

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

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

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

13 *Organization.* Revised to reflect standard NCCUSL language.

14 *Person.* Revised to reflect standard NCCUSL language.

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

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

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

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

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

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

State. The standard NCCUSL definition has been utilized.

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

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

SECTION 1-202. NOTICE; KNOWLEDGE

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

(1) has actual knowledge of it;

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

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

(b) “Knowledge” means actual knowledge.

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

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

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

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

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

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

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

Changes Since September 1997 Draft

Brackets around “Uniform Commercial Code” in subsection (g) added.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

SECTION 1-203. LEASE DISTINGUISHED FROM SECURITY INTEREST.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

21 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.

Changes Since September 1997 Draft

None.

Changes Since 1997 Annual Meeting Draft

In the 1997 Annual Meeting Draft, subsection (c)(2) (which is based on current UCC section 1-201(37)) covered both the lessee’s assumption of the risk of loss of the goods and the lessee’s agreement to pay certain expenses with respect to them. At the suggestion of a Commissioner, these two concepts have been broken out into separate subsections, and subsequent subsections have been renumbered.

Revision Notes (1997 Annual Meeting Draft)

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

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

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

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

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

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

Changes Since September 1997 Draft

None.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

SECTION 1-205. REASONABLE TIME; SEASONABLENESS.

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

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

Changes Since September 1997 Draft

None.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

PART 3

SCOPE, TERRITORIAL APPLICABILITY, AND GENERAL RULES

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

Changes Since September 1997 Draft

The word “statutory” has been added to conform to Section 1-201(a). Entire section bracketed by Drafting Committee decision.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

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

(a) Except as provided in this section, an agreement by parties to a transaction to which the [Uniform Commercial Code] applies [in whole or in ~~substantial~~ not insignificant ~~insubstantial~~ part] that any or all of their rights and obligations ~~with respect to each other~~ are

1 to be determined by the law of this State or of another State or country is effective, whether or
2 not the transaction bears a ~~[reasonable]~~ relation to the State or country designated. In the
3 absence of such an effective agreement, their rights and obligations with respect to each other are
4 determined, except as provided in subsection (e) [or (f)], by the law that would be selected by
5 application of this State's conflict of laws principles.

6 (b) If one of the parties to an agreement referred to in subsection (a) is a consumer, the
7 agreement is not effective [against the consumer] unless the State or country specified either:

8 (1) is the State or country in which the consumer resides at the time the transaction
9 becomes enforceable or within 30 days thereafter; **or**

10 (2) is the State or country in which, under the contract between the parties, the goods,
11 services, or other consideration flowing to the consumer are to be received by the consumer or a
12 person designated by the consumer; ~~or~~

13 ~~[(3) is a State or country to which the transaction bears a reasonable relation.]~~

14 (c) An agreement referred to in subsection (a) is not effective to the extent that the law of
15 the State or nation specified is contrary to a fundamental public policy of ~~[Alternative A—the~~
16 ~~State or country whose law would otherwise govern]~~ ~~[Alternative B—this State]~~.

17 (d) If the transaction does not bear a reasonable relationship to any country other than the
18 United States, an agreement referred to in subsection (a) is effective only if it specifies the law of
19 a State or of the United States.

20 (e) To the extent that, in the absence of an effective agreement to the contrary, the [Uniform
21 Commercial Code] would govern a transaction, **where one of** the following provisions ~~specify the~~
22 ~~governing law and the effect of any agreement to the contrary:~~ **of the [Uniform Commercial**

Code] specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of law rules) so specified]:

(1) Section 2-xxx

(2) Sections 2A-xxx

~~(3) Section 2B-xxx~~

~~(4)~~ Section 4-102

~~(5)~~**(4)** Section 4A-507

~~(6)~~**(5)** Section 5-116

~~(7)~~**(6)** Section 6-103

~~(8)~~**(7)** Section 8-110

~~(9) Section 9-xxx~~**(8) Sections 9-301 through 9-307.**

[(f) If, in the absence of an effective agreement specifying the law this State or of another State or country, the law that would be selected by application of this State's conflict of laws principles would result in the unenforceability of all or part of an agreement that is enforceable under the laws of this State, the law governing the agreement or that part of the agreement is the law of this State unless:

(1) the transaction does not bear an appropriate relationship to this State; or

(2) the party against whom enforcement is sought is a consumer.]

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

Changes Since September 1997 Draft

In subsection (a), this draft reflects minor editorial changes and decisions made concerning bracketed phrases.

In subsection (b), paragraph (3) has been deleted.

In subsection (c), the word “public” has been deleted from the phrase “fundamental public policy.” Alternative A has been retained in preference to Alternative B.

In subsection (e), the articulation in current UCC Section 1-105 has replaced previous wording of this draft. Reference to Article 2B has been deleted. Reference to Revised Article 9 has been inserted in paragraph (8).

Changes Since 1997 Annual Meeting Draft

Reorganization. This section has been reorganized for clarity since the 1997 Annual Meeting Draft. In this version, the main rules for determining which jurisdiction’s law governs (both in cases in which the agreement specifies a particular jurisdiction and in cases in which it does not) are in subsection (a) and the various limitations on those rules are stated separately in subsections (b) through (f). In addition, as a result of comments at the Annual Meeting and elsewhere, this draft proposes some options for substantive change to the Drafting Committee. Those options are indicated in the draft by brackets, and are explained below.

Scope of section. The 1997 Annual Meeting Draft provided that a choice of law agreement in a transaction “to which the Uniform Commercial Code applies in whole or part” is governed by the rules of this section. Some have criticized the breadth of that statement, noting that, for example, it might be interpreted so that a transaction unrelated to the Uniform Commercial Code except that it provides for payment by check would be governed by this section. This draft

1 provides two other options. The first additional option is to delete the phrase in its entirety. If
2 this option were adopted, it would presumably be left to the courts, as it is under current UCC
3 section 1-105, to determine whether the transaction's relationship to the UCC is sufficient to
4 justify application of the section. Of course, leaving this matter to the courts would result in
5 substantial uncertainty as to the application of this section inasmuch as few transactions are
6 governed exclusively by the UCC. The second additional option is to add the word "substantial"
7 before "part" so that the rule of this section would not apply to transactions to which the Uniform
8 Commercial Code applies only in insubstantial part. While this might ease concerns about
9 overbreadth, it would also come with the cost of uncertainty as to what constitutes "substantial
10 part."

11 *Consumer transactions.* A number of changes are suggested in this draft. First, the
12 provisions have been reorganized in such a way that the phrase "consumer transaction" is no
13 longer used.

14 Second, it was noted that there are many transactions involving multiple parties in which at
15 least two of the parties are not consumers. It has been argued that there is no substantial
16 justification for declining to enforce a choice of law agreement between these non-consumers
17 merely because there is also a consumer elsewhere in the transaction. Accordingly, this draft adds
18 in brackets the phrase "against the consumer" in subsection (b). (One commentator suggested
19 that, if the choice of law clause selects a jurisdiction whose rule is *better* for the consumer than
20 that of the jurisdictions specified in subsection (b), the consumer should not lose the benefit of
21 that better rule. Query whether (i) this point should be reflected in the draft, and (ii) if so, the
22 "against the consumer" language effects this?)

1 Third, it was noted that, under the 1997 Annual Meeting Draft, a person in the business of
2 selling goods to consumers in many states (such as a mail order catalog merchant) would not be
3 able to designate effectively the law of the state in which it is located to govern those sales. This
4 result would be more restrictive of choice of law clauses than is current UCC section 1-105.
5 Accordingly, to alleviate this restriction without opening up choice of law in consumer
6 transactions to quite the same level of autonomy as in non-consumer cases, bracketed subsection
7 (3) would also allow the agreement to designate a “State or country to which the transaction
8 bears a reasonable relation.”

9 *Fundamental public policy.* The “fundamental public policy” exception in the 1997 Annual
10 Meeting Draft (appearing in this draft in subsection (c)) has been the subject of much debate.
11 One criticism is that the section might require the courts in one state to determine what
12 constitutes a fundamental public policy of a different state. To allay that possibility, subsection (c)
13 contains an Alternative B that would direct a court to decline to enforce a choice of law clause
14 only if the law specified is contrary to a fundamental public policy of *this (i.e., the forum’s) State*.
15 Alternative A retains the language from the 1997 Annual Meeting Draft pursuant to which the
16 question is whether the law specified is contrary to a fundamental public policy of the State or
17 nation whose law would otherwise govern. While Alternative B would eliminate the need for a
18 court to assess the public policy of another state, it might encourage forum shopping when that is
19 possible.

20 A second criticism of the “fundamental public policy” exception is based on the belief that,
21 even without subsection (c), courts will decline to enforce foreign law that is abhorrent to local
22 policy and that stating the exception in the text of the section will encourage courts to find such a

1 policy (and thereby override the agreement as to choice of law) more often than one actually
2 exists. Many of those raising this criticism would delete subsection (c) entirely. In an effort to
3 lessen the possibility of over-use of this subsection, a comment on the order of the following
4 could be utilized:

5 *Fundamental public policy.* Subsection (c) provides that an agreement choosing the
6 governing law will not be given effect to the extent that the law of the State or nation
7 specified is contrary to a fundamental public policy of this State. This rule provides only
8 a narrow exception to the broad freedom of contract afforded to parties in subsection
9 (a). After all, one of the prime objectives of contract law is to protect the justified
10 expectations of the parties and to make it possible for them to foretell with accuracy
11 what will be their rights and liabilities under the contract; in this way, certainty and
12 predictability of result are most likely to be secured. See Restatement (Second) Conflict
13 of Laws, § 187, comment *e*. Under this exception, a court should not refrain from
14 applying the chosen law merely because this would lead to a different result than would
15 be obtained under the local law of [Alternative A — the State or nation whose law
16 would otherwise govern] [*Alternative B* — this State]; rather, the difference must be
17 contrary to a public policy that is so substantial that it would not only cause a court to
18 forego application of general choice of law rules that would otherwise have pointed to
19 that rule but also justify overriding the concerns for certainty and predictability
20 underlying modern commercial law as well as concerns for judicial economy generally.
21 No comprehensive listing of fundamental public policies can be accomplished, but certain
22 patterns can emerge from typical situations. A fundamental public policy will rarely be

1 found, for example, in a requirement, such as a statute of frauds, that relates to
2 formalities, or in general rules of contract law, such as those concerned with the need for
3 consideration. On the other hand, a rule that makes a certain kind of contract illegal or
4 protects a person against the oppressive use of superior bargaining power may reflect
5 such a policy. See Restatement (Second) Conflict of Laws, § 187, comment g.

6 *Invalidating law.* In the absence of a choice of law agreement, this section provides that the
7 law governing a transaction is that of the jurisdiction that would be chosen by application of the
8 forum's general choice of law principles. Occasionally, this will result in a transaction (or portion
9 thereof) that would be effective under the law of the forum being denied effectiveness by
10 application of the law of a different jurisdiction. The 1997 Annual Meeting Draft contained
11 optional language in subsection (b) to prevent this situation by having the forum's law govern in
12 those cases. This draft continues that optional language as subsection (f). The Drafting
13 Committee should decide at this meeting whether or not to recommend this language.

14 **Revision Notes (1997 Annual Meeting Draft)**

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

16 *a. Contractual choice of law.* Subsection (a), which governs contractual choice of law
17 clauses, allows parties broad freedom to select governing law, even if the transaction bears no
18 relation to the State or country whose law is selected, with several important limitations. First,
19 there are significant limitations on the freedom to select governing law in the context of consumer
20 transactions. Second, contractual choice of law will not be given effect if it would be contrary to
21 a fundamental public policy of the State or country whose law would otherwise be chosen under
22 subsection (b). [The Drafting Committee is giving consideration to moving this limitation, now

expressed in subsection (a)(2), to a Comment.] Third, the agreement of the parties may not select the law of a country other than the United States unless the transaction bears a reasonable relationship to a country other than the United States (not necessarily the country selected).

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

Choice of law in the absence of contract. Subsection (b) replaces the last sentence of current UCC Section 1-105(1), which determines which jurisdiction's law governs a transaction in the absence of an effective contractual choice by the parties. Current Section 1-105(1), by providing that the law of the forum (*i.e.*, the UCC) applies if the transaction bears "an appropriate relation to this state" rather than, say, requiring that the forum be the location of the "most significant" contact, expresses a bias in favor of applying the forum's law. This bias, while not universally respected by the courts, was most justifiable in light of the uncertainty that existed at the time of drafting as to whether the UCC would be adopted by all the states; the pro-forum bias would assure that the UCC would be applied so long as the transaction bore an "appropriate" relation to the forum. Inasmuch as the UCC has been adopted, at least in part, in all American jurisdictions, the vitality of this point is minimal in the domestic context, and international comity concerns

1 militate against continuing the pro-forum, pro-UCC bias in transnational transactions. When the
2 choice is between the law of two jurisdictions that have adopted the UCC, but whose law differs
3 (whether because of differences in enacted language or differing judicial interpretations), there is
4 no strong justification for directing a court to apply different choice of law principles to its
5 determination than it would apply if the matter were not governed by the UCC. Similarly, given
6 the wide variety of operative choice of law principles applied by the states, it would not be
7 prudent to designate only one such principle as the proper principle for transactions governed by
8 the UCC. Accordingly, with the exception noted below, Section 1-302(b) simply directs the
9 forum to apply its general choice of law principles to determine which jurisdiction's law governs.

10 *Invalidating law.* Once it is determined that there has been sufficient agreement to conclude
11 that a contract has been formed, the law, with very few exceptions, treats the parties as intending
12 to be bound by the terms of that contract. Nonetheless, the Uniform Commercial Code limits
13 freedom of contract in several contexts, and the law of particular jurisdictions may limit such
14 freedom in additional contexts. If a contract is formed that has an appropriate relation with more
15 than one jurisdiction, and the law of one of those jurisdictions would invalidate the contract or a
16 portion thereof while the law of another of those jurisdictions would validate it, the choice of law
17 issue is critical. Given the intent to be bound that is presumed by the law, a strong argument can
18 be made that if the forum's general choice of law principles would result in the application of the
19 law of a different jurisdiction that would invalidate the contract or a portion of it, even though
20 under the Uniform Commercial Code and other law of the forum that contract or portion would
21 be held valid, the forum should apply its own validating law so as to effectuate the parties' intent.
22 See ABA Task Force Report. Such a rule would also prevent transactions valid under the forum

1 state's UCC from invalidation by application of another jurisdiction's non-UCC law. The
2 bracketed language in subsection (b) would effectuate this principle.

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

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

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

20 *Primacy of other UCC choice of law rules.* Subsection (c) repeats the list in current Section
21 1-105(2) and adds a placeholder for Article 2B.

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

7 **SECTION 1-303. VARIATION BY AGREEMENT**

8 (a) Except as otherwise provided in subsection (b) or elsewhere in [the Uniform
9 Commercial Code], the effect of provisions of [the Uniform Commercial Code] ~~[on the rights and~~
10 ~~obligations of parties with respect to each other]~~ may be varied by agreement ~~[between those~~
11 ~~parties]~~. ~~[Such an agreement may include agreement that a trade code or similar record will~~
12 ~~govern the relationship between the parties.]~~

13 (b) ~~Except as provided elsewhere in [the Uniform Commercial Code], the~~ **The**
14 obligations of good faith, diligence, reasonableness and care prescribed by [the Uniform
15 Commercial Code] may not be disclaimed by agreement. The parties, by agreement, may
16 determine the standards by which the performance of those obligations is to be measured if those
17 standards are not manifestly unreasonable. **[Whenever the [Uniform Commercial Code]**
18 **requires any action to be taken within a reasonable time, any time which is not manifestly**
19 **unreasonable may be fixed by agreement.]**

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

Changes Since September 1997 Draft

Bracketed language in subsection (a) deleted to conform more closely to current Section 1-102(3). Bracketed sentence in subsection (a) regarding trade codes deleted by Drafting Committee decision. Introductory language in subsection (b) deleted as no longer necessary in light of Official Text of Revised Article 9. Last sentence of subsection (b), which currently appears in Section 1-204(1) added by Drafting Committee decision.

Changes Since 1997 Annual Meeting Draft

Variation by agreement. Current Article 1, from which subsection (a) is adapted, has been criticized as not making clear *which* parties must agree in order to vary the effect of provisions of the Uniform Commercial Code. Bracketed language for consideration by the Drafting Committee is designed to make it clear that the parties affected by a variation must agree to it. Thus, for example, the debtor and creditor cannot effectively agree in a security agreement that the priority rules of Article 9 will be varied to give the creditor priority over a competing secured party who would otherwise prevail under the Article 9 rules. Current Article 1 has also been criticized as suggesting that certain rules of validity (such as statutes of frauds) are variable by the formulation that suggests that *all* rules are variable unless flagged to the contrary. Query whether the bracketed language eases this problem. Alternatively, the Drafting Committee could decide to flag additional sections as non-variable.

1 *Trade codes.* It has been suggested that a reference to trade codes and the like be added to
2 subsection (a). Bracketed language to that effect is provided for the Drafting Committee's
3 review.

4 *Good faith, reasonableness, etc.* The current draft of revised Article 9 allows some obligors
5 to agree that some Part 6 duties (including some duties of reasonableness) do not apply to them.
6 So as to avoid any inconsistency with Article 9, the phrase "Except as provided elsewhere in [the
7 Uniform Commercial Code]" has been added to the beginning of subsection (b).

8 **Revision Notes (1997 Annual Meeting Draft)**

9 This section is substantively identical to subsections (3) and (4) of current UCC Section
10 1-102.

11 **SECTION 1-304. COURSE OF PERFORMANCE, COURSE OF DEALING, AND**
12 **USAGE OF TRADE.**

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

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

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

18 (2~~3~~) the other party, with knowledge of the nature of the performance and
19 opportunity for objection to it, accepts the performance or acquiesces in it without objection.

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

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

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

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

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

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

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

(f) Subject to ~~Sections [on modification and waiver]~~**current Section 2-209]**, a course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.

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

Changes Since September 1997 Draft

Subsection (a)(2) deleted to conform to current Section 2-208. Language in subsection (b) added for clarity. Subsection (d) changed for stylistic reasons. Cross-reference in subsection (f) clarified.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

a. Addition of course of performance. As suggested by the ABA Task Force, this section integrates the “course of performance” concept into the principles of current Section 1-205, which deals with course of dealing and usage of trade. In so doing, the section slightly modifies the articulation of the course of performance rules to fit more comfortably with the approach and structure of current UCC Section 1-205. There are also slight modifications to be more consistent with the definition of “agreement” in current section 1-201(3).

b. Possible side effects of incorporating course of performance into Article 1.
Incorporation of course of performance into Article 1 will require close examination of at least

two issues. First, a course of performance that might otherwise create a defense to the obligation of a party to a negotiable instrument should not be available as a defense against a holder in due course who took the instrument without notice of the course of performance. A Comment in this section or in section 3-302 may be sufficient to make this point, but it is possible that some statutory tweaking may be required.

Second, in light of the rule that course of performance may be relevant to establish a waiver or modification, consideration should be given to whether those concepts should be articulated in Article 1 or, rather, if the current treatment of these concepts in Articles 2, 2A and 2B is sufficient.

It has been suggested that subsection (g) be moved to a new section concerned with litigation matters.

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

Changes Since September 1997 Draft

Returned to wording of current section 1-203.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

Slightly rewritten in light of suggestions of Drafting Committee.

[SECTION 1-306. UNCONSCIONABLE AGREEMENT OR TERM.

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

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

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

Changes Since September 1997 Draft

None.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

1 A decision to apply generally the unconscionability provision now present in Articles 2 and
2 2A could be justified as reflecting a policy decision that, in light of almost two decades of
3 experience applying unconscionability principles to contracts generally under Restatement,
4 Second, Contracts, § 208, and similar experience under California Civil code § 1670.5, there is no
5 longer any compelling reason to limit application of the principle in the Uniform Commercial
6 Code to only sales and leases. Of course, such a policy decision would be significant and should
7 be considered carefully.

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

11 **SECTION 1-307. REMEDIES TO BE LIBERALLY ADMINISTERED.**

12 (a) The remedies provided by [the Uniform Commercial Code] must be liberally
13 administered to the end that the aggrieved party may be put in as good a position as if the other
14 party had fully performed; but ~~Neither~~ **neither** consequential; **or** special nor penal damages may
15 be ~~imposed~~ **had** except as ~~expressly~~ **specifically** provided in [the Uniform Commercial Code] or
16 by other ~~statute or~~ rule of law.

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

Changes Since September 1997 Draft

Returned to wording of current section 1-106.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

SECTION 1-308. WAIVER OR RENUNCIATION OF CLAIM OR RIGHT AFTER BREACH. A claim or right arising out of an alleged breach may be discharged in whole or in part without consideration by agreement of the aggrieved party in an authenticated record.

Changes Since September 1997 Draft

None.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

This section is based on current UCC Section 1-107. It has been revised in two respects. First, the current section, requiring the “delivery” of a “written waiver or renunciation” merges the separate concepts of the aggrieved party’s agreement to forego rights and the manifestation of that agreement. Revised section 1-308 separates those concepts, and explicitly requires

1 *agreement* of the required party. Second, the revised section reflects developments in electronic
2 commerce by providing for memorialization in an authenticated record.

3 **SECTION 1-309. PRIMA FACIE EVIDENCE BY THIRD PARTY RECORDS**

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

9 **Changes Since September 1997 Draft**

10 References to “document[s]” changed to “record[s].”

11 **Changes Since 1997 Annual Meeting Draft**

12 None.

13 **Revision Notes (1997 Annual Meeting Draft)**

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

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

(a) Except as otherwise provided in subsection (b), a party that, with explicit reservation of rights, performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Words such as "without prejudice", "under protest" or the like are sufficient.

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

Changes Since September 1997 Draft

None.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

SECTION 1-311. OPTION TO ACCELERATE AT WILL. A term providing that one party or that party's successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or when the party "deems itself insecure", or words of similar import, means that the party has power to do so only if that party in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against which the power has been exercised.

Changes Since September 1997 Draft

None.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

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

SECTION 1-312. SUBORDINATED OBLIGATIONS. An obligation may be issued as subordinated to payment of another obligation of the person obligated, or a creditor may subordinate its right to payment of an obligation by agreement with either the person obligated or another creditor of the person obligated. Subordination does not create a security interest as against either the common debtor or a subordinated creditor.

Changes Since September 1997 Draft

None.

Changes Since 1997 Annual Meeting Draft

None.

Revision Notes (1997 Annual Meeting Draft)

This section is identical to current UCC section 1-209, except that the language stating that the section “shall be construed as declaring the law as it existed prior to the enactment of this section and not as modifying it” has been deleted.