**A** **BILL**

TO AMEND CHAPTER 1, TITLE 36, CODE OF LAWS OF SOUTH CAROLINA, 1976, RELATING TO GENERAL PROVISIONS OF THE UNIFORM COMMERCIAL CODE, SO AS TO MAKE CONFORMING AND TECHNICAL CORRECTIONS IN ORDER FOR CHAPTER 1 TO REMAIN CONSISTENT WITH OTHER REVISED CHAPTERS; TO MAKE CERTAIN CHANGES TO CLARIFY AMBIGUITIES THAT HAVE ARISEN OVER THE YEARS; TO MAKE CERTAIN SUBSTANTIVE CHANGES, INCLUDING CHANGES RELATED TO THE EXPANSION OF THE DEFINITION OF GOOD FAITH AND THE RELEVANCE OF COURSE OF PERFORMANCE IN CONTRACT INTERPRETATION; TO MAKE CONFORMING CHANGES IN OTHER CHAPTERS OF THE UNIFORM COMMERCIAL CODE; AND TO REPEAL SECTIONS 36‑2‑208 AND 36‑2A‑207.

Be it enacted by the General Assembly of the State of South Carolina:

SECTION 1. Chapter 1, Title 36 of the 1976 Code is amended to read:

“CHAPTER 1

Commercial Code‑General Provisions

Part 1

Short Title, Construction, Application

and Subject Matter of the Act

Section 36‑1‑101. (1) This act ~~shall be known and~~ may be cited as the Uniform Commercial Code.

(2) This chapter may be cited as Uniform Commercial Code‑General Provisions.

OFFICIAL COMMENT

Each Article of the Code (except this Article and Article 10) may also be cited by its own short title. See Sections 2‑101, 3‑101, 4‑101, 5‑101, 6‑101, 7‑101, 8‑101 and 9‑101.

Section 36‑1‑102. This chapter applies to a transaction to the extent that it is governed by another chapter of this act.

Section ~~36‑1‑102~~ 36‑1‑103. ~~(1)~~(a) This act ~~shall~~ must be liberally construed and applied to promote its underlying purposes and policies~~.~~, which are:

~~(2)~~ ~~Underlying purposes and policies of this act are~~

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

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

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

~~(3)~~ ~~The effect of provisions of this act may be varied by agreement, except as otherwise provided in this act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.~~

~~(4)~~ ~~The presence in certain provisions of this act of the words ‘unless otherwise agreed’ or words of similar import does not imply that the effect of other provisions may not be varied by agreement under subsection (3).~~

~~(5)~~ ~~In this act unless the context otherwise requires~~

~~(a)~~ ~~words in the singular number include the plural, and in the plural include the singular;~~

~~(b)~~ ~~words of the masculine gender include the feminine and the neuter, and when the sense so indicates words of the neuter gender may refer to any gender.~~

~~Section 36‑1‑103.~~

(b) Unless displaced by the particular provisions of this act, the 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 shall supplement its provisions.

OFFICIAL COMMENT

Prior uniform statutory provision: Section 74, Uniform Sales Act, Section 57, Uniform Warehouse Receipts Act; Section 52, Uniform Bills of Lading Act; Section 19, Uniform Stock Transfer Act.

Changes: Rephrased and new material added.

Purposes of changes:

1. ~~Subsections~~ Subsection ~~(1) and (2)~~ (1)(a) ~~are~~ is intended to make it clear that:

This Act is drawn to provide flexibility so that, since it is intended to be a semi‑permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices. However, the proper construction of the Act requires that its interpretation and application be limited to its reason.

Courts have been careful to keep broad acts being hampered in their effects by later acts of limited scope. Pacific Wool Growers v Draper & Co., 158 Or 1, 73 P2d 1391 (1937), and compare Section 1‑104. They have recognized the policies embodied in an act as applicable in reason to subject‑matter which was not expressly included in the language of the act, Commercial Nat. Bank of New Orleans v Canal‑Louisiana Bank & Trust Co., 239 US 520, 36 Sup Ct 194, 60 L Ed 417 (1916) (bona fide purchase policy of Uniform Warehouse Receipts Act extended to case not covered but of equivalent nature). They have done the same where reason and policy so required, even where the subject‑matter had been intentionally excluded from the act in general. Agar v Orda, 264 NY 248, 190 NE 479 (1934) (Uniform Sales Act change in seller’s remedies applied to contract for sale of choses in action even though the general coverage of that Act was intentionally limited to goods “other than things in action.”) They have implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They have disregarded a statutory limitation of remedy where the reason of the limitation did not apply. Fiterman v J. N. Johnson & Co., 156 Minn 201, 194 NW 399 (1923) (requirement of return of the goods as a condition to rescission for breach of warranty; also, partial rescission allowed). Nothing in this Act stands in the way of the continuance of such action by the courts.

The Act should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

2. ~~Subsection (3) states affirmatively at the outset that freedom of contract is a principle of the Code: “the effect” of its provisions may be varied by "agreement." The meaning of the statute itself must be found in its text, including its definitions, and in appropriate extrinsic aids; it cannot be varied by agreement. But the Code seeks to avoid the type of interference with evolutionary growth found in Manhattan Co. v Morgan, 242 NY 38, 150 NE 594 (1926). Thus private parties cannot make an instrument negotiable within the meaning of Article 3 except as provided in Section 3‑104; nor can they change the meaning of such terms as “bona fide purchaser,” “holder in due course,” or “due negotiation,” as used in this Act. But an agreement can change the legal consequences which would otherwise flow from the provisions of the Act. “Agreement” here includes the effect given to course of dealing, usage of trade and course of performance by Sections 1‑201, 1‑205 and 2‑208; the effect of an agreement on the rights of third parties is left to specific provisions of this Act and to supplementary principles applicable under the next section. The rights of third parties under Section 9‑317 when a security interest is unperfected, for example, cannot be destroyed by a clause in the security agreement.~~

~~This principle of freedom of contract is subject to specific exceptions found elsewhere in the Act and to the general exception stated here. The specific exceptions vary in explicitness: the statute of frauds found in Section 2‑201, for example, does not explicitly preclude oral waiver of the requirement of a writing, but a fair reading denies enforcement to such a waiver as part of the “contract” made unenforceable; Section 9‑602, on the other hand, is quite explicit. Under the exception for “the obligations of good faith, diligence, reasonableness and care prescribed by this Act,” provisions of the Act prescribing such obligations are not to be disclaimed. However, the section also recognizes the prevailing practice of having agreements set forth standards by which due diligence is measured and explicitly provides that, in the absence of a showing that the standards manifestly are unreasonable, the agreement controls. In this connection, Section 1‑205 incorporating into the agreement prior course of dealing and usages of trade is of particular importance.~~

~~3. Subsection (4) is intended to make it clear that, as a matter of drafting, words such as “unless otherwise agreed” have been used to avoid controversy as to whether the subject matter of a particular section does or does not fall within the exceptions to subsection (3), but absence of such words contains no negative implication since under subsection (3) the general and residual rule is that the effect of all provisions of the Act may be varied by agreement.~~

~~4. Subsection (5) is modelled on 1 USC Section 1 and New York General Construction Law Sections 22 and 35.~~

Prior uniform statutory provision: Sections 2 and 73, Uniform Sales Act; Section 196, Uniform Negotiable Instruments Act; Section 56, Uniform Warehouse Receipts Act; Section 51, Uniform Bills of Lading Act; Section 18, Uniform Stock Transfer Act.

Changes: Rephrased, the reference to "estoppel" and ‘validating’ being new.

Purposes of changes:

1. While 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 principle has been stated in more detail and the phrasing enlarged to make it clear that the "validating", as well as the "invalidating" causes referred to in the prior uniform statutory provisions, are included here. "Validating" as used here in conjunction with "invalidating" is not intended as a narrow word confined to original validation, but extends to cover any factor which at any time or in any manner renders or helps to render valid any right or transaction.

2. The general law of capacity is continued by express mention to make clear that section 2 of the old Uniform Sales Act (omitted in this Act as stating no matter not contained in the general law) is also consolidated in the present section. Hence, where a statute limits the capacity of a non‑complying corporation to sue, this is equally applicable to contracts of sale to which such corporation is a party.

3. The listing given in this section is merely illustrative; no listing could be exhaustive. Nor is the fact that in some sections particular circumstances have led to express reference to other fields of law intended at any time to suggest the negation of the general application of the principles of this section.

Section 36‑1‑104. This act 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.

OFFICIAL COMMENT

Prior uniform statutory provision: None.

Purposes:

To express the policy that no Act which bears evidence of carefully considered permanent regulative intention should lightly be regarded as impliedly repealed by subsequent legislation. This Act, 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. See Pacific Wool Growers v Draper & Co., 158 Or 1, 73 P2d 1391 (1937).

~~Section 36‑1‑105.~~ ~~(1)~~ ~~Except as provided in this section, when a transaction bears a reasonable relation to this State and also to another state or nation the parties may agree that the law either of this State or of another state or nation shall govern their rights and duties. Failing an agreement this title applies to transactions bearing an appropriate relation to this State.~~

~~(2)~~ ~~Where one of the following provisions of this title 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 laws rules) so specified:~~

~~Rights of seller’s creditors against sold goods. Section 36‑2‑402.~~

~~Applicability of the Chapter on Leases. Sections 36‑2A‑102, 36‑2A‑105 and 36‑2A‑106.~~

~~Applicability of the Chapter on Bank Deposits and Collections. Section 36‑4‑102.~~

~~Governing law in the Chapter on Funds Transfers. Section 36‑4A‑507.~~

~~Letters of credit. Sections 35‑5‑116.~~

~~Applicability of the Chapter on Investment Securities. Section 36‑8‑110.~~

~~Law governing perfection, the effect of perfection or nonperfection, and the priority of security interests and agricultural liens. Sections 36‑9‑301 through 36‑9‑307.’~~

~~OFFICIAL COMMENT~~

~~Prior uniform statutory provision: None.~~

~~Purposes:~~

~~1. Subsection (1) states affirmatively the right of the parties to a multistate transaction or a transaction involving foreign trade to choose their own law. That right is subject to the firm rules stated in the five sections listed in subsection (2), and is limited to jurisdictions to which the transaction bears a "reasonable relation". In general, the test of "reasonable relation" is similar to that laid down by the Supreme Court in Seeman v. Philadelphia Warehouse Co., 274 U.S. 403, 47 S. Ct. 626, 71 L. Ed. 1123 (1927). Ordinarily the law chosen must be that of a jurisdiction where a significant enough portion of the making or performance of the contract is to occur or occurs. But an agreement as to choice of law may sometimes take effect as a shorthand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen.~~

~~2. Where there is no agreement as to the governing law, the act is applicable to any transaction having an "appropriate" relation to any state which enacts it. Of course, the act applies to any transaction which takes place in its entirety in a state which has enacted the act. But the mere fact that suit is brought in a state does not make it appropriate to apply the substantive law of that state. Cases where a relation to the enacting state is not "appropriate" include, for example, those where the parties have clearly contracted on the basis of some other law, as where the law of the place of contracting and the law of the place of contemplated performance are the same and are contrary to the law under the code.~~

~~3. Where a transaction has significant contacts with a state which has enacted the act and also with other jurisdictions, the question what relation is "appropriate" is left to judicial decision. In deciding that question, the court is not strictly bound by precedents established in other contexts. Thus a conflict‑of‑laws decision refusing to apply a purely local statute or rule of law to a particular multistate transaction may not be valid precedent for refusal to apply the code in an analogous situation. Application of the code in such circumstances may be justified by its comprehensiveness, by the policy of uniformity, and by the fact that it is in large part a reformulation and restatement of the law merchant and of the understanding of a business community which transcends state and even national boundaries. Compare Global Commerce Corp. v. Clark‑Babbitt Industries, Inc., 239 F. 2d 716, 719 (2d Cir. 1956). In particular, where a transaction is governed in large part by the code, application of another law to some detail of performance because of an accident of geography may violate the commercial understanding of the parties.~~

~~4. The act does not attempt to prescribe choice‑of‑law rules for states which do not enact it, but this section does not prevent application of the act in a court of such a state. Common‑law choice of law often rests on policies of giving effect to agreements and of uniformity of result regardless of where suit is brought. To the extent that such policies prevail, the relevant considerations are similar in such a court to those outlined above.~~

~~5. Subsection (2) spells out essential limitations on the parties’ right to choose the applicable law. Especially in Article 9 parties taking a security interest or asked to extend credit which may be subject to a security interest must have sure ways to find out whether and where to file and where to look for possible existing filings.~~

~~6. Sections 9‑301 through 9‑307 should be consulted as to the rules for perfection of security interests and agricultural liens, the effect of perfection and nonperfection, and priority.~~

~~OFFICIAL COMMENT TO 2001 AMENDMENT~~

~~Uniform Statutory Source: Section 1‑105, 1978 Official Text of the Act.~~

~~Changes: Subsection (2) is amended to reference two sections of the Article on Leases (Article 2A), which is being promulgated at the same time as this amendment.~~

~~Section 36‑1‑106.~~ ~~(1)~~ ~~The remedies provided by this act shall 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 nor penal damages may be had except as specifically provided in this act or by other rule of law.~~

~~(2)~~ ~~Any right or obligation declared by this act is enforceable by action unless the provision declaring it specifies a different and limited effect.~~

~~OFFICIAL COMMENT~~

~~Prior uniform statutory provision: Subsection (1)‑‑none; Subsection (2)‑‑Section 72, Uniform Sales Act.~~

~~Changes: Reworded.~~

~~Purposes of changes and new matter:~~

~~Subsection (1) is intended to effect three things:~~

~~1. First, to negate the unduly narrow or technical interpretation of some remedial provisions of prior legislation by providing that the remedies in this Act are to be liberally administered to the end stated in the section. Second, to make it clear that compensatory damages are limited to compensation. They do not include consequential or special damages, or penal damages; and the Act elsewhere makes it clear that damages must be minimized. Cf. Sections 1‑203, 2‑706(1), and 2‑712(2). The third purpose of subsection (1) is to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more. Cf. Section 2‑204(3).~~

~~2. Under subsection (2) any right or obligation described in this Act is enforceable by court action, even though no remedy may be expressly provided, unless a particular provision specifies a different and limited effect. Whether specific performance or other equitable relief is available is determined not by this section but by specific provisions and by supplementary principles. Cf. Sections 1‑103, 2‑716.~~

~~3. "Consequential" or "special" damages and "penal" damages are not defined in terms in the Code, but are used in the sense given them by the leading cases on the subject.~~

~~Cross :~~

~~Sections 1‑103, 1‑203, 2‑204(3), 2‑701, 2‑706(1), 2‑712(2) and 2‑716.~~

~~Definitional Cross :~~

~~"Action" Section 1‑201.~~

~~"Aggrieved party" Section 1‑201.~~

~~"Party" Section 1‑201.~~

~~"Remedy" Section 1‑201.~~

~~"Rights" Section 1‑201.~~

~~Section 36‑1‑107.~~ ~~Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by waiver or renunciation.~~

~~OFFICIAL COMMENT~~

~~Prior uniform statutory provision: Compare Section 1, Uniform Written Obligations Act; Sections 119(3), 120(2) and 122, Uniform Negotiable Instruments Law.~~

~~Purposes:~~

~~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 such renunciation is in writing and signed and delivered by the aggrieved party. Its provisions, however, must be read in conjunction with the section imposing an obligation of good faith (Section 1‑203). There may, of course, also be an oral renunciation or waiver sustained by consideration but subject to Statute of Frauds provisions and to the section of Article 2 on Sales dealing with the modification of signed writings (Section 2‑209). As is made express in the latter section this Act fully recognizes the effectiveness of waiver and estoppel.~~

~~Cross :~~

~~Sections 1‑203, 2‑201 and 2‑209. And see Section 2‑719.~~

~~Definitional Cross :~~

~~"Aggrieved party" Section 1‑201.~~

~~"Rights" Section 1‑201.~~

~~"Signed" Section 1‑201.~~

~~"Written" Section 1‑201.~~

Section ~~36‑1‑108.~~ 36‑1‑105. If any provision or clause of this act or its application ~~thereof~~ to any person or circumstance~~s~~ is held invalid, ~~such~~ the invalidity ~~shall~~ does not affect other provisions or applications of this act which can be given effect without the invalid provision or application, and to this end the provisions of this act are ~~declared to be~~ severable.

OFFICIAL COMMENT

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.

Definitional Cross :

"Person" Section 1‑201.

Section 36‑1‑106. In this act, unless the statutory context otherwise requires:

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

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

Section ~~36‑1‑109~~ 36‑1‑107. Section captions are part~~s~~ of this act~~, but the comments are not parts of the act~~.

OFFICIAL COMMENT

Prior uniform statutory provision: None.

Purposes:

To make explicit in all jurisdictions that section captions are a part of the text of this Act and not mere surplusage.

Section 36‑1‑108. This chapter modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., except that nothing in this chapter modifies, limits, or supersedes Section 7001 (c) of that Act or authorizes electronic delivery of any of the notices described in Section 7003(b) of that Act.

Part 2

General Definitions and Principles of Interpretation

Section 36‑1‑201. (a) Unless the context otherwise requires, words or phrases defined in this section, or in the additional definitions contained in other chapters of this act that apply to particular chapters or parts thereof, have the meanings stated.

(b) Subject to ~~additional~~ definitions contained in ~~the subsequent~~ other chapters of this act ~~which are applicable~~ that apply to ~~specific~~ particular chapters or parts thereof~~, and unless the context otherwise requires, in this act~~:

(1) ‘Action’, in the sense of a judicial proceeding, includes recoupment, counterclaim, set‑off, suit in equity, and any other ~~proceedings~~ proceeding in which rights are determined.

(2) ‘Aggrieved party’ means a party entitled to ~~resort to~~ pursue a remedy.

(3) ‘Agreement’, as distinguished from ‘contract’, means the bargain of the parties in fact, as found in their language or ~~by implication~~ inferred from other circumstances, including course of performance, course of dealing, or usage of trade ~~or course of performance~~ as provided in ~~this act~~ Section 36‑1‑303. ~~Whether an agreement has legal consequences is determined by the provisions of this act, if applicable; otherwise by the law of contracts (Section 36‑1‑103). (Compare ‘Contract.’)~~

(4) ‘Bank’ means ~~any~~ a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company.

(5) ‘Bearer’ means ~~the~~ a person in possession of ~~an~~ a negotiable instrument, document of title, or certificated security that is payable to bearer or indorsed in blank.

(6) ‘Bill of lading’ means a document evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods~~, and includes an airbill. ‘Airbill’ means a document serving for air transportation as a bill of lading does for marine or rail transportation, and includes an air consignment note or air waybill~~.

(7) ‘Branch’ includes a separately incorporated foreign branch of a bank.

(8) ‘Burden of establishing’ a fact means the burden of persuading the ~~triers~~ trier of fact that the existence of the fact is more probable than its nonexistence.

(9) ‘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 ~~ownership~~ rights ~~or security interest~~ of ~~a third party~~ another person in the goods ~~buys~~, and in ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind. ~~but does not include a pawnbroker.~~ A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller’s own usual or customary practices. ~~All~~ A ~~persons~~ person ~~who~~ that ~~sell minerals or the like (including~~ sells oil, ~~and~~ gas~~)~~, or other minerals at the wellhead or minehead ~~are considered to be~~ is a ~~persons~~ person in the business of selling goods of that kind. ~~‘Buying’~~ A buyer in the ordinary course of business may buy ~~may be~~ for cash, ~~or~~ by exchange of other property, or on secured or unsecured credit, and may acquire ~~includes receiving~~ goods or documents of title under a preexisting contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under Chapter 2 may be a buyer in the ordinary course. ~~but~~ ‘Buyer in ordinary course of business’ does not include a person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(10) ‘Conspicuous’~~:~~, with reference to a term, ~~or clause is conspicuous when it is so written~~ means so written, displayed, or presented that a reasonable person against ~~whom~~ which it is to operate ought to have noticed it. Whether a term is ‘conspicuous’ or not is a decision for the court. Conspicuous terms include the following:

(A) a ~~printed~~ heading in capitals ~~(as Nonnegotiable Bill of Lading) is conspicuous.~~ equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and

(B) ~~(as: Nonnegotiable Bill of Lading) is conspicuous.~~ language in the body of a ~~form~~ record or display ~~is ‘conspicuous’ if it is~~ in larger ~~or other contrasting~~ type ~~or color~~ than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from surrounding text of the same size by symbols or other marks that call attention to the language. ~~But in a telegram any stated term is ‘conspicuous.’ Whether a term or clause is ‘conspicuous’ or not is for decision by the court.~~

(11) ‘Consumer’ means an individual who enters into a transaction primarily for personal, family, or household purposes.

~~(11)~~(12) ‘Contract’, as distinguished from ‘agreement’, means the total legal obligation ~~which~~ that results from the parties’ agreement as ~~affected~~ determined by this act as supplemented by ~~and~~ any other applicable ~~rules of law~~ laws. ~~(Compare ‘Agreement.’)~~

~~(12)~~(13) ‘Creditor’ includes a general creditor, a secured creditor, a lien creditor, and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity, and an executor or administrator of an insolvent debtor’s or assignor’s estate.

~~(13)~~(14) ‘Defendant’ includes a person in the position of defendant in a ~~coss‑action or~~ counterclaim, cross‑claim, or third‑party claim.

~~(14)~~(15) ‘Delivery’, with respect to ~~instruments~~ an instrument, ~~documents~~ document of title, or chattel paper ~~or certificated securities~~ means voluntary transfer of possession.

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

~~(16)~~(17) ‘Fault’ means ~~wrongful act, omission or breach~~ a default, breach, or wrongful act or omission.

~~(17)~~(18) ‘Fungible goods’ ~~with respect to goods or securities~~ means:

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

(B) goods ~~which are not fungible shall be deemed fungible for the purposes of this act to the extent that under a particular agreement or document unlike units are treated as equivalents.~~ that by agreement are treated as equivalent.

~~(18)~~(19) ‘Genuine’ means free of forgery or counterfeiting.

~~(19)~~(20) ‘Good faith’, except as otherwise provided in Chapter 5, means honesty in fact and the observance of reasonable commercial standards of fair dealing. ~~in the conduct or transaction concerned.~~

~~(20)~~(21) ‘Holder’ means:

(A) ~~a~~ the person ~~who is~~ in possession of a ~~document of title or an~~ negotiable instrument ~~or a certificated investment security drawn, issued, or indorsed to him or to his order or to bearer or in blank~~ that is payable either to bearer or an identified person that is the person in possession; or~~.~~

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

~~(21) To ‘honor’ is to pay or to accept and pay, or where a credit so engages to purchase or discount a draft complying with the terms of the credit.~~

(22) ‘Insolvency ~~proceedings~~ proceeding’ includes ~~any~~ an assignment for the benefit of creditors or other proceeding~~s~~ intended to liquidate or rehabilitate the estate of the person involved.

(23) ~~A person is~~ ‘Insolvent’ means:

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

(B) ~~or cannot~~ being unable to pay ~~his~~ debts as they become due; or

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

(24) ‘Money’ means a medium of exchange currently authorized or adopted by a domestic or foreign government ~~as a part of its currency~~. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more countries.

~~(25) A person has ‘notice’ of a fact when~~

~~(a) he has actual knowledge of it; or~~

~~(b) he has received a notice or notification of it; or~~

~~(c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists.~~

~~A person ‘knows’ or has ‘knowledge’ of a fact when he has actual knowledge of it. ‘Discover’ or ‘learn’ or a word or phrase of similar import refers to knowledge rather than to reason to know. The time and circumstances under which a notice or notification may cease to be effective are not determined by this act.~~

~~(26) A person ‘notifies’ or ‘gives’ a notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it. A person ‘receives’ a notice or notification when~~

~~(a) it comes to his attention; or~~

~~(b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications.~~

~~(27) Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.~~

~~(28) ‘Organization’ includes a corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, two or more persons having a joint or common interest, or any other legal or commercial entity.~~

(25) ‘Organization’ means a person other than an individual.

~~(29)~~(26) ‘Party’, as ~~distinct~~ distinguished from ‘third party’, means a person ~~who~~ that has engaged in a transaction or made an agreement ~~within~~ subject to this act.

~~(30)~~(27) ‘Person’ ~~includes~~ means an individual, ~~or an organization~~ corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity. ~~(See Section 36‑1‑102).~~

~~(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.~~

(28) ‘Present value’ means the amount as of a date certain or 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 at the time the transaction is entered into.

~~(32)~~(29) ‘Purchase’ ~~includes~~ means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift or any other voluntary transaction creatingan interest in property.

~~(33)~~(30) ‘Purchaser’ means a person ~~who~~ that takes by purchase.

(31) ‘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.

~~(34)~~(32) ‘Remedy’ means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal.

~~(35)~~(33) ‘Representative’ ~~includes~~ means a 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~~, or any other person empowered to act for another~~.

~~(36)~~(34) ~~‘Rights’~~ ‘Right’ includes ~~remedies~~ remedy.

~~(37)~~ ~~‘Security interest’ means an interest in personal property or fixtures 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 36‑2‑401) is limited in effect to a reservation of a ‘security interest’. The term also includes any interest of a buyer of accounts or chattel paper which is subject to Chapter 9. The special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 36‑2‑401 is not a ‘security interest’, but a buyer also may acquire a ‘security interest’ by complying with Chapter 9. Unless a consignment is intended as security, reservation of title under a lease or consignment is not a ‘security interest’, but a consignment in any event is subject to the provisions on consignment sales ( Section 36‑2‑326).~~

~~(A)~~ ~~Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration 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 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 nominal additional consideration upon compliance with the lease agreement, or~~

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

~~(B)~~ ~~A transaction does not create a security interest merely because it provides that~~

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

~~(2)~~ ~~the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,~~

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

~~(4)~~ ~~the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or~~

~~(5)~~ ~~the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.~~

~~For Purposes of this subsection (37):~~

~~Additional consideration is not nominal if (i) 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 (ii) 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. Additional consideration is nominal if it is less than the lessee’s reasonably predictable cost of performing under the lease agreement if the option is not exercised;~~

~~‘Reasonably predictable’ and ‘remaining economic life of the goods’ are to be determined with reference to the facts and circumstances at the time the transaction is entered into; and~~

~~‘Present value’ means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate is not manifestly unreasonable at the time the transaction is entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.~~

(35) ‘Security interest’ means an interest in personal property or fixtures which secures payment or performance of an obligation. ‘Security interest’ includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Chapter 9. ‘Security interest’ does not include the special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 36‑2‑401, but a buyer may also acquire a ‘security interest’ by complying with Chapter 9. Except as otherwise provided in Section 36‑2‑505, the right of a seller or lessor of goods under Chapter 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 Chapter 9. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer under Section 36‑2‑401 is limited in effect to a reservation of a ‘security interest’. Whether a transaction in the form of a lease creates a ‘security interest’ is determined pursuant to Section 36‑1‑203.

~~(38)~~(36) ‘Send’ in connection with ~~any~~ a writing, record, or notice means:

(A) to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and in the case of an instrument to an address specified thereon or otherwise agreed, or if there be none to any address reasonable under the circumstances~~. The receipt of any writing or notice within the time at which it would have arrived if properly sent has the effect of a proper sending.~~ ; or

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

~~(39)~~(37) ‘Signed’ includes using any symbol executed or adopted ~~by a party~~ with present intention to ~~authenticate~~ adopt or accept a writing.

(38) ‘State’ means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

~~(40)~~(39) ‘Surety’ includes a guarantor or other secondary obligor.

~~(41) ‘Telegram’ includes a message transmitted by radio, teletype, cable, any mechanical method of transmission, or the like.~~

~~(42)~~(40) ‘Term’ means ~~that~~ a portion of an agreement ~~which~~ that relates to a particular matter.

~~(43)~~(41) ‘Unauthorized signature’ ~~or indorsement~~ means ~~one~~ a signature made without actual, implied or apparent authority. ~~and includes a~~ The term includes forgery.

~~(44) ‘Value.’ Except as otherwise provided with respect to negotiable instruments and bank collections (Sections 36‑3‑303, 36‑4‑208 and 36‑4‑209) a person gives ‘value’ for rights if he acquires them~~

~~(a) 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; or~~

~~(b) as security for or in total or partial satisfaction of a preexisting claim; or~~

~~(c) by accepting delivery pursuant to a preexisting contract for purchase; or~~

~~(d) generally, in return for any consideration sufficient to support a simple contract.~~

~~(45)~~(42) ‘Warehouse receipt’ means a receipt issued by a person engaged in the business of storing goods for hire.

~~(46)~~(43) ~~‘Written’ or~~ ‘Writing’ includes printing, typewriting or any other intentional reduction to tangible form. ‘Written’ has a corresponding meaning.

OFFICIAL COMMENT

Prior uniform statutory provision, changes and new matter:

1. "Action". See similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act. The definition has been rephrased and enlarged.

2. "Aggrieved party". New.

3. "Agreement". New. As used in this Act the word is intended to include full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts thereof, and of any agreement permitted under the provisions of this Act to displace a stated rule of law.

4. "Bank". See Section 191, Uniform Negotiable Instruments Law.

5. "Bearer". From Section 191, Uniform Negotiable Instruments Law. The prior definition has been broadened.

6. "Bill of Lading". See similar definitions in Section 1, Uniform Bills of Lading Act. The definition has been enlarged to include freight forwarders’ bills and bills issued by contract carriers as well as those issued by common carriers. The definition of airbill is new.

7. "Branch". New.

8. "Burden of establishing a fact". New.

9. "Buyer in Ordinary Course of Business".

From Section 1, Uniform Trust Receipts Act. The definition has been expanded to make clear the type of person protected. Its major significance lies in Section 2‑403 and in the Article on Secured Transactions (Article 9).

The reference to minerals and the like makes clear that a buyer in ordinary course buying minerals under the circumstances described takes free of a prior mortgage created by the sellers. See comment to Section 9‑103.

A pawnbroker cannot be a buyer in ordinary course of business because the person from whom he buys goods (or acquires ownership after foreclosing an initial pledge) is typically an ordinary user and not a person engaged in selling goods of that kind.

10. "Conspicuous". New. This is intended to indicate some of the methods of making a term attention‑calling. But the test is whether attention can reasonably be expected to be called to it.

11. "Contract". New. But see Sections 3 and 71, Uniform Sales Act.

12. "Creditor". New.

13. "Defendant". From Section 76, Uniform Sales Act. Rephrased.

14. "Delivery". Section 76, Uniform Sales Act; Section 191, Uniform Negotiable Instruments Law; Section 58, Uniform Warehouse Receipts Act and Section 53, Uniform Bills of Lading Act.

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

Dock warrants were within the Sales Act definition of document of title apparently for the purpose of recognizing a valid tender by means of such paper. In current commercial practice a dock warrant or receipt is a kind of interim certificate issued by steamship companies upon delivery of the goods at the dock, entitling a designated person to have issued to him at the company’s office a bill of lading. The receipt itself is invariably nonnegotiable in form although it may indicate that a negotiable bill is to be forthcoming. Such a document is not within the general compass of the definition, although trade usage may in some cases entitle such paper to be treated as a document of title. If the dock receipt actually represents a storage obligation undertaken by the shipping company, then it is a warehouse receipt within this Section regardless of the name given to the instrument.

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

The definition is broad enough to include an airway bill.

16. "Fault". From Section 76, Uniform Sales Act.

17. "Fungible". See Sections 5, 6, and 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act. Fungibility of goods ‘by agreement’ has been added for clarity and accuracy.

18. "Genuine". New.

19. "Good faith". See Section 76(2), Uniform Sales Act; Section 58(2), Uniform Warehouse Receipts Act; Section 53(2), Uniform Bills of Lading Act; Section 22(2), Uniform Stock Transfer Act. "Good faith", whenever it is used in the Code, means at least what is here stated. In certain Articles, by specific provision, additional requirements are made applicable. See e.g., Secs. 2‑103(1)(b), 7‑404. To illustrate, in the Article on Sales, Section 2‑103, good faith is expressly defined as including in the case of a merchant observance of reasonable commercial standards of fair dealing in the trade, so that throughout that Article wherever a merchant appears in the case an inquiry into his observance of such standards is necessary to determine his good faith.

20. "Holder". See similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act.

21. "Honor". New.

22. "Insolvency proceedings". New.

23. "Insolvent". Section 76(3), Uniform Sales Act. The three tests of insolvency‑‑"ceased to pay his debts in the ordinary course of business," "cannot pay his debts as they become due," and "insolvent within the meaning of the federal bankruptcy law"‑‑are expressly set up as alternative tests and must be approached from a commercial stand‑point.

24. "Money". Section 6(5), Uniform Negotiable Instruments Law. The test adopted is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected.

~~25. "Notice". New. Compare NIL Section 56. Under the definition a person has notice when he has received a notification of the fact in question. But by the last sentence the act leaves open the time and circumstances under which notice or notification may cease to be effective. Therefore such cases as Graham v White‑Phillips Co., 296 US 27, 56 Sup Ct 21, 80 L Ed 20 (1935), are not overruled.~~

~~26. "Notifies". New. This is the word used when the essential fact is the proper dispatch of the notice, not its receipt. Compare "Send". When the essential fact is the other party’s receipt of the notice, that is stated. The second sentence states when a notification is received.~~

~~27. New. This makes clear that reason to know, knowledge, or a notification, although "received" for instance by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when, it was or should have been communicated to the individual conducting that transaction.~~

~~28~~25. "Organization". This is the definition of every type of entity or association, excluding an individual, acting as such. Definitions of "person" were included in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. The definition of "organization" given here includes a number of entities or associations not specifically mentioned in prior definition of "person", namely, government, governmental subdivision or agency, business trust, trust and estate.

~~29~~26. "Party". New. Mention of a party includes, of course, a person acting through an agent. However, where an agent comes into opposition or contrast to his principal, particular account is taken of that situation.

~~30~~27. "Person". See Comment to definition of "Organization". The reference to Section 1‑102 is to subsection (5) of that section.

~~31. "Presumption". New.~~

~~32~~29. "Purchase". Section 58, Uniform Warehouse Receipts Act; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. Rephrased.

~~33~~30. "Purchaser". Section 58, Uniform Warehouse Receipts Act; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. Rephrased.

~~34~~32. "Remedy". New. The purpose is to make it clear that both remedy and rights (as defined) include those remedial rights of "self help" which are among the most important bodies of rights under this Act, remedial rights being those to which an aggrieved party can resort on his own motion.

~~35~~33. "Representative". New.

~~36~~34. "Rights". New. See Comment to "Remedy".

~~37. "Security Interest".~~

~~Uniform Statutory Source: Section 1‑201(37), 1978 Official Text of the Act.~~

~~Changes: Substantially revised.~~

~~Purposes: This amendment to Section 1‑201(37) is being promulgated at the same time that the Article on Leases (Article 2A) is being promulgated as an amendment to this Act.~~

~~One of the reasons it was decided to codify the law with respect to leases was to resolve an issue that has created considerable confusion in the courts: what is a lease? The confusion exists, 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 is 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 transaction creates a lease and not a security interest, the lessee’s interest in the goods is limited to its leasehold estate; the residual interest in the goods belongs to the lessor. This has significant implications to the lessee’s creditors. "On common law theory, the lessor, since he has not parted with title, is entitled to full protection against the lessee’s creditors and trustee in bankruptcy...." 1 G. Gilmore, Security Interests in Personal Property Section 3.6, at 76 (l965).~~

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

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

~~The first paragraph of this definition is a revised version of the first five sentences of the 1978 Official Text of Section 1‑201(37). The changes are modest in that they make a style change in the fourth sentence and delete the reference to lease in the fifth sentence. The balance of this definition is new, although it preserves elements of the last two sentences of the prior definition. The focus of the changes was to draw a sharper line between leases and security interests disguised as leases to create greater certainty in commercial transactions.~~

~~Prior to this amendment, Section 1‑201(37) provided that whether a lease was intended as security (i.e., a security interest disguised as a lease) was to be determined from the facts of each case; however, (a) the inclusion of an option to purchase did not itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee would become, or had the option to become, the owner of the property for no additional consideration, or for a nominal consideration, did make the lease one intended for security.~~

~~Reference to the intent of the parties to create a lease or security interest has led to unfortunate results. In discovering intent, courts have relied upon factors that were thought to be more consistent with sales or loans than leases. Most of these criteria, however, are as applicable to true leases as to security interests. Examples include the typical net lease provisions, a purported lessor’s lack of storage facilities or its character as a financing party rather than a dealer in goods. Accordingly, amended Section 1‑201(37) deletes all reference to the parties’ intent.~~

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

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

~~The relationship of the second paragraph of this subsection to the third paragraph of this subsection 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.~~

~~The fourth paragraph provides definitions and rules of construction.~~

~~38~~36. "Send". New. Compare "notifies".

~~39~~37. "Signed". New. The inclusion of authentication in the definition of "signed" is to make clear that as the term is used in this Act a complete signature is not necessary. Authentication may be printed, stamped or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible authentications can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the symbol was executed or adopted by the party with present intention to authenticate the writing.

~~40~~39. "Surety". New.

~~41. "Telegram". New.~~

~~42~~40. "Term". New.

~~43~~41. "Unauthorized". New.

~~44. "Value". See 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; Section 1, Uniform Trust Receipts Act. All the Uniform Acts in the commercial law field (except the Uniform Conditional Sales Act) have carried definitions of "value". All those definitions provided that value was any consideration sufficient to support a simple contract, including the taking of property in satisfaction of or as security for a pre‑existing claim. Subsections (a), (b) and (d) in substance continue the definitions of "value" in the earlier acts. Subsection (c) makes explicit that "value" is also given in a third situation: where a buyer by taking delivery under a pre‑existing contract converts a contingent into a fixed obligation.~~

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

~~45~~42. "Warehouse receipt". See Section 76(1), Uniform Sales Act; Section 1, Uniform Warehouse Receipts Act. Receipts issued by a field warehouse are included, provided the warehouseman and the depositor of the goods are different persons.

~~46~~43. "Written" or "writing". This is a broadening of the definition contained in Section 191 of the Uniform Negotiable Instruments Law.

Section 36‑1‑202**.** ~~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.~~

(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;

(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. ‘Knows’ has a corresponding meaning.

(c) ‘Discover’, ‘learn’, or words of similar import refer to knowledge rather than to reason to know.

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

(e) Subject to subsection (f), a person ‘receives’ a notice or notification when:

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

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

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

~~OFFICIAL COMMENT~~

~~Prior uniform statutory provision: None.~~

~~Purposes:~~

~~1. This section is designed to supply judicial recognition for documents which have traditionally been relied upon as trustworthy by commercial men.~~

~~2. This section is concerned only with documents which have been given a preferred status by the parties themselves who have required their procurement in the agreement and for this reason the applicability of the section is limited to actions arising out of the contract which authorized or required the document. The documents listed are intended to be illustrative and not all inclusive.~~

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

~~Definitional Cross :~~

~~"Bill of lading" Section 1‑201.~~

~~"Contract" Section 1‑201.~~

~~"Genuine" Section 1‑201.~~

Section 36‑1‑203. ~~Every contract or duty within this act imposes an obligation of good faith in its performance or enforcement.~~

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(1) when the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the tem 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.

~~OFFICIAL COMMENT~~

~~Prior uniform statutory provision: None.~~

~~Purposes:~~

~~This section sets forth a basic principle running throughout this Act. The principle involved is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. Particular applications of this general principle appear in specific provisions of the Act such as the option to accelerate at will (Section 1‑208), the right to cure a defective delivery of goods (Section 2‑508), the duty of a merchant buyer who has rejected goods to effect salvage operations (Section 2‑603), substituted performance (Section 2‑614), and failure of presupposed conditions (Section 2‑615). The concept, however, is broader than any of these illustrations 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 1‑205 on course of dealing and usage of trade.~~

~~It is to be noted that under the Sales Article definition of good faith (Section 2‑103), contracts made by a merchant have incorporated in them the explicit standard not only of honesty in fact (Section 1‑201), but also of observance by the merchant of reasonable commercial standards of fair dealing in the trade.~~

~~Cross :~~

~~Sections 1‑201; 1‑205; 1‑208; 2‑103; 2‑508; 2‑603; 2‑614; 2‑615.~~

~~Definitional Cross :~~

~~"Contract" Section 1‑201.~~

~~"Good faith" Section 1‑201; 2‑103.~~

Section 36‑1‑204. ~~(1)~~ ~~Whenever this act requires any action to be taken within a reasonable time, any time which is not manifestly unreasonable may be fixed by agreement.~~

~~(2)~~ ~~What is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action.~~

~~(3)~~ ~~An action is taken ‘seasonably’ when it is taken at or within the time agreed or if no time is agreed at or within a reasonable time.~~ Except as otherwise provided in Chapters 3, 4, 4A, 5, and 6, a person gives value for rights if the person acquires them:

(a) 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:

(b) as security for, or in total or partial satisfaction of, a preexisting contract for purchase; or

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

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

~~OFFICIAL COMMENT~~

~~Prior uniform statutory provision: None.~~

~~Purposes:~~

~~1. Subsection (1) recognizes that nothing is stronger evidence of a reasonable time than the fixing of such time by a fair agreement between the parties. However, provision is made for disregarding a clause which whether by inadvertence or over‑reaching fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not obviously unfair as judged by the time of contracting.~~

~~2. Under the section, the agreement which fixes the time need not be part of the main agreement, but may occur separately. Notice also that under the definition of "agreement" (Section 1‑201) the circumstances of the transaction including course of dealing or usages of trade or course of performance may be material. On the question what is a reasonable time these matters will often be important.~~

~~Definitional Cross :~~

~~"Agreement" Section 1‑201.~~

Section 36‑1‑205. ~~(1)~~ ~~A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.~~

~~(2)~~ ~~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 written trade code or similar writing the interpretation of the writing is for the court.~~

~~(3)~~ ~~A course of dealing between parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement.~~

~~(4) The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade.~~

~~(5)~~ ~~An applicable usage of trade in the place where any part of performance is to occur shall be used in interpreting the agreement as to that part of the performance.~~

~~(6)~~ ~~Evidence of a relevant usage of trade offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise to the latter.~~ (a) Whether a time for taking an action required by the this act is reasonable depends on the nature, purpose, and circumstances of the action.

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

~~OFFICIAL COMMENT~~

~~Prior uniform statutory provision: No such general provision but see Sections 9(1), 15(5), 18(2), and 71, Uniform Sales Act.~~

~~Purposes:~~

~~This section makes it clear that:~~

~~1. This Act rejects both the "lay‑dictionary" and the "conveyancer’s" reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.~~

~~2. Course of dealing under subsection (1) is restricted, literally, to a sequence of conduct between the parties previous to the agreement. However, the provisions of the Act on course of performance make it clear that a sequence of conduct after or under the agreement may have equivalent meaning. (Section 2‑208).~~

~~3. "Course of dealing" may enter the agreement either by explicit provisions of the agreement or by tacit recognition.~~

~~4. This Act deals with "usage of trade" as a factor in reaching the commercial meaning of the agreement which the parties have made. The language used is to be interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade. By adopting in this context the term "usage of trade" this Act expresses its intent to reject those cases which see evidence of "custom" as representing an effort to displace or negate "established rules of law". A distinction is to be drawn between mandatory rules of law such as the Statute of Frauds provisions of Article 2 on Sales whose very office is to control and restrict the actions of the parties, and which cannot be abrogated by agreement, or by a usage of trade, and those rules of law (such as those in Part 3 of Article 2 on Sales) which fill in points which the parties have not considered and in fact agreed upon. The latter rules hold "unless otherwise agreed" but yield to the contrary agreement of the parties. Part of the agreement of the parties to which such rules yield is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding.~~

~~5. A usage of trade under subsection (2) must have the "regularity of observance" specified. The ancient English tests for "custom" are abandoned in this connection. Therefore, it is not required that a usage of trade be "ancient or immemorial", "universal" or the like. Under the requirement of subsection (2) full recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree. There is room also for proper recognition of usage agreed upon by merchants in trade codes.~~

~~6. The policy of this Act controlling explicit unconscionable contracts and clauses (Sections 1‑203, 2‑302) applies to implicit clauses which rest on usage of trade and carries forward the policy underlying the ancient requirement that a custom or usage must be "reasonable". However, the emphasis is shifted. The very fact of commercial acceptance makes out a prima facie case that the usage is reasonable, and the burden is no longer on the usage to establish itself as being reasonable. But the anciently established policing of usage by the courts is continued to the extent necessary to cope with the situation arising if an unconscionable or dishonest practice should become standard.~~

~~7. Subsection (3), giving the prescribed effect to usages of which the parties "are or should be aware", reinforces the provision of subsection (2) requiring not universality but only the described "regularity of observance" of the practice or method. This subsection also reinforces the point of subsection (2) that such usages may be either general to trade or particular to a special branch of trade.~~

~~8. Although the terms in which this Act defines "agreement" include the elements of course of dealing and usage of trade, the fact that express reference is made in some sections to those elements is not to be construed as carrying a contrary intent or implication elsewhere. Compare Section 1‑102(4).~~

~~9. In cases of a well established line of usage varying from the general rules of this Act where the precise amount of the variation has not been worked out into a single standard, the party relying on the usage is entitled, in any event, to the minimum variation demonstrated. The whole is not to be disregarded because no particular line of detail has been established. In case a dominant pattern has been fairly evidenced, the party relying on the usage is entitled under this section to go to the trier of fact on the question of whether such dominant pattern has been incorporated into the agreement.~~

~~10. Subsection (6) is intended to insure that this Act’s liberal recognition of the needs of commerce in regard to usage of trade shall not be made into an instrument of abuse.~~

~~Cross :~~

~~Point 1: Sections 1‑203, 2‑104 and 2‑202.~~

~~Point 2: Section 2‑208.~~

~~Point 4: Section 2‑201 and Part 3 of Article 2.~~

~~Point 6: Sections 1‑203 and 2‑302.~~

~~Point 8: Sections 1‑102 and 1‑201.~~

~~Point 9: Section 2‑204(3).~~

~~Definitional Cross :~~

~~"Agreement" Section 1‑201.~~

~~"Contract" Section 1‑201.~~

~~"Party" Section 1‑201.~~

~~"Term" Section 1‑201.~~

Section 36‑1‑206. ~~(1)~~ ~~Except in cases described in subsection (2) of this section a contract for the sale of personal property is not enforceable by way of action or defense beyond five thousand dollars in amount or value of remedy unless there is some writing which indicates that a contract for sale has been made between the parties at a defined or stated price, reasonably identifies the subject matter, and is signed by the party against whom enforcement is sought or by his authorized agent.~~

~~(2)~~ ~~Subsection (1) of this section does not apply to contract for the sale of goods (Section 36‑1‑201) nor of securities (Section 36‑8‑113) nor to security agreements (Section 36‑9‑203).~~ Whenever this act creates a ‘presumption’ with respect to a fact, or provides that a fact is ‘presumed’, the trier of fact must find the existence of the fact unless and until evidence is introduced that supports a finding of its nonexistence.

~~OFFICIAL COMMENT~~

~~Prior uniform statutory provision: Section 4, Uniform Sales Act (which was based on Section 17 of the Statute of 29 Charles II).~~

~~Purposes of changes: Completely rewritten by this and other sections.~~

~~To fill the gap left by the Statute of Frauds provisions for goods (Section 2‑201), and security interests (Section 9‑203). As to securities, see Section 8‑113. The Uniform Sales Act covered the sale of "choses in action"; the principal gap relates to sale of "general intangibles" that are not "payment intangibles" (as those terms are defined in Section 9‑102 and to transactions excluded from Article 9 by Section 9‑109(d). The informality normal to such transactions is recognized by lifting the limit for oral transactions to $5,000. In such transactions there is often no standard of practice by which to judge, and values can rise or drop without warning; troubling abuses are avoided when the dollar limit is exceeded by requiring that the subject‑matter be reasonably identified in a signed writing which indicates that a contract for sale has been made at a defined or stated price.~~

~~Definitional Cross :~~

~~"Action" Section 1‑201.~~

~~"Agreement" Section 1‑201.~~

~~"Contract" Section 1‑201.~~

~~"Contract for sale" Section 2‑106.~~

~~"Goods" Section 2‑105.~~

~~"Party" Section 1‑201.~~

~~"Sale" Section 2‑106.~~

~~"Signed" Section 1‑201.~~

~~"Writing" Section 1‑201.~~

~~Section 36‑1‑207.~~ ~~A party who 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. Such words as ‘without prejudice,’ ‘under protest’ or the like are sufficient.~~

~~OFFICIAL COMMENT~~

~~Prior uniform statutory provision: None.~~

~~Purposes:~~

~~1. This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment "without prejudice," "under protest," "under reserve," "with reservation of all our rights", and the like. All of these phrases completely reserve all rights within the meaning of this section. The section therefore contemplates that limited as well as general reservations and acceptance by a party may be made "subject to satisfaction of our purchaser," "subject to acceptance by our customers," or the like.~~

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

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

~~Cross :~~

~~Section 2‑607.~~

~~Definitional Cross :~~

~~"Party" Section 1‑201.~~

~~"Rights" Section 1‑201.~~

~~Section 36‑1‑208.~~ ~~A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral ‘at will’ or ‘when he deems himself insecure’ or in words of similar import shall be construed to mean that he shall have power to do so only if he 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 whom the power has been exercised.~~

~~OFFICIAL COMMENT~~

~~Prior uniform statutory provision: None.~~

~~Purposes:~~

~~The increased use of acceleration clauses either in the case of sales on credit or in time paper or in security transactions has led to some confusion in the cases as to the effect to be given to a clause which seemingly grants the power of an acceleration at the whim and caprice of one party. This Section is intended to make clear that despite language which can 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 clause means that 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 agreement or to paper which in the first instance is payable at a future date.~~

~~Definitional Cross :~~

~~"Burden of establishing" Section 1‑201.~~

~~"Good faith" Section 1‑201.~~

~~"Party" Section 1‑201.~~

~~"Term" Section 1‑201.~~

Part 3

Territorial Applicability and General Rules

Section 36‑1‑301. (a) Except as otherwise provided in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties.

(b) In the absence of an agreement effective under subsection (a), and except as provided in subsection (c), this act applies to transactions bearing an appropriate relation to this State.

(c) If one of the following provisions of this act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by law so specified:

(1) Section 36‑2‑402;

(2) Sections 36‑2A‑105 and 36‑2A‑106;

(3) Section 36‑4‑102;

(4) Section 36‑4A‑507;

(5) Section 36‑5‑116;

(6) Section 36‑6‑103;

(7) Section 36‑8‑110;

(8) Sections 36‑9‑301 through 36‑9‑307.

Section 36‑1‑302. (a) Except as otherwise provided in subsection (b) or elsewhere in this act, the effect of provisions of this act may be varied by agreement.

(b) The obligations of good faith, diligence, reasonableness, and care prescribed by this act may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever this act requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement.

(c) The presence in certain provisions of this act 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.

Section 36‑1‑303. (a) A ‘course of performance’ is a sequence of conduct between the parties to a particular transaction that exists if:

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

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

(b) A ‘course of dealing’ is a sequence of 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 must 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 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 Section 36‑2‑209, a course of performance is relevant to show a waive 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.

Section 36‑1‑304. Every contract or duty within this act imposes an obligation of good faith in its performance and enforcement.

Section 36‑1‑305. (a) The remedies provided by this act 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 damages nor penal damages may be had except as specifically provided in this act or by other rule of law.

(b) Any right or obligation declared by this act is enforceable by action unless the provision declaring it specifies a different and limited effect.

Section 36‑1‑306. 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.

Section 36‑1‑307. 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 is prima facie evidence of its own authenticity and genuineness and of the facts stated in the document by the third party.

Section 36‑1‑308. (a) 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. Such words as ‘without prejudice’, ‘under protest’, or the like are sufficient.

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

Section 36‑1‑309. 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.

Section 36‑1‑310. 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.”

SECTION 2. Section 36‑2‑103(1) of the 1976 Code is amended to read:

“ (1) In this chapter unless the context otherwise requires:

(a) ‘Buyer’ means a person who buys or contracts to buy goods.

(b) ~~‘Good faith’ in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade~~ [Reserved].

(c) ‘Receipt’ of goods means taking physical possession of them.

(d) ‘Seller’ means a person who sells or contracts to sell goods.”

OFFICIAL COMMENT

Prior uniform statutory provision: Subsection (1): Section 76, Uniform Sales Act.

Changes: The definitions of "buyer" and "seller" have been slightly rephrased, the reference in Section 76 of the prior Act to "any legal successor in interest of such person" being omitted. The definition of "receipt" is new.

Purposes of changes and new matter:

1. The phase "any legal successor in interest of such person" has been eliminated since Section 2‑210 of this Article, which limits some types of delegation of performance on assignment of a sales contract, makes it clear that not every such successor can be safely included in the definition. In every ordinary case, however, such successors are as of course included.

2. "Receipt" must be distinguished from delivery particularly in regard to the problems arising out of shipment of goods, whether or not the contract calls for making delivery by way of documents of title, since the seller may frequently fulfill his obligations to "deliver" even though the buyer may never "receive" the goods. Delivery with respect to documents of title is defined in Article 1 and requires transfer of physical delivery. Otherwise the many divergent incidents of delivery are handled incident by incident.

Cross :

Point 1: See Section 2‑210 and Comment thereon.

Point 2: Section 1‑201.

Definitional Cross :

"Person" Section 1‑201.

SECTION 3. Section 36‑2‑202 of the 1976 Code is amended to read:

“Section 36‑2‑202. Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

(a) by course of performance, course of dealing, or usage of trade (Section ~~36‑1‑205~~ 36‑1‑303) ~~or by course of performance (Section 36‑2‑208)~~; and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.”

OFFICIAL COMMENT

Prior uniform statutory provision: None.

Purposes:

1. This section definitely rejects:

(a) Any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon;.

(b) The premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used; and.

(c) The requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.

2. Paragraph (a) makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties is considered the best indication of what they intended the writing to mean.

3. Under paragraph (b) consistent additional terms, not reduced to writing, may be proved unless the court finds that the writing was intended by both parties as a complete and exclusive statement of all the terms. If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact.

Cross :

Point 3: Sections 1‑205, 2‑207, 2‑302 and 2‑316.

Definitional Cross :

‘Agreed’ and ‘agreement’ Section 1‑201.

‘Course of dealing’ Section 1‑303.

‘Party’ Section 1‑201.

‘Term’ Section 1‑201.

‘Usage of trade’ Section 1‑303.

‘Written’ and ‘writing’ Section 1‑201.

SECTION 4. Section 36‑2A‑103(3) of the 1976 Code is amended to read:

“(3) The following definitions in other chapters apply to this chapter:

‘Account’. Section 36‑9‑106.

‘Between merchants’. Section 36‑2‑104(3).

‘Buyer’. Section 36‑2‑103(1)(a).

‘Chattel paper’. Section 36‑9‑105(1)(b).

‘Consumer goods’. Section 36‑9‑109(1).

‘Document’. Section 36‑9‑105(1)(f).

‘Entrusting’. Section 36‑2‑403(3).

‘General intangibles’. Section 36‑9‑102(a)(42).

~~‘Good faith’. Section 36‑2‑103(1)(b).~~

‘Instrument’. Section 36‑9‑105(1)(i).

‘Merchant’. Section 36‑2‑104(1).

‘Mortgage’. Section 36‑9‑105(1)(j).

‘Pursuant to commitment’. Section 36‑9‑105(1)(k).

‘Receipt’. Section 36‑2‑103(1)(c).

‘Sale’. Section 36‑2‑106(1).

‘Sale on approval’. Section 36‑2‑326.

‘Sale or return’. Section 36‑2‑326.

‘Seller’. Section 36‑2‑103(1)(d).”

OFFICIAL COMMENT

(a) ‘Buyer in ordinary course of business’. Section 1‑201(b)(9).

(b) ‘Cancellation’. Section 2‑106(4). The effect of a cancellation is provided in Section 2A‑505(1).

(c) ‘Commercial unit’. Section 2‑105(6).

(d) ‘Conforming’. Section 2‑106(2).

(e) ‘Consumer lease’. New. This Article includes a subset of rules that applies only to consumer leases. Sections 2A‑106, 2A‑108(2), 2A‑108(4), 2A‑109(2), 2A‑221, 2A‑309, 2A‑406, 2A‑407, 2A‑504(3)(b) , and 2A‑516(3)(b).

For a transaction to qualify as a consumer lease it must first qualify as a lease. Section 2A‑103(1)(j). Note that this Article regulates the transactional elements of a lease, including a consumer lease; consumer protection statutes, present and future, and existing consumer protection decisions are unaffected by this Article. Section 2A‑104(1)(c) and (2). Of course, Article 2A as state law also is subject to federal consumer protection law.

This definition is modeled after the definition of consumer lease in the Consumer Leasing Act, 15 U.S.C. Section 1667 (1982), and in the Unif. Consumer Credit Code Section 1.301(14), 7A U.L.A. 43 (1974). However, this definition of consumer lease differs from its models in several respects: the lessor can be a person regularly engaged either in the business of leasing or of selling goods, the lease need not be for a term exceeding four months, a lease primarily for an agricultural purpose is not covered, and whether there should be a limitation by dollar amount and its amount is left up to the individual states.

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

(f) ‘Fault’. Section 1‑201(16).

(g) ‘Finance Lease’. New. This Article includes a subset of rules that applies only to finance leases. Sections 2A‑209, 2A‑211(2), 2A‑212(1), 2A‑213, 2A‑219(1), 2A‑220(1)(a), 2A‑221, 2A‑405(c), 2A‑407, 2A‑516(2) and 2A‑517(1)(a) and (2).

For a transaction to qualify as a finance lease it must first qualify as a lease. Section 2A‑103(1)(j). Unless the lessor is comfortable that the transaction will qualify as a finance lease, the lease agreement should include provisions giving the lessor the benefits created by the subset of rules applicable to the transaction that qualifies as a finance lease under this Article.

A finance lease is the product of a three party transaction. The supplier manufactures or supplies the goods pursuant to the lessee’s specification, perhaps even pursuant to a purchase order, sales agreement or lease agreement between the supplier and the lessee. After the prospective finance lease is negotiated, a purchase order, sales agreement, or lease agreement is entered into by the lessor (as buyer or prime lessee) or an existing order, agreement or lease is assigned by the lessee to the lessor, and the lessor and the lessee then enter into a lease or sublease of the goods. Due to the limited function usually performed by the lessor, the lessee looks almost entirely to the supplier for representations, covenants and warranties. If a manufacturer’s warranty carries through, the lessee may also look to that. Yet, this definition does not restrict the lessor’s function solely to the supply of funds; if the lessor undertakes or performs other functions, express warranties, covenants and the common law will protect the lessee.

This definition focuses on the transaction, not the status of the parties; to avoid confusion it is important to note that in other contexts, e.g., tax and accounting, the term finance lease has been used to connote different types of lease transactions, including leases that are disguised secured transactions. M. Rice, Equipment Financing, 62‑71 (1981). A lessor who is a merchant with respect to goods of the kind subject to the lease may be a lessor under a finance lease. Many leases that are leases back to the seller of goods (Section 2A‑308(3)) will be finance leases. This conclusion is easily demonstrated by a hypothetical. Assume that B has bought goods from C pursuant to a sales contract. After delivery to and acceptance of the goods by B, B negotiates to sell the goods to A and simultaneously to lease the goods back from A, on terms and conditions that, we assume, will qualify the transaction as a lease. Section 2A‑103(1)(j). In documenting the sale and lease back, B assigns the original sales contract between B, as buyer, and C, as seller, to A. A review of these facts leads to the conclusion that the lease from A to B qualifies as a finance lease, as all three conditions of the definition are satisfied. Subparagraph (i) is satisfied as A, the lessor, had nothing to do with the selection, manufacture, or supply of the equipment. Subparagraph (ii) is satisfied as A, the lessor, bought the equipment at the same time that A leased the equipment to B, which certainly is in connection with the lease. Finally, subparagraph (iii) (A) is satisfied as A entered into the sales contract with B at the same time that A leased the equipment back to B. B, the lessee, will have received a copy of the sales contract in a timely fashion.

Subsection (i) requires the lessor to remain outside the selection, manufacture and supply of the goods; that is the rationale for releasing the lessor from most of its traditional liability. The lessor is not prohibited from possession, maintenance or operation of the goods, as policy does not require such prohibition. To insure the lessee’s reliance on the supplier, and not on the lessor, subsection (ii) requires that the goods ( where the lessor is the buyer of the goods) or that the right to possession and use of the goods (where the lessor is the prime lessee and the sublessor of the goods) be acquired in connection with the lease (or sublease) to qualify as a finance lease. The scope of the phrase ‘in connection with’ is to be developed by the courts, case by case. Finally, as the lessee generally relies almost entirely upon the supplier for representations and covenants, and upon the supplier or a manufacturer, or both, for warranties with respect to the goods, subsection (iii) requires that one of the following occur: (A) the lessee receive a copy of the supply contract before signing the lease contract; (B) the lessee’s approval of the supply contract is a condition to the effectiveness of the lease contract; ( C) the lessee receive a statement describing the promises and warranties and any limitations relevant to the lessee before signing the lease contract; or (D) before signing the lease contract and except in a consumer lease, the lessee receive a writing identifying the supplier (unless the supplier was selected and required by the lessee) and the rights of the lessee under Section 2A‑209, and advising the lessee a statement of promises and warranties is available from the supplier. Thus, even where oral supply orders or computer placed supply orders are compelled by custom and usage the transaction may still qualify as a finance lease if the lessee approves the supply contract before the lease contract is effective and such approval was a condition to the effectiveness of the lease contract. Moreover, where the lessor does not want the lessee to see the entire supply contract, including price information, the lessee may be provided with a separate statement of the terms of the supply contract relevant to the lessee; promises between the supplier and the lessor that do not affect the lessee need not be included. The statement can be a restatement of those terms or a copy of portions of the supply contract with the relevant terms clearly designated. Any implied warranties need not be designated, but a disclaimer or modification of remedy must be designated. A copy of any manufacturer’s warranty is sufficient if that is the warranty provided. However, a copy of any Regulation M disclosure given pursuant to 12 C.F.R. Section 213.4(g) concerning warranties in itself is not sufficient since those disclosures need only briefly identify express warranties and need not include any disclaimer of warranty.

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

(h) ‘Goods’. Section 9‑102(a)(44). See Section 2A‑103(3) for reference to the definition of ‘Account’, ‘Chattel paper’, ‘Document’, ‘General intangibles’ and ‘Instrument’. See Section 2A‑217 for determination of the time and manner of identification.

(i) ‘Installment lease contract’. Section 2‑612(1).

(j) ‘Lease’. New. There are several reasons to codify the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least several significant issues to be resolved by codification. First and foremost is the definition of a lease. It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the transaction will be governed by the Article on Secured Transactions (Article 9) and the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases under the common law and, except with respect to leases of fixtures (Section 2A‑309), this Article imposes no such requirement. Yet the distinction between a lease and a security interest disguised as a lease is not clear from the case law at the time of the promulgation of this Article. DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.S.F. L. Rev. 257 (1978).

At common law a lease of personal property is a bailment for hire. While there are several definitions of bailment for hire, all require a thing to be let and a price for the letting. Thus, in modern terms and as provided in this definition, a lease is created when the lessee agrees to furnish consideration for the right to the possession and use of goods over a specified period of time. Mooney, Personal Property Leasing: A Challenge, 36 Bus. Law. 1605, 1607 (1981). Further, a lease is neither a sale (Section 2‑106(1)) nor a retention or creation of a security interest (Sections 1‑201(b)(35) and 1‑203). Due to extensive litigation to distinguish true leases from security interests, an amendment to former Section 1‑201(37) (now codified as Section 1‑203 was promulgated with this Article to create a sharper distinction.

This section as well as Section 1‑203 must be examined to determine whether the transaction in question creates a lease or a security interest. The following hypotheticals indicate the perimeters of the issue. Assume that A has purchased a number of copying machines, new, for $1,000 each; the machines have an estimated useful economic life of three years. A advertises that the machines are available to rent for a minimum of one month and that the monthly rental is $100.00. A intends to enter into leases where A provides all maintenance, without charge to the lessee. Further, the lessee will rent the machine, month to month, with no obligation to renew. At the end of the lease term the lessee will be obligated to return the machine to A’s place of business. This transaction qualifies as a lease under the first half of the definition, for the transaction includes a transfer by A to a prospective lessee of possession and use of the machine for a stated term, month to month. The machines are goods (Section 2A‑103(1)( h)). The lessee is obligated to pay consideration in return, $100.00 for each month of the term.

However, the second half of the definition provides that a sale or a security interest is not a lease. Since there is no passing of title, there is no sale. Sections 2A‑103(3) and 2‑106(1). Under pre‑Act security law this transaction would have created a bailment for hire or a true lease and not a conditional sale. Da Rocha v. Macomber, 330 Mass. 611, 614‑15, 116 N.E.2d 139, 142 (1953). Under Section 1‑203, the same result would follow. While the lessee is obligated to pay rent for the one month term of the lease, one of the other four conditions of Section 1‑203(b) must be met and none is. The term of the lease is one month and the economic life of the machine is 36 months; thus, Section 1‑203(b)(1) is not now satisfied. Considering the amount of the monthly rent, absent economic duress or coercion, the lessee is not bound either to renew the lease for the remaining economic life of the goods or to become the owner. If the lessee did lease the machine for 36 months, the lessee would have paid the lessor $3,600 for a machine that could have been purchased for $1,000; thus, Section 1‑203(b)(2) is not satisfied. Finally, there are no options; thus, subparagraphs (3) and (4) of Section 1‑203(b) are not satisfied. This transaction creates a lease, not a security interest. However, with each renewal of the lease the facts and circumstances at the time of each renewal must be examined to determine if that conclusion remains accurate, as it is possible that a transaction that first creates a lease, later creates a security interest.

Assume that the facts are changed and that A requires each lessee to lease the goods for 36 months, with no right to terminate. Under pre‑Act security law this transaction would have created a conditional sale, and not a bailment for hire or true lease. Hervey v. Rhode Island Locomotive Works, 93 U.S. 664, 672‑73 (1876). Under this subsection, and Section 1‑203, the same result would follow. The lessee’s obligation for the term is not subject to termination by the lessee and the term is equal to the economic life of the machine.

Between these extremes there are many transactions that can be created. Some of the transactions were not properly categorized by the courts in applying the 1978 and earlier Official Texts of former Section 1‑201(37). This subsection, together with Section 1‑203, draws a brighter line, which should create a clearer signal to the professional lessor and lessee.

(k) ‘Lease agreement’. This definition is derived from ~~the first sentence of~~ Section 1‑201(b)(3). Because the definition of lease is broad enough to cover future transfers, lease agreement includes an agreement contemplating a current or subsequent transfer. Thus it was not necessary to make an express reference to an agreement for the future lease of goods (Section 2‑106(1)). This concept is also incorporated in the definition of lease contract. Note that the definition of lease does not include transactions in ordinary building materials that are incorporated into an improvement on land. Section 2A‑309(2).

The provisions of this Article, if applicable, determine whether a lease agreement has legal consequences; otherwise the law of bailments and other applicable law determine the same. Sections 2A‑103(4) and 1‑103.

(l) ‘Lease contract’. This definition is derived from the definition of contract in Section 1‑201(b)(12). Note that a lease contract may be for the future lease of goods, since this notion is included in the definition of lease.

(m) ‘Leasehold interest’. New.

(n) ‘Lessee’. New.

(o) ‘Lessee in ordinary course of business’. Section 1‑201(9).

(p) ‘Lessor’. New.

(q) ‘Lessor’s residual interest’. New.

(r) ‘Lien’. New. This term is used in Section 2A‑307

(Priority of Liens Arising by Attachment or Levy on, Security Interests in, and Other Claims to Goods).

(s) ‘Lot’. Section 2‑105(5).

(t) ‘Merchant lessee’. New. This term is used in Section 2A‑511 (Merchant Lessee’s Duties as to Rightfully Rejected Goods). A person may satisfy the requirement of dealing in goods of the kind subject to the lease as lessor, lessee, seller, or buyer.

(v) ‘Purchase’. Section 1‑201(32). This definition omits the reference to lien contained in the definition of purchase in Article 1 (Section 1‑201(32)). This should not be construed to exclude consensual liens from the definition of purchase in this Article; the exclusion was mandated by the scope of the definition of lien in Section 2A‑103(1)(r). Further, the definition of purchaser in this Article adds a reference to lease; as purchase is defined in Section 1‑201(32) to include any other voluntary transaction creating an interest in property, this addition is not substantive.

(w) ‘Sublease’. New.

(x) ‘Supplier’. New.

(y) ‘Supply contract’. New.

(z) ‘Termination’. Section 2‑106(3). The effect of a termination is provided in Section 2A‑505(2).

SECTION 5. Section 36‑2A‑501 of the 1976 Code is amended to read:

“Section 36‑2A‑501. (1) Whether the lessor or the lessee is in default under a lease contract is determined by the lease agreement and this chapter.

(2) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement has rights and remedies as provided in this chapter and, except as limited by this chapter, as provided in the lease agreement.

(3) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement may reduce the party’s claim to judgment, or otherwise enforce the lease contract by self‑help or any available judicial procedure or nonjudicial procedure, including administrative proceeding, arbitration, or the like, in accordance with this chapter.

(4) Except as otherwise provided in Section ~~36‑1‑106(1)~~ 36‑1‑305(a) or this chapter or the lease agreement, the rights and remedies referred to in subsections (2) and (3) are cumulative.

(5) If the lease agreement covers both real property and goods, the party seeking enforcement may proceed under this Part as to the goods, or under other applicable law as to both the real property and the goods in accordance with that party’s rights and remedies in respect of the real property, in which case this Part does not apply.”

OFFICIAL COMMENT

Uniform Statutory Source: Former Section 9‑501 (now codified as Sections 9‑601).

Changes: Substantially revised.

Purposes: 1. Subsection (1) is new and represents a departure from the Article on Secured Transactions (Article 9) as the subsection makes clear that whether a party to the lease agreement is in default is determined by this Article as well as the agreement. Sections 2A‑508 and 2A‑523. It further departs from Article 9 in recognizing the potential default of either party, a function of the bilateral nature of the obligations between the parties to the lease contract.

2. Subsection (2) is a version of the first sentence of Section 9‑601(a), revised to reflect leasing terminology.

3. Subsection (3), an expansive version of the second sentence of Section 9‑601(a), lists the procedures that may be followed by the party seeking enforcement; in effect, the scope of the procedures listed in subsection (3) is consistent with the scope of the procedures available to the foreclosing secured party.

4. Subsection (4) establishes that the parties’ rights and remedies are cumulative. DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.S.F. L. Rev. 257, 276‑80 (1978). Cumulation, and largely unrestricted selection, of remedies is allowed in furtherance of the general policy of the Commercial Code, stated in Section 1‑305, that remedies be liberally administered to put the aggrieved party in as good a position as if the other party had fully performed. Therefore, cumulation of, or selection among, remedies is available to the extent necessary to put the aggrieved party in as good a position as it would have been in had there been full performance. However, cumulation of, or selection among, remedies is not available to the extent that the cumulation or selection would put the aggrieved party in a better position than it would have been in had there been full performance by the other party.

5. Section 9‑602, which, among other things, states that certain rules, to the extent they give rights to the debtor and impose duties on the secured party, may not be waived or varied, is not incorporated in this Article. Given the significance of freedom of contract in the development of the common law as it applies to bailments for hire and the lessee’s lack of an equity of redemption, there is no reason to impose that restraint.

SECTION 6. Section 36‑2A‑518(2) of the 1976 Code is amended to read:

“(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 36‑2A‑504) or otherwise determined pursuant to agreement of the parties (Sections ~~36‑1‑102(3)~~ 36‑1‑302 and 36‑2A‑503), if a lessee’s cover is by a lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessee may recover from the lessor as damages (i) the present value, as of the date of the commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement minus the present value as of the same date of the total rent for the then remaining lease term of the original lease agreement, and (ii) any incidental or consequential damages, less expenses saved in consequence of the lessor’s default.”

OFFICIAL COMMENT

Uniform Statutory Source: Section 2‑712.

Changes: Substantially revised.

Purposes: 1. Subsection (1) allows the lessee to take action to fix its damages after default by the lessor. Such action may consist of the lease of goods. The decision to cover is a function of commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9‑625.

2. Subsection (2) states a rule for determining the amount of lessee’s damages provided that there is no agreement to the contrary. The lessee’s damages will be established using the new lease agreement as a measure if the following three criteria are met: (i) the lessee’s cover is by lease agreement, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such cover was effected in good faith, and in a commercially reasonable manner. Thus, the lessee will be entitled to recover from the lessor the present value, as of the date of commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period which is comparable to the then remaining term of the original lease agreement less the present value of the rent reserved for the remaining term under the original lease, together with incidental or consequential damages less expenses saved in consequence of the lessor’s default. Consequential damages may include loss suffered by the lessee because of deprivation of the use of the goods during the period between the default and the acquisition of the goods under the new lease agreement. If the lessee’s cover does not satisfy the criteria of subsection (2), Section 2A‑519 governs.

3. Two of the three criteria to be met by the lessee are familiar, but the concept of the new lease agreement being substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. Thus, the decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

4. While the section does not draw a bright line, it is possible to describe some of the factors that should be considered in finding that a new lease agreement is substantially similar to the original. First, the goods subject to the new lease agreement should be examined. For example, in a lease of computer equipment the new lease might be for more modern equipment. However, it may be that at the time of the lessor’s breach it was not possible to obtain the same type of goods in the market place. Because the lessee’s remedy under Section 2A‑519 is intended to place the lessee in essentially the same position as if he had covered, if goods similar to those to have been delivered under the original lease are not available, then the computer equipment in this hypothetical should qualify as a commercially reasonable substitute. See Section 2‑712(1).

5. Second, the various elements of the new lease agreement should also be examined. Those elements include the presence or absence of options to purchase or release; the lessor’s representations, warranties and covenants to the lessee, as well as those to be provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the amount of rent to be paid. If the differences between the original lease and the new lease can be easily valued, it would be appropriate for a court to adjust the difference in rental to take account of the difference between the two leases, find that the new lease is substantially similar to the old lease, and award cover damages under this section. If, for example, the new lease requires the lessor to insure the goods in the hands of the lessee, while the original lease required the lessee to insure, the usual cost of such insurance could be deducted from the rent due under the new lease before determining the difference in rental between the two leases.

6. Having examined the goods and the agreement, the test to be applied is whether, in light of these comparisons, the new lease agreement is substantially similar to the original lease agreement. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently with respect to the goods and each element of the agreement, as it is important that a sense of commercial judgment pervade the finding. To establish the new lease as a proper measure of damage under subsection (2), these factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original.

7. A new lease can be substantially similar to the original lease even though its term extends beyond the remaining term of the original lease, so long as both (a) the lease terms are commercially comparable (e.g., it is highly unlikely that a one‑month rental and a five‑year lease would reflect similar commercial realities), and (b) the court can fairly apportion a part of the rental payments under the new lease to that part of the term of the new lease which is comparable to the remaining lease term under the original lease. Also, the lease term of the new lease may be comparable to the term of the original lease even though the beginning and ending dates of the two leases are not the same. For example, a two‑month lease of agricultural equipment for the months of August and September may be comparable to a two‑ month lease running from the 15th of August to the 15th of October if in the particular location two‑month leases beginning on August 15th are basically interchangeable with two‑month leases beginning August 1st. Similarly, the term of a one‑year truck lease beginning on the 15th of January may be comparable to the term of a one‑year truck lease beginning January 2d. If the lease terms are found to be comparable, the court may base cover damages on the entire difference between the costs under the two leases.

Cross : Sections 2‑712(1), 2A‑519 and 9‑625.

Definitional Cross :

"Agreement" Section 1‑201(3).

"Contract" Section 1‑201(11).

"Good faith" Sections 1‑201(19) and 2‑103(1)(b).

"Goods" Section 2A‑103(1)(h).

"Lease" Section 2A‑103(1)(j).

"Lease agreement" Section 2A‑103(1)(k).

"Lease contract" Section 2A‑103(l)(l).

"Lessee" Section 2A‑103(1)(n).

"Lessor" Section 2A‑103(1)(p).

"Party" Section 1‑201(29).

"Present value" Section 2A‑103(1)(u).

"Purchase" Section 2A‑103(1)(v).

SECTION 7. Section 36‑2A‑519(1) of the 1976 Code is amended to read:

“(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 36‑2A‑504) or otherwise determined pursuant to agreement of the parties (Sections ~~36‑1‑102(3)~~ 36‑1‑302 and 36‑2A‑503), if a lessee elects not to cover or a lessee elects to cover and the cover is by lease agreement that for any reason does not qualify for treatment under Section 36‑2A‑518(2), or is by purchase or otherwise, the measure of damages for nondelivery or repudiation by the lessor or for rejection or revocation of acceptance by the lessee is the present value, as of the date of the default, of the then market rent minus the present value as of the same date of the original rent, computed for the remaining lease term of the original lease agreement, together with incidental and consequential damages, less expenses saved in consequence of the lessor’s default.”

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2‑713 and 2‑714.

Changes: Substantially revised.

Purposes: 1. Subsection (1), a revised version of the provisions of Section 2‑713(1), states the basic rule governing the measure of lessee’s damages for non‑delivery or repudiation by the lessor or for rightful rejection or revocation of acceptance by the lessee. This measure will apply, absent agreement to the contrary, if the lessee does not cover or if the cover does not qualify under Section 2A‑518. There is no sanction for cover that does not qualify.

2. The measure of damage is the present value, as of the date of default, of the market rent for the remaining term of the lease less the present value of the original rent for the remaining term of the lease, plus incidental and consequential damages less expenses saved in consequence of the default. Note that the reference in Section 2A‑519(1) is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, Section 5‑1, at 216‑217 (1971). Section 2A‑501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A‑103(4) and 1‑103.

3. Subsection (2), a revised version of the provisions of Section 2‑713(2), states the rule with respect to determining market rent.

4. Subsection (3), a revised version of the provisions of Section 2‑714(1) and (3), states the measure of damages where goods have been accepted and acceptance is not revoked. The subsection applies both to defaults which occur at the inception of the lease and to defaults which occur subsequently, such as failure to comply with an obligation to maintain the leased goods. The measure in essence is the loss, in the ordinary course of events, flowing from the default.

5. Subsection (4), a revised version of the provisions of Section 2‑714(2), states the measure of damages for breach of warranty. The measure in essence is the present value of the difference between the value of the goods accepted and of the goods if they had been as warranted.

6. Subsections (1), (3) and (4) specifically state that the parties may by contract vary the damages rules stated in those subsections.

Cross : Sections 2‑713(1), 2‑713(2), 2‑714 and Section 2A‑518.

Definitional Cross :

"Conforming" Section 2A‑103(1)(d).

"Delivery" Section 1‑201(14).

"Goods" Section 2A‑103(1)(h).

"Lease" Section 2A‑103(1)(j).

"Lease agreement" Section 2A‑103(1)(k).

"Lessee" Section 2A‑103(1)(n).

"Lessor" Section 2A‑103(1)(p).

"Notification" Section 1‑201(26).

"Present value" Section 2A‑103(1)(u).

"Value" Section 1‑201(44).

SECTION 8. Section 36‑2A‑527(2) of the 1976 Code is amended to read:

“(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 36‑2A‑504) or otherwise determined pursuant to agreement of the parties (Sections ~~36‑1‑102(3)~~ 36‑1‑302 and 36‑2A‑503), if the disposition is by lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessor may recover from the lessee as damages (i) accrued and unpaid rent as of the date of the commencement of the term of the new lease agreement, (ii) the present value, as of the same date, of the total rent for the then remaining lease term of the original lease agreement minus the present value, as of the same date, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement, and (iii) any incidental damages allowed under Section 36‑2A‑530, less expenses saved in consequence of the lessee’s default.”

OFFICIAL COMMENT

Uniform Statutory Source: Section 2‑706(1), (5) and (6).

Changes: Substantially revised.

Purposes: 1. Subsection (1), a revised version of the first sentence of subsection 2‑706(1), allows the lessor the right to dispose of goods after a statutory or other material default by the lessee (even if the goods remain in the lessee’s possession‑‑Section 2A‑525(2)), after the lessor refuses to deliver or takes possession of the goods, or, if agreed, after other contractual default. The lessor’s decision to exercise this right is a function of a commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9‑625. As the owner of the goods, in the case of a lessor, or as the prime lessee of the goods, in the case of a sublessor, compulsory disposition of the goods is inconsistent with the nature of the interest held by the lessor or the sublessor and is not necessary because the interest held by the lessee or the sublessee is not protected by a right of redemption under the common law or this Article. Subsection 2A‑527(5).

2. The rule for determining the measure of damages recoverable by the lessor against the lessee is a function of several variables. If the lessor has elected to effect disposition under subsection (1) and such disposition is by lease that qualifies under subsection (2), the measure of damages set forth in subsection (2) will apply, absent agreement to the contrary. Sections 2A‑504, 2A‑103(4) and 1‑102(3).

3. The lessor’s damages will be established using the new lease agreement as a measure if the following three criteria are satisfied: (i) the lessor disposed of the goods by lease, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such disposition was in good faith, and in a commercially reasonable manner. Thus, the lessor will be entitled to recover from the lessee the accrued and unpaid rent as of the date of commencement of the term of the new lease, and the present value, as of the same date , of the rent under the original lease for the then remaining term less the present value as of the same date of the rent under the new lease agreement applicable to the period of the new lease comparable to the remaining term under the original lease, together with incidental damages less expenses saved in consequence of the lessee’s default. If the lessor’s disposition does not satisfy the criteria of subsection (2), the lessor may calculate its claim against the lessee pursuant to Section 2A‑528. Section 2A‑523(1)(e).

4. Two of the three criteria to be met by the lessor are familiar, but the concept of the new lease agreement that is substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. The decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

5. While the section does not draw a bright line, it is possible to describe some of the factors that should be considered in a finding that a new lease agreement is substantially similar to the original. The various elements of the new lease agreement should be examined. Those elements include the options to purchase or release; the lessor’s representations, warranties and covenants to the lessee as well as those to be provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the amount of rent to be paid. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently, as it is important that a sense of commercial judgment pervade the finding. See Section 2A‑507(2). To establish the new lease as a proper measure of damage under subsection (2), these various factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original. If the differences between the original lease and the new lease can be easily valued, it would be appropriate for a court to find that the new lease is substantially similar to the old lease, adjust the difference in the rent between the two leases to take account of the differences, and award damages under this section. If, for example, the new lease requires the lessor to insure the goods in the hands of the lessee, while the original lease required the lessee to insure, the usual cost of such insurance could be deducted from rent due under the new lease before the difference in rental between the two leases is determined.

6. The following hypothetical illustrates the difficulty of providing a bright line. Assume that A buys a jumbo tractor for $1 million and then leases the tractor to B for a term of 36 months. The tractor is delivered to and is accepted by B on May 1. On June 1 B fails to pay the monthly rent to A. B returns the tractor to A, who immediately releases the tractor to C for a term identical to the term remaining under the lease between A and B. All terms and conditions under the lease between A and C are identical to those under the original lease between A and B, except that C does not provide any property damage or other insurance coverage, and B agreed to provide complete coverage. Coverage is expensive and difficult to obtain. It is a question of fact whether it is so difficult to adjust the recovery to take account of the difference between the two leases as to insurance that the second lease is not substantially similar to the original.

7. A new lease can be substantially similar to the original lease even though its term extends beyond the remaining term of the original lease, so long as both (a) the lease terms are commercially comparable (e.g., it is highly unlikely that a one‑month rental and a five‑year lease would reflect similar realities), and (b) the court can fairly apportion a part of the rental payments under the new lease to that part of the term of the new lease which is comparable to the remaining lease term under the original lease. Also, the lease term of the new lease may be comparable to the remaining term of the original lease even though the beginning and ending dates of the two leases are not the same. For example, a two‑month lease of agricultural equipment for the months of August and September may be comparable to a two‑month lease running from the 15th of August to the 15th of October if in the particular location two‑month leases beginning on August 15th are basically interchangeable with two‑month leases beginning August 1st. Similarly, the term of a one‑year truck lease beginning on the 15th of January may be comparable to the term of a one‑year truck lease beginning January 2d. If the lease terms are found to be comparable, the court may base cover damages on the entire difference between the costs under the two leases.

8. Subsection (3), which is new, provides that if the lessor’s disposition is by lease that does not qualify under subsection (2), or is by sale or otherwise, Section 2A‑528 governs.

9. Subsection (4), a revised version of subsection 2‑706(5), applies to protect a subsequent buyer or lessee who buys or leases from the lessor in good faith and for value, pursuant to a disposition under this section. Note that by its terms, the rule in subsection 2A‑304(1), which provides that the subsequent lessee takes subject to the original lease contract, is controlled by the rule stated in this subsection.

10. Subsection (5), a revised version of subsection 2‑706(6), provides that the lessor is not accountable to the lessee for any profit made by the lessor on a disposition. This rule follows from the fundamental premise of the bailment for hire that the lessee under a lease of goods has no equity of redemption to protect.

Cross : Sections 1‑102(3), 2‑706(1), 2‑706(5), 2‑706(6), 2A‑103(4), 2A‑304(1), 2A‑504, 2A‑507(2), 2A‑523(1)(e), 2A‑525(2), 2A‑527(5), 2A‑528 and 9‑625.

Definitional Cross :

"Buyer" and "Buying" Section 2‑103(1)(a).

"Delivery" Section 1‑201(14).

"Good faith" Sections 1‑201(19) and 2‑103(1)(b).

"Goods" Section 2A‑103(1)(h).

"Lease" Section 2A‑103(1)(j).

"Lease contract" Section 2A‑103(1)(l).

"Lessee" Section 2A‑103(1)(n).

"Lessor" Section 2A‑103(1)(p).

"Present value" Section 2A‑103(1)(u).

"Rights" Section 1‑201(36).

"Sale" Section 2‑106(1).

"Security interest" Section 1‑201(37).

"Value" Section 1‑201(44).

SECTION 9. Section 36‑2A‑528(1) of the 1976 Code is amended to read:

“(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 36‑2A‑504) or otherwise determined pursuant to agreement of the parties (Sections ~~36‑1‑102(3)~~ Section 36‑1‑302 and 36‑2A‑503), if a lessor elects to retain the goods or a lessor elects to dispose of the goods and the disposition is by lease agreement that for any reason does not qualify for treatment under Section 36‑2A‑527(2), or is by sale or otherwise, the lessor may recover from the lessee as damages for a default of the type described in Section 36‑2A‑523(1) or 36‑2A‑523(3)(a), or, if agreed, for other default of the lessee, (i) accrued and unpaid rent as of the date of default if the lessee has never taken possession of the goods, or, if the lessee has taken possession of the goods, as of the date the lessor repossesses the goods or an earlier date on which the lessee makes a tender of the goods to the lessor, (ii) the present value as of the date determined under clause (i) of the total rent for the then remaining lease term of the original lease agreement minus the present value as of the same date of the market rent at the place where the goods are located computed for the same lease term, and (iii) any incidental damages allowed under Section 36‑2A‑530, less expenses saved in consequence of the lessee’s default.”

OFFICIAL COMMENT

Uniform Statutory Source: Section 2‑708.

Changes: Substantially revised.

Purposes: 1. Subsection (1), a substantially revised version of Section 2‑708(1), states the basic rule governing the measure of lessor’s damages for a default described in Section 2A‑523(1) or (3)(a), and, if agreed, for a contractual default. This measure will apply if the lessor elects to retain the goods (whether undelivered, returned by the lessee, or repossessed by the lessor after acceptance and default by the lessee) or if the lessor’s disposition does not qualify under subsection 2A‑527(2). Section 2A‑527(3). Note that under some of these conditions, the lessor may recover damages from the lessee pursuant to the rule set forth in Section 2A‑529. There is no sanction for disposition that does not qualify under subsection 2A‑527(2). Application of the rule set forth in this section is subject to agreement to the contrary. Sections 2A‑504, 2A‑103(4) and 1‑302.

2. If the lessee has never taken possession of the goods, the measure of damage is the accrued and unpaid rent as of the date of default together with the present value, as of the date of default, of the original rent for the remaining term of the lease less the present value as of the same date of market rent, and incidental damages, less expenses saved in consequence of the default. Note that the reference in Section 2A‑528(1)(i) and (ii) is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, Section 5‑1, at 216‑217 (1971). Section 2A‑501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A‑103(4) and 1‑103. If the lessee has taken possession of the goods, the measure of damages is the accrued and unpaid rent as of the earlier of the time the lessor repossesses the goods or the time the lessee tenders the goods to the lessor plus the difference between the present value, as of the same time, of the rent under the lease for the remaining lease term and the present value, as of the same time, of the market rent.

3. Market rent will be computed pursuant to Section 2A‑507.

4. Subsection (2), a somewhat revised version of the provisions of subsection 2‑708(2), states a measure of damages which applies if the measure of damages in subsection (1) is inadequate to put the lessor in as good a position as performance would have. The measure of damage is the lessor’s profit, including overhead, together with incidental damages, with allowance for costs reasonably incurred and credit for payments or proceeds of disposition. In determining the amount of due credit with respect to proceeds of disposition a proper value should be attributed to the lessor’s residual interest in the goods. Sections 2A‑103(1)(q) and 2A‑507(4).

5. In calculating profit, a court should include any expected appreciation of the goods, e.g. the foal of a leased brood mare. Because this subsection is intended to give the lessor the benefit of the bargain, a court should consider any reasonable benefit or profit expected by the lessor from the performance of the lease agreement. See Honeywell, Inc. v. Lithonia Lighting, Inc., 317 F. Supp. 406, 413 (N.D. Ga. 1970); Locks v. Wade, 36 N.J. Super. 128, 131, 114 A.2d 875, 877 (Super. Ct. App. Div. 1955). Further, in calculating profit the concept of present value must be given effect. Taylor v. Commercial Credit Equip. Corp., 170 Ga. App. 322, 316 S.E.2d 788 (Ct. App. 1984). See generally Section 2A‑103(1)(u).

SECTION 10. Section 36‑3‑103(6) and (13) of the 1976 Code, as amended by Act 204 of 2008, is further amended to read:

“(6) ~~‘Good faith’ means honesty in fact and the observance of reasonable commercial standards of fair dealing~~ [Reserved].”

(13) ‘Prove’ with respect to a fact means to meet the burden of establishing the fact (Section 36‑1‑201(b)(8)).”

OFFICIAL COMMENT

1. Subsection (a) defines some common terms used throughout the Article that were not defined by former Article 3 and adds the definitions of "order" and "promise" found in former Section 3‑102(1)(b) and (c).

2. The definition of "order" includes an instruction given by the signer to itself. The most common example of this kind of order is a cashier’s check: a draft with respect to which the drawer and drawee are the same bank or branches of the same bank. Former Section 3‑118(a) treated a cashier’s check as a note. It stated "a draft drawn on the drawer is effective as a note." Although it is technically more correct to treat a cashier’s check as a promise by the issuing bank to pay rather than an order to pay, a cashier’s check is in the form of a check and it is normally referred to as a check. Thus, revised Article 3 follows banking practice in referring to a cashier’s check as both a draft and a check rather than a note. Some insurance companies also follow the practice of issuing drafts in which the drawer draws on itself and makes the draft payable at or through a bank. These instruments are also treated as drafts. The obligation of the drawer of a cashier’s check or other draft drawn on the drawer is stated in Section 3‑412.

An order may be addressed to more than one person as drawee either jointly or in the alternative. The authorization of alternative drawees follows former Section 3‑102(1)(b) and recognizes the practice of drawers, such as corporations issuing dividend checks, who for commercial convenience name a number of drawees, usually in different parts of the country. Section 3‑501(b)(1) provides that presentment may be made to any one of multiple drawees. Drawees in succession are not permitted because the holder should not be required to make more than one presentment. Dishonor by any drawee named in the draft entitles the holder to rights of recourse against the drawer or indorsers.

3. The last sentence of subsection (a)(9) is intended to make it clear that an I.O.U. or other written acknowledgment of indebtedness is not a note unless there is also an undertaking to pay the obligation.

4. This Article now uses the broadened definition of good faith in revised Article 1. The definition requires not only honesty in fact but also "observance of reasonable commercial standards of fair dealing." Although fair dealing is a broad term that must be defined in context, it is clear that it is concerned with the fairness of conduct rather than the care with which an act is performed. Failure to exercise ordinary care in conducting a transaction is an entirely different concept than failure to deal fairly in conducting the transaction. Both fair dealing and ordinary care, which is defined in Section 3‑103(a)(7), are to be judged in the light of reasonable commercial standards, but those standards in each case are directed to different aspects of commercial conduct.

5. Subsection (a)(7) is a definition of ordinary care which is applicable not only to Article 3 but to Article 4 as well. See Section 4‑104(c). The general rule is stated in the first sentence of subsection (a)(7) and it applies both to banks and to persons engaged in businesses other than banking. Ordinary care means observance of reasonable commercial standards of the relevant businesses prevailing in the area in which the person is located. The second sentence of subsection (a)(7) is a particular rule limited to the duty of a bank to examine an instrument taken by a bank for processing for collection or payment by automated means. This particular rule applies primarily to Section 4‑406 and it is discussed in Comment 4 to that section. Nothing in Section 3‑103(a)(7) is intended to prevent a customer from proving that the procedures followed by a bank are unreasonable, arbitrary, or unfair.

6. The definition of consumer account includes a joint account established by more than one individual. See Section 1‑106(1).”

SECTION 11. Section 36‑4‑104(c) of the 1976 Code, as amended by Act 204 of 2008, is further amended to read:

“(c) The following definitions in other chapters apply to this chapter:

‘Acceptance’ Section 36‑3‑409.

‘Alteration’ Section 36‑3‑407.

‘Cashier’s check’ Section 36‑3‑104.

‘Certificate of deposit’ Section 36‑3‑104.

‘Certified check’ Section 36‑3‑409.

‘Check’ Section 36‑3‑104.

‘Holder in due course’ Section 36‑3‑302.

‘Instrument’ Section 36‑3‑104.

‘Notice of dishonor’ Section 36‑3‑503.

‘Order’ Section 36‑3‑103.

‘Ordinary care’ Section 36‑3‑103.

‘Person entitled to enforce’ Section 36‑3‑301.

‘Presentment’ Section 36‑3‑501.

‘Promise’ Section 36‑3‑103.

‘Prove’ Section 36‑3‑103.

‘Record’ Section 36‑3‑103.

‘Remotely‑Created consumer item’ Section 36‑3‑103.

‘Teller’s check’ Section 36‑3‑104.

‘Unauthorized signature’ Section 36‑3‑403.”

OFFICIAL COMMENT

1. Article 4A governs a method of payment in which the person making payment (the "originator") directly transmits an instruction to a bank either to make payment to the person receiving payment (the "beneficiary") or to instruct some other bank to make payment to the beneficiary. The payment from the originator to the beneficiary occurs when the bank that is to pay the beneficiary becomes obligated to pay the beneficiary. There are two basic definitions: "Payment order" stated in Section 4A‑103 and "Funds transfer" stated in Section 4A‑104. These definitions, other related definitions, and the scope of Article 4A can best be understood in the context of specific fact situations. Consider the following cases:

Case #1. X, which has an account in Bank A, instructs that bank to pay $1,000,000 to Y’s account in Bank A. Bank A carries out X’s instruction by making a credit of $1,000,000 to Y’s account and notifying Y that the credit is available for immediate withdrawal. The instruction by X to Bank A is a "payment order" which was issued when it was sent to Bank A. Section 4A‑103(a)(1) and (c). X is the "sender" of the payment order and Bank A is the "receiving bank." Section 4A‑103(a)(5) and (a)(4). Y is the "beneficiary" of the payment order and Bank A is the "beneficiary’s bank." Section 4A‑103(a)(2) and (a)(3). When Bank A notified Y of receipt of the payment order, Bank A "accepted" the payment order. Section 4A‑209(b)(1). When Bank A accepted the order, it incurred an obligation to Y to pay the amount of the order. Section 4A‑404(a). When Bank A accepted X’s order, X incurred an obligation to pay Bank A the amount of the order. Section 4A‑402(b). Payment from X to Bank A would normally be made by a debit to X’s account in Bank A. Section 4A‑403(a)(3). At the time Bank A incurred the obligation to pay Y, payment of $1,000,000 by X to Y was also made. Section 4A‑406(a). Bank A paid Y when it gave notice to Y of a withdrawable credit of $1,000,000 to Y’s account. Section 4A‑405(a). The overall transaction, which comprises the acts of X and Bank A, in which the payment by X to Y is accomplished is referred to as the "funds transfer." Section 4A‑104(a). In this case only one payment order was involved in the funds transfer. A one‑payment‑order funds transfer is usually referred to as a "book transfer" because the payment is accomplished by the receiving bank’s debiting the account of the sender and crediting the account of the beneficiary in the same bank. X, in addition to being the sender of the payment order to Bank A, is the "originator" of the funds transfer. Section 4A‑104(c). Bank A is the "originator’s bank" in the funds transfer as well as the beneficiary’s bank. Section 4A‑104(d).

Case #2. Assume the same facts as in Case #1 except that X instructs Bank A to pay $1,000,000 to Y’s account in Bank B. With respect to this payment order, X is the sender, Y is the beneficiary, and Bank A is the receiving bank. Bank A carries out X’s order by instructing Bank B to pay $1,000,000 to Y’s account. This instruction is a payment order in which Bank A is the sender, Bank B is the receiving bank, and Y is the beneficiary. When Bank A issued its payment order to Bank B, Bank A "executed" X’s order. Section 4A‑301(a). In the funds transfer, X is the originator, Bank A is the originator’s bank, and Bank B is the beneficiary’s bank. When Bank A executed X’s order, X incurred an obligation to pay Bank A the amount of the order. Section 4A‑402(c). When Bank B accepts the payment order issued to it by Bank A, Bank B incurs an obligation to Y to pay the amount of the order (Section 4A‑404 (a)) and Bank A incurs an obligation to pay Bank B. Section 4A‑402(b). Acceptance by Bank B also results in payment of $1,000,000 by X to Y. Section 4A‑406(a). In this case two payment orders are involved in the funds transfer.

Case #3. Assume the same facts as in Case #2 except that Bank A does not execute X’s payment order by issuing a payment order to Bank B. One bank will not normally act to carry out a funds transfer for another bank unless there is a preexisting arrangement between the banks for transmittal of payment orders and settlement of accounts. For example, if Bank B is a foreign bank with which Bank A has no relationship, Bank A can utilize a bank that is a correspondent of both Bank A and Bank B. Assume Bank A issues a payment order to Bank C to pay $1,000,000 to Y’s account in Bank B. With respect to this order, Bank A is the sender, Bank C is the receiving bank, and Y is the beneficiary. Bank C will execute the payment order of Bank A by issuing a payment order to Bank B to pay $1,000,000 to Y’s account in Bank B. With respect to Bank C’s payment order, Bank C is the sender, Bank B is the receiving bank, and Y is the beneficiary. Payment of $1,000,000 by X to Y occurs when Bank B accepts the payment order issued to it by Bank C. In this case the funds transfer involves three payment orders. In the funds transfer, X is the originator, Bank A is the originator’s bank, Bank B is the beneficiary’s bank, and Bank C is an "intermediary bank." Section 4A‑104 (b). In some cases there may be more than one intermediary bank, and in those cases each intermediary bank is treated like Bank C in Case #3.

As the three cases demonstrate, a payment under Article 4A involves an overall transaction, the funds transfer, in which the originator, X, is making payment to the beneficiary, Y, but the funds transfer may encompass a series of payment orders that are issued in order to effect the payment initiated by the originator’s payment order.

In some cases the originator and the beneficiary may be the same person. This will occur, for example, when a corporation orders a bank to transfer funds from an account of the corporation in that bank to another account of the corporation in that bank or in some other bank. In some funds transfers the first bank to issue a payment order is a bank that is executing a payment order of a customer that is not a bank. In this case the customer is the originator. In other cases, the first bank to issue a payment order is not acting for a customer, but is making a payment for its own account. In that event the first bank to issue a payment order is the originator as well as the originator’s bank.

2. "Payment order" is defined in Section 4A‑103(a)(1) as an instruction to a bank to pay, or to cause another bank to pay, a fixed or determinable amount of money. The bank to which the instruction is addressed is known as the "receiving bank." Section 4A‑103(a)(4). "Bank" is defined in Section 4A‑105(a)(2). The effect of this definition is to limit Article 4A to payments made through the banking system. A transfer of funds made by an entity outside the banking system is excluded. A transfer of funds through an entity other than a bank is usually a consumer transaction involving relatively small amounts of money and a single contract carried out by transfers of cash or a cash equivalent such as a check. Typically, the transferor delivers cash or a check to the company making the transfer, which agrees to pay a like amount to a person designated by the transferor. Transactions covered by Article 4A typically involve very large amounts of money in which several transactions involving several banks may be necessary to carry out the payment. Payments are normally made by debits or credits to bank accounts. Originators and beneficiaries are almost always business organizations and the transfers are usually made to pay obligations. Moreover, these transactions are frequently done on the basis of very short‑term credit granted by the receiving bank to the sender of the payment order. Wholesale wire transfers involve policy questions that are distinct from those involved in consumer‑based transactions by nonbanks.

3. Further limitations on the scope of Article 4A are found in the three requirements found in subparagraphs (i), (ii), and (iii) of Section 4A‑103(a)(1). Subparagraph (i) states that the instruction to pay is a payment order only if it "does not state a condition to payment to the beneficiary other than time of payment." An instruction to pay a beneficiary sometimes is subject to a requirement that the beneficiary perform some act such as delivery of documents. For example, a New York bank may have issued a letter of credit in favor of X, a California seller of goods to be shipped to the New York bank’s customer in New York. The terms of the letter of credit provide for payment to X if documents are presented to prove shipment of the goods. Instead of providing for presentment of the documents to the New York bank, the letter of credit states that they may be presented to a California bank that acts as an agent for payment. The New York bank sends an instruction to the California bank to pay X upon presentation of the required documents. The instruction is not covered by Article 4A because payment to the beneficiary is conditional upon receipt of shipping documents. The function of banks in a funds transfer under Article 4A is comparable to the role of banks in the collection and payment of checks in that it is essentially mechanical in nature. The low price and high speed that characterize funds transfers reflect this fact. Conditions to payment by the California bank other than time of payment impose responsibilities on that bank that go beyond those in Article 4A funds transfers. Although the payment by the New York bank to X under the letter of credit is not covered by Article 4A, if X is paid by the California bank, payment of the obligation of the New York bank to reimburse the California bank could be made by an Article 4A funds transfer. In such a case there is a distinction between the payment by the New York bank to X under the letter of credit and the payment by the New York bank to the California bank. For example, if the New York bank pays its reimbursement obligation to the California bank by a Fedwire naming the California bank as beneficiary (see Comment 1 to Section 4A‑107), payment is made to the California bank rather than to X. That payment is governed by Article 4A and it could be made either before or after payment by the California bank to X. The payment by the New York bank to X under the letter of credit is not governed by Article 4A and it occurs when the California bank, as agent of the New York bank, pays X. No payment order was involved in that transaction. In this example, if the New York bank had erroneously sent an instruction to the California bank unconditionally instructing payment to X, the instruction would have been an Article 4A payment order. If the payment order was accepted (Section 4A‑209(b)) by the California bank, a payment by the New York bank to X would have resulted (Section 4A‑406(a)). But Article 4A would not prevent recovery of funds from X on the basis that X was not entitled to retain the funds under the law of mistake and restitution, letter of credit law, or other applicable law.

4. Transfers of funds made through the banking system are commonly referred to as either "credit" transfers or "debit" transfers. In a credit transfer the instruction to pay is given by the person making payment. In a debit transfer the instruction to pay is given by the person receiving payment. The purpose of subparagraph (ii) of subsection (a)(1) of Section 4A‑103 is to include credit transfers in Article 4A and to exclude debit transfers. All of the instructions to pay in the three cases described in Comment 1 fall within subparagraph (ii). Take Case #2 as an example. With respect to X’s instruction given to Bank A, Bank A will be reimbursed by debiting X’s account or otherwise receiving payment from X. With respect to Bank A’s instruction to Bank B, Bank B will be reimbursed by receiving payment from Bank A. In a debit transfer, a creditor, pursuant to authority from the debtor, is enabled to draw on the debtor’s bank account by issuing an instruction to pay to the debtor’s bank. If the debtor’s bank pays, it will be reimbursed by the debtor rather than by the person giving the instruction. For example, the holder of an insurance policy may pay premiums by authorizing the insurance company to order the policyholder’s bank to pay the insurance company. The order to pay may be in the form of a draft covered by Article 3, or it might be an instruction to pay that is not an instrument under that Article. The bank receives reimbursement by debiting the policyholder’s account. Or, a subsidiary corporation may make payments to its parent by authorizing the parent to order the subsidiary’s bank to pay the parent from the subsidiary’s account. These transactions are not covered by Article 4A because subparagraph (2) is not satisfied. Article 4A is limited to transactions in which the account to be debited by the receiving bank is that of the person in whose name the instruction is given.

If the beneficiary of a funds transfer is the originator of the transfer, the transfer is governed by Article 4A if it is a credit transfer in form. If it is in the form of a debit transfer it is not governed by Article 4A. For example, Corporation has accounts in Bank A and Bank B. Corporation instructs Bank A to pay to Corporation’s account in Bank B. The funds transfer is governed by Article 4A. Sometimes, Corporation will authorize Bank B to draw on Corporation’s account in Bank A for the purpose of transferring funds into Corporation’s account in Bank B. If Corporation also makes an agreement with Bank A under which Bank A is authorized to follow instructions of Bank B, as agent of Corporation, to transfer funds from Customer’s account in Bank A, the instruction of Bank B is a payment order of Customer and is governed by Article 4A. This kind of transaction is known in the wire‑transfer business as a "drawdown transfer." If Corporation does not make such an agreement with Bank A and Bank B instructs Bank A to make the transfer, the order is in form a debit transfer and is not governed by Article 4A. These debit transfers are normally ACH transactions in which Bank A relies on Bank B’s warranties pursuant to ACH rules, including the warranty that the transfer is authorized.

5. The principal effect of subparagraph (iii) of subsection (a) of Section 4A‑103 is to exclude from Article 4A payments made by check or credit card. In those cases the instruction of the debtor to the bank on which the check is drawn or to which the credit card slip is to be presented is contained in the check or credit card slip signed by the debtor. The instruction is not transmitted by the debtor directly to the debtor’s bank. Rather, the instruction is delivered or otherwise transmitted by the debtor to the creditor who then presents it to the bank either directly or through bank collection channels. These payments are governed by Articles 3 and 4 and federal law. There are, however, limited instances in which the paper on which a check is printed can be used as the means of transmitting a payment order that is covered by Article 4A. Assume that Originator instructs Originator’s Bank to pay $10,000 to the account of Beneficiary in Beneficiary’s Bank. Since the amount of Originator’s payment order is small, if Originator’s Bank and Beneficiary’s Bank do not have an account relationship, Originator’s Bank may execute Originator’s order by issuing a teller’s check payable to Beneficiary’s Bank for $10,000 along with instructions to credit Beneficiary’s account in that amount. The instruction to Beneficiary’s Bank to credit Beneficiary’s account is a payment order. The check is the means by which Originator’s Bank pays its obligation as sender of the payment order. The instruction of Originator’s Bank to Beneficiary’s Bank might be given in a letter accompanying the check or it may be written on the check itself. In either case the instruction to Beneficiary’s Bank is a payment order but the check itself (which is an order to pay addressed to the drawee rather than to Beneficiary’s Bank) is an instrument under Article 3 and is not a payment order. The check can be both the means by which Originator’s Bank pays its obligation under Section 4A‑402(b) to Beneficiary’s Bank and the means by which the instruction to Beneficiary’s Bank is transmitted.

6. Most payments covered by Article 4A are commonly referred to as wire transfers and usually involve some kind of electronic transmission, but the applicability of Article 4A does not depend upon the means used to transmit the instruction of the sender. Transmission may be by letter or other written communication, oral communication, or electronic communication. An oral communication is normally given by telephone. Frequently the message is recorded by the receiving bank to provide evidence of the transaction, but apart from problems of proof there is no need to record the oral instruction. Transmission of an instruction may be a direct communication between the sender and the receiving bank or through an intermediary such as an agent of the sender, a communication system such as international cable, or a funds transfer system such as CHIPS, SWIFT, or an automated clearing house.

SECTION 12. Section 36‑4A‑105(a)(6) and (7) of the 1976 Code is amended to read:

“(6) ~~‘Good faith’ means honesty in fact and the observance of reasonable commercial standards of fair dealing~~ [Reserved].

(7) ‘Prove’ with respect to a fact means to meet the burden of establishing the fact (Section 36‑1‑201(b)(8)).”

OFFICIAL COMMENT

1. The definition of "bank" in subsection (a)(2) includes some institutions that are not commercial banks. The definition reflects the fact that many financial institutions now perform functions previously restricted to commercial banks, including acting on behalf of customers in funds transfers. Since many funds transfers involve payment orders to or from foreign countries, the definition also covers foreign banks. The definition also includes Federal Reserve Banks. Funds transfers carried out by Federal Reserve Banks are described in Comments 1 and 2 to Section 4A‑107.

2. Funds transfer business is frequently transacted by banks outside of general banking hours. Thus, the definition of banking day in Section 4‑104(1)(c) cannot be used to describe when a bank is open for funds transfer business. Subsection (a)(4) defines a new term, "funds transfer business day," which is applicable to Article 4A. The definition states, "is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders." In some cases it is possible to electronically transmit payment orders and other communications to a receiving bank at any time. If the receiving bank is not open for the processing of an order when it is received, the communication is stored in the receiving bank’s computer for retrieval when the receiving bank is open for processing. The use of the conjunctive makes clear that the defined term is limited to the period during which all functions of the receiving bank can be performed, i.e., receipt, processing, and transmittal of payment orders, cancellations, and amendments.

3. Subsection (a)(5) defines "funds transfer system." The term includes a system such as CHIPS which provides for transmission of a payment order as well as settlement of the obligation of the sender to pay the order. It also includes automated clearing houses, operated by a clearing house or other association of banks, which process and transmit payment orders of banks to other banks. In addition the term includes organizations that provide only transmission services such as SWIFT. The definition also includes the wire transfer network and automated clearing houses of Federal Reserve Banks. Systems of the Federal Reserve Banks, however, are treated differently from systems of other associations of banks. Funds transfer systems other than systems of the Federal Reserve Banks are treated in Article 4A as a means of communication of payment orders between participating banks. Section 4A‑206. The Comment to that section and the Comment to Section 4A‑107 explain how Federal Reserve Banks function under Article 4A. Funds transfer systems are also able to promulgate rules binding on participating banks that, under Section 4A‑501, may supplement or in some cases may even override provisions of Article 4A.

4. Subsection (d) incorporates definitions stated in Article 1 as well as principles of construction and interpretation stated in that Article. Included is Section 1‑103. The last paragraph of the Comment to Section 4A‑102 is addressed to the issue of the extent to which general principles of law and equity should apply to situations covered by provisions of Article 4A.

SECTION 13. Section 36‑4A‑106(a) of the 1976 Code is amended to read:

“(a) The time of receipt of a payment order or communication canceling or amending a payment order is determined by the rules applicable to receipt of a notice stated in Section ~~36‑1‑201(27)~~ 36‑1‑202. A receiving bank may fix a cut‑off time or times on a funds‑transfer business day for the receipt and processing of payment orders and communications canceling or amending payment orders. Different cut‑off times may apply to payment orders, cancellations, or amendments, or to different categories of payment orders, cancellations, or amendments. A cut‑off time may apply to senders generally or different cut‑off times may apply to different senders or categories of payment orders. If a payment order or communication canceling or amending a payment order is received after the close of a funds‑transfer business day or after the appropriate cut‑off time on a funds‑transfer business day, the receiving bank may treat the payment order or communication as received at the opening of the next funds‑transfer business day.”

Official Comment

The time that a payment order is received by a receiving bank usually defines the payment date or the execution date of a payment order. Section 4A‑401 and Section 4A‑301. The time of receipt of a payment order, or communication canceling or amending a payment order is defined in subsection (a) by reference to the rules stated in Section 1‑202. Thus, time of receipt is determined by the same rules that determine when a notice is received. Time of receipt, however, may be altered by a cut‑off time.

SECTION 14. Section 36‑4A‑204(b) of the 1976 Code is amended to read:

“(b) Reasonable time under subsection (a) may be fixed by agreement as stated in Section ~~36‑1‑204(1)~~ 36‑1‑302(b), but the obligation of a receiving bank to refund payment as stated in subsection (a) may not otherwise be varied by agreement.”

OFFICIAL COMMENT

1. With respect to unauthorized payment orders, in a very large percentage of cases a commercially reasonable security procedure will be in effect. Section 4A‑204 applies only to cases in which (i) no commercially reasonable security procedure is in effect, (ii) the bank did not comply with a commercially reasonable security procedure that was in effect, (iii) the sender can prove, pursuant to Section 4A‑203(a)(2), that the culprit did not obtain confidential security information controlled by the customer, or (iv) the bank, pursuant to Section 4A‑203(a)(1) agreed to take all or part of the loss resulting from an unauthorized payment order. In each of these cases the bank takes the risk of loss with respect to an unauthorized payment order because the bank is not entitled to payment from the customer with respect to the order. The bank normally debits the customer’s account or otherwise receives payment from the customer shortly after acceptance of the payment order. Subsection (a) of Section 4A‑204 states that the bank must recredit the account or refund payment to the extent the bank is not entitled to enforce payment.

2. Section 4A‑204 is designed to encourage a customer to promptly notify the receiving bank that it has accepted an unauthorized payment order. Since cases of unauthorized payment orders will almost always involve fraud, the bank’s remedy is normally to recover from the beneficiary of the unauthorized order if the beneficiary was party to the fraud. This remedy may not be worth very much and it may not make any difference whether or not the bank promptly learns about the fraud. But in some cases prompt notification may make it easier for the bank to recover some part of its loss from the culprit. The customer will routinely be notified of the debit to its account with respect to an unauthorized order or will otherwise be notified of acceptance of the order. The customer has a duty to exercise ordinary care to determine that the order was unauthorized after it has received notification from the bank, and to advise the bank of the relevant facts within a reasonable time not exceeding ninety days after receipt of notification. Reasonable time is not defined and it may depend on the facts of the particular case. If a payment order for $1,000,000 is wholly unauthorized, the customer should normally discover it in far less than ninety days. If a $1,000,000 payment order was authorized but the name of the beneficiary was fraudulently changed, a much longer period may be necessary to discover the fraud. But in any event, if the customer delays more than ninety days, the customer’s duty has not been met. The only consequence of a failure of the customer to perform this duty is a loss of interest on the refund payable by the bank. A customer that acts promptly is entitled to interest from the time the customer’s account was debited or the customer otherwise made payment. The rate of interest is stated in Section 4A‑506. If the customer fails to perform the duty, no interest is recoverable for any part of the period before the bank learns that it accepted an unauthorized order. But the bank is not entitled to any recovery from the customer based on negligence for failure to inform the bank. Loss of interest is in the nature of a penalty on the customer designed to provide an incentive for the customer to police its account. There is no intention to impose a duty on the customer that might result in shifting loss from the unauthorized order to the customer.

SECTION 15. Section 36‑5‑103(c) of the 1976 Code is amended to read:

“(c) With the exception of this subsection, subsections (a) and (d), Sections 36‑5‑102(a)(9) and (10), 36‑5‑106(d), and 36‑5‑114(d), and except to the extent prohibited in Sections ~~36‑1‑102(3)~~ 36‑1‑302 and 36‑5‑117(d), the effect of this chapter may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this chapter.”

Official Comment

1. Sections 5‑102(a)(10) and 5‑103 are the principal limits on the scope of Article 5. Many undertakings in commerce and contract are similar, but not identical to the letter of credit. Principal among those are "secondary," "accessory," or "suretyship" guarantees. Although the word "guarantee" is sometimes used to describe an independent obligation like that of the issuer of a letter of credit (most often in the case of European bank undertakings but occasionally in the case of undertakings of American banks), in the United States the word "guarantee" is more typically used to describe a suretyship transaction in which the "guarantor" is only secondarily liable and has the right to assert the underlying debtor’s defenses. This article does not apply to secondary or accessory guarantees and it is important to recognize the distinction between letters of credit and those guarantees. It is often a defense to a secondary or accessory guarantor’s liability that the underlying debt has been discharged or that the debtor has other defenses to the underlying liability. In letter of credit law, on the other hand, the independence principle recognized throughout Article 5 states that the issuer’s liability is independent of the underlying obligation. That the beneficiary may have breached the underlying contract and thus have given a good defense on that contract to the applicant against the beneficiary is no defense for the issuer’s refusal to honor. Only staunch recognition of this principle by the issuers and the courts will give letters of credit the continuing vitality that arises from the certainty and speed of payment under letters of credit. To that end, it is important that the law not carry into letter of credit transactions rules that properly apply only to secondary guarantees or to other forms of engagement.

2. Like all of the provisions of the Uniform Commercial Code, Article 5 is supplemented by Section 1‑103 and, through it, by many rules of statutory and common law. Because this article is quite short and has no rules on many issues that will affect liability with respect to a letter of credit transaction, law beyond Article 5 will often determine rights and liabilities in letter of credit transactions. Even within letter of credit law, the article is far from comprehensive; it deals only with "certain" rights of the parties. Particularly with respect to the standards of performance that are set out in Section 5‑108, it is appropriate for the parties and the courts to turn to customs and practice such as the Uniform Customs and Practice for Documentary Credits, currently published by the International Chamber of Commerce as I.C.C. Pub. No. 500 (hereafter UCP). Many letters of credit specifically adopt the UCP as applicable to the particular transaction. Where the UCP are adopted but conflict with Article 5 and except where variation is prohibited, the UCP terms are permissible contractual modifications under Sections ~~1‑102(3)~~ 1‑302 and 5‑103(c). See Section 5‑116(c). Normally Article 5 should not be considered to conflict with practice except when a rule explicitly stated in the UCP or other practice is different from a rule explicitly stated in Article 5.

Except by choosing the law of a jurisdiction that has not adopted the Uniform Commercial Code, it is not possible entirely to escape the Uniform Commercial Code. Since incorporation of the UCP avoids only "conflicting" Article 5 rules, parties who do not wish to be governed by the nonconflicting provisions of Article 5 must normally either adopt the law of a jurisdiction other than a State of the United States or state explicitly the rule that is to govern. When rules of custom and practice are incorporated by reference, they are considered to be explicit terms of the agreement or undertaking.

Neither the obligation of an issuer under Section 5‑108 nor that of an adviser under Section 5‑107 is an obligation of the kind that is invariable under Section 1‑102(3). Section 5‑103(c) and Comment 1 to Section 5‑108 make it clear that the applicant and the issuer may agree to almost any provision establishing the obligations of the issuer to the applicant. The last sentence of subsection (c) limits the power of the issuer to achieve that result by a nonnegotiated disclaimer or limitation of remedy.

What the issuer could achieve by an explicit agreement with its applicant or by a term that explicitly defines its duty, it cannot accomplish by a general disclaimer. The restriction on disclaimers in the last sentence of subsection (c) is based more on procedural than on substantive unfairness. Where, for example, the reimbursement agreement provides explicitly that the issuer need not examine any documents, the applicant understands the risk it has undertaken. A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in "bad faith" or committed "gross negligence" is ineffective under Section 5‑103(c). On the other hand, less general terms such as terms that permit issuer reliance on an oral or electronic message believed in good faith to have been received from the applicant or terms that entitle an issuer to reimbursement when it honors a "substantially" though not "strictly" complying presentation, are effective. In each case the question is whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 provision.

Of course, no term in a letter of credit, whether incorporated by reference to practice rules or stated specifically, can free an issuer from a conflicting contractual obligation to its applicant. If, for example, an issuer promised its applicant that it would pay only against an inspection certificate of a particular company but failed to require such a certificate in its letter of credit or made the requirement only a nondocumentary condition that had to be disregarded, the issuer might be obliged to pay the beneficiary even though its payment might violate its contract with its applicant.

3. Parties should generally avoid modifying the definitions in Section 5‑102. The effect of such an agreement is almost inevitably unclear. To say that something is a "guarantee" in the typical domestic transaction is to say that the parties intend that particular legal rules apply to it. By acknowledging that something is a guarantee, but asserting that it is to be treated as a "letter of credit," the parties leave a court uncertain about where the rules on guarantees stop and those concerning letters of credit begin.

4. Section 5‑102(2) and (3) of Article 5 are omitted as unneeded; the omission does not change the law.

SECTION 16. Section 36‑8‑102(a)(10) of the 1976 Code is amended to read:

“(10) ~~‘Good faith,’ for purposes of the obligation of good faith in the performance or enforcement of contracts or duties within this chapter, means honesty in fact and the observance of reasonable commercial standards of fair dealing~~ [Reserved].”

OFFICIAL COMMENT

1. "Adverse claim." The definition of the term "adverse claim" has two components. First, the term refers only to property interests. Second, the term means not merely that a person has a property interest in a financial asset but that it is a violation of the claimant’s property interest for the other person to hold or transfer the security or other financial asset.

The term adverse claim is not, of course, limited to ownership rights, but extends to other property interests established by other law. A security interest, for example, would be an adverse claim with respect to a transferee from the debtor since any effort by the secured party to enforce the security interest against the property would be an interference with the transferee’s interest.

The definition of adverse claim in the prior version of Article 8 might have been read to suggest that any wrongful action concerning a security, even a simple breach of contract, gave rise to an adverse claim. Insofar as such cases as Fallon v. Wall Street Clearing Corp., 586 N.Y.S.2d 953, 182 A.D.2d 245, (1992) and Pentech Intl. v. Wall St. Clearing Co., 983 F.2d 441 (2d Cir. 1993), were based on that view, they are rejected by the new definition which explicitly limits the term adverse claim to property interests. Suppose, for example, that A contracts to sell or deliver securities to B, but fails to do so and instead sells or pledges the securities to C. B, the promisee, has an action against A for breach of contract, but absent unusual circumstances the action for breach would not give rise to a property interest in the securities. Accordingly, B does not have an adverse claim. An adverse claim might, however, be based upon principles of equitable remedies that give rise to property claims. It would, for example, cover a right established by other law to rescind a transaction in which securities were transferred. Suppose, for example, that A holds securities and is induced by B’s fraud to transfer them to B. Under the law of contract or restitution, A may have a right to rescind the transfer, which gives a property claim to the securities. If so, A has an adverse claim to the securities in B’s hands. By contrast, if B had committed no fraud, but had merely committed a breach of contract in connection with the transfer from A to B, A may have only a right to damages for breach, not a right to rescind. In that case, A would not have an adverse claim to the securities in B’s hands.

2. "Bearer form." The definition of "bearer form" has remained substantially unchanged since the early drafts of the original version of Article 8. The requirement that the certificate be payable to bearer by its terms rather than by an indorsement has the effect of preventing instruments governed by other law, such as chattel paper or Article 3 negotiable instruments, from being inadvertently swept into the Article 8 definition of security merely by virtue of blank indorsements. Although the other elements of the definition of security in Section 8‑102(a)( 14) probably suffice for that purpose in any event, the language used in the prior version of Article 8 has been retained.

3. "Broker." Broker is defined by reference to the definitions of broker and dealer in the federal securities laws. The only difference is that banks, which are excluded from the federal securities law definition, are included in the Article 8 definition when they perform functions that would bring them within the federal securities law definition if it did not have the clause excluding banks. The definition covers both those who act as agents ("brokers" in securities parlance) and those who act as principals ("dealers" in securities parlance). Since the definition refers to persons "defined" as brokers or dealers under the federal securities law, rather than to persons required to "register" as brokers or dealers under the federal securities law, it covers not only registered brokers and dealers but also those exempt from the registration requirement, such as purely intrastate brokers. The only substantive rules that turn on the defined term broker are one provision of the section on warranties, Section 8‑108(i), and the special perfection rule in Article 9 for security interests granted by brokers or security intermediaries, Section 9‑309(10).

4. "Certificated security." The term "certificated security" means a security that is represented by a security certificate.

5. "Clearing corporation." The definition of clearing corporation limits its application to entities that are subject to a rigorous regulatory framework. Accordingly, the definition includes only federal reserve banks, persons who are registered as "clearing agencies" under the federal securities laws (which impose a comprehensive system of regulation of the activities and rules of clearing agencies), and other entities subject to a comparable system of regulatory oversight.

6. "Communicate." The term "communicate" assures that the Article 8 rules will be sufficiently flexible to adapt to changes in information technology. Sending a signed writing always suffices as a communication, but the parties can agree that a different means of transmitting information is to be used. Agreement is defined in Section 1‑201(3) as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance." Thus, use of an information transmission method might be found to be authorized by agreement, even though the parties have not explicitly so specified in a formal agreement. The term communicate is used in Sections 8‑102(a)(7) (definition of entitlement order), 8‑102(a)(11) (definition of instruction), and 8‑403 (demand that issuer not register transfer).

7. "Entitlement holder." This term designates those who hold financial assets through intermediaries in the indirect holding system. Because many of the rules of Part 5 impose duties on securities intermediaries in favor of entitlement holders, the definition of entitlement holder is, in most cases, limited to the person specifically designated as such on the records of the intermediary. The last sentence of the definition covers the relatively unusual cases where a person may acquire a security entitlement under Section 8‑501 even though the person may not be specifically designated as an entitlement holder on the records of the securities intermediary.

A person may have an interest in a security entitlement, and may even have the right to give entitlement orders to the securities intermediary with respect to it, even though the person is not the entitlement holder. For example, a person who holds securities through a securities account in its own name may have given discretionary trading authority to another person, such as an investment adviser. Similarly, the control provisions in Section 8‑106 and the related provisions in Article 9 are designed to facilitate transactions in which a person who holds securities through a securities account uses them as collateral in an arrangement where the securities intermediary has agreed that if the secured party so directs the intermediary will dispose of the positions. In such arrangements, the debtor remains the entitlement holder but has agreed that the secured party can initiate entitlement orders. Moreover, an entitlement holder may be acting for another person as a nominee, agent, trustee, or in another capacity. Unless the entitlement holder is itself acting as a securities intermediary for the other person, in which case the other person would be an entitlement holder with respect to the securities entitlement, the relationship between an entitlement holder, and another person for whose benefit the entitlement holder holds a securities entitlement is governed by other law.

8. "Entitlement order." This term is defined as a notification communicated to a securities intermediary directing transfer or redemption of the financial asset to which an entitlement holder has a security entitlement. The term is used in the rules for the indirect holding system in a fashion analogous to the use of the terms "indorsement" and "instruction" in the rules for the direct holding system. If a person directly holds a certificated security in registered form and wishes to transfer it, the means of transfer is an indorsement. If a person directly holds an uncertificated security and wishes to transfer it, the means of transfer is an instruction. If a person holds a security entitlement, the means of disposition is an entitlement order. An entitlement order includes a direction under Section 8‑508 to the securities intermediary to transfer a financial asset to the account of the entitlement holder at another financial intermediary or to cause the financial asset to be transferred to the entitlement holder in the direct holding system (e.g., the delivery of a securities certificate registered in the name of the former entitlement holder). As noted in Comment 7, an entitlement order need not be initiated by the entitlement holder in order to be effective, so long as the entitlement holder has authorized the other party to initiate entitlement orders. See Section 8‑107(b).

9. "Financial asset." The definition of "financial asset," in conjunction with the definition of "securities account" in Section 8‑501, sets the scope of the indirect holding system rules of Part 5 of Revised Article 8. The Part 5 rules apply not only to securities held through intermediaries, but also to other financial assets held through intermediaries. The term financial asset is defined to include not only securities but also a broader category of obligations, shares, participations, and interests.

Having separate definitions of security and financial asset makes it possible to separate the question of the proper scope of the traditional Article 8 rules from the question of the proper scope of the new indirect holding system rules. Some forms of financial assets should be covered by the indirect holding system rules of Part 5, but not by the rules of Parts 2, 3, and 4. The term financial asset is used to cover such property. Because the term security entitlement is defined in terms of financial assets rather than securities, the rules concerning security entitlements set out in Part 5 of Article 8 and in Revised Article 9 apply to the broader class of financial assets.

The fact that something does or could fall within the definition of financial asset does not, without more, trigger Article 8 coverage. The indirect holding system rules of Revised Article 8 apply only if the financial asset is in fact held in a securities account, so that the interest of the person who holds the financial asset through the securities account is a security entitlement. Thus, questions of the scope of the indirect holding system rules cannot be framed as "Is such‑and‑such a ‘financial asset’ under Article 8?" Rather, one must analyze whether the relationship between an institution and a person on whose behalf the institution holds an asset falls within the scope of the term securities account as defined in Section 8‑501. That question turns in large measure on whether it makes sense to apply the Part 5 rules to the relationship.

The term financial asset is used to refer both to the underlying asset and the particular means by which ownership of that asset is evidenced. Thus, with respect to a certificated security, the term financial asset may, as context requires, refer either to the interest or obligation of the issuer or to the security certificate representing that interest or obligation. Similarly, if a person holds a security or other financial asset through a securities account, the term financial asset may, as context requires, refer either to the underlying asset or to the person’s security entitlement.

~~10. Good faith. Section 1‑203 provides that "Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance or enforcement." Section 1‑201(b)(20) defines “good faith” as “honesty in fact and the observance of reasonable commencial standards of fair dealing.” The reference to commercial standards makes clear that assessments of conduct are to be made in light of the commercial setting. The substantive rules of Article 8 have been drafted to take account of the commercial circumstances of the securities holding and processing system. For example, Section 8‑115 provides that a securities intermediary acting on an effective entitlement order, or a broker or other agent acting as a conduit in a securities transaction, is not liable to an adverse claimant, unless the claimant obtained legal process or the intermediary acted in collusion with the wrongdoer. This, and other similar provisions, see Sections 8‑404 and 8‑503(e), do not depend on notice of adverse claims, because it would impair rather than advance the interest of investors in having a sound and efficient securities clearance and settlement system to require intermediaries to investigate the propriety of the transactions they are processing. The good faith obligation does not supplant the standards of conduct established in provisions of this kind.~~

~~In Revised Article 8, the definition of good faith is not germane to the question whether a purchaser takes free from adverse claims. The rules on such questions as whether a purchaser who takes in suspicious circumstances is disqualified from protected purchaser status are treated not as an aspect of good faith but directly in the rules of Section 8‑105 on notice of adverse claims.~~

11. "Indorsement" is defined as a signature made on a security certificate or separate document for purposes of transferring or redeeming the security. The definition is adapted from the language of Section 8‑308(1) of the prior version and from the definition of indorsement in the Negotiable Instruments Article, see Section 3‑204(a). The definition of indorsement does not include the requirement that the signature be made by an appropriate person or be authorized. Those questions are treated in the separate substantive provision on whether the indorsement is effective, rather than in the definition of indorsement. See Section 8‑107.

12. "Instruction" is defined as a notification communicated to the issuer of an uncertificated security directing that transfer be registered or that the security be redeemed. Instructions are the analog for uncertificated securities of indorsements of certificated securities.

13. "Registered form." The definition of "registered form" is substantially the same as in the prior version of Article 8. Like the definition of bearer form, it serves primarily to distinguish Article 8 securities from instruments governed by other law, such as Article 3.

14. "Securities intermediary." A "securities intermediary" is a person that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity. The most common examples of securities intermediaries would be clearing corporations holding securities for their participants, banks acting as securities custodians, and brokers holding securities on behalf of their customers. Clearing corporations are listed separately as a category of securities intermediary in subparagraph (i) even though in most circumstances they would fall within the general definition in subparagraph (ii). The reason is to simplify the analysis of arrangements such as the NSCC‑DTC system in which NSCC performs the comparison, clearance, and netting function, while DTC acts as the depository. Because NSCC is a registered clearing agency under the federal securities laws, it is a clearing corporation and hence a securities intermediary under Article 8, regardless of whether it is at any particular time or in any particular aspect of its operations holding securities on behalf of its participants.

The terms securities intermediary and broker have different meanings. Broker means a person engaged in the business of buying and selling securities, as agent for others or as principal. Securities intermediary means a person maintaining securities accounts for others. A stockbroker, in the colloquial sense, may or may not be acting as a securities intermediary.

The definition of securities intermediary includes the requirement that the person in question is "acting in the capacity" of maintaining securities accounts for others. This is to take account of the fact that a particular entity, such as a bank, may act in many different capacities in securities transactions. A bank may act as a transfer agent for issuers, as a securities custodian for institutional investors and private investors, as a dealer in government securities, as a lender taking securities as collateral, and as a provider of general payment and collection services that might be used in connection with securities transactions. A bank that maintains securities accounts for its customers would be a securities intermediary with respect to those accounts; but if it takes a pledge of securities from a borrower to secure a loan, it is not thereby acting as a securities intermediary with respect to the pledged securities, since it holds them for its own account rather than for a customer. In other circumstances, those two functions might be combined. For example, if the bank is a government securities dealer it may maintain securities accounts for customers and also provide the customers with margin credit to purchase or carry the securities, in much the same way that brokers provide margin loans to their customers.

15. "Security." The definition of "security" has three components. First, there is the subparagraph (i) test that the interest or obligation be fully transferable, in the sense that the issuer either maintains transfer books or the obligation or interest is represented by a certificate in bearer or registered form. Second, there is the subparagraph (ii) test that the interest or obligation be divisible, that is, one of a class or series, as distinguished from individual obligations of the sort governed by ordinary contract law or by Article 3. Third, there is the subparagraph (iii) functional test, which generally turns on whether the interest or obligation is, or is of a type, dealt in or traded on securities markets or securities exchanges. There is, however, an "opt‑in" provision in subparagraph (iii) which permits the issuer of any interest or obligation that is "a medium of investment" to specify that it is a security governed by Article 8.

The divisibility test of subparagraph (ii) applies to the security‑‑that is, the underlying intangible interest‑‑not the means by which that interest is evidenced. Thus, securities issued in book‑entry only form meet the divisibility test because the underlying intangible interest is divisible via the mechanism of the indirect holding system. This is so even though the clearing corporation is the only eligible direct holder of the security.

The third component, the functional test in subparagraph (iii), provides flexibility while ensuring that the Article 8 rules do not apply to interests or obligations in circumstances so unconnected with the securities markets that parties are unlikely to have thought of the possibility that Article 8 might apply. Subparagraph (iii)(A) covers interests or obligations that either are dealt in or traded on securities exchanges or securities markets, or are of a type dealt in or traded on securities exchanges or securities markets. The "is dealt in or traded on" phrase eliminates problems in the characterization of new forms of securities which are to be traded in the markets, even though no similar type has previously been dealt in or traded in the markets. Subparagraph (iii)(B) covers the broader category of media for investment, but it applies only if the terms of the interest or obligation specify that it is an Article 8 security. This opt‑in provision allows for deliberate expansion of the scope of Article 8.

Section 8‑103 contains additional rules on the treatment of particular interests as securities or financial assets.

16. "Security certificate." The term "security" refers to the underlying asset, e.g., 1000 shares of common stock of Acme, Inc. The term "security certificate" refers to the paper certificates that have traditionally been used to embody the underlying intangible interest.

17. "Security entitlement" means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary. A security entitlement is both a package of personal rights against the securities intermediary and an interest in the property held by the securities intermediary. A security entitlement is not, however, a specific property interest in any financial asset held by the securities intermediary or by the clearing corporation through which the securities intermediary holds the financial asset. See Sections 8‑104(c) and 8‑503. The formal definition of security entitlement set out in subsection (a)(17) of this section is a cross‑reference to the rules of Part 5. In a sense, then, the entirety of Part 5 is the definition of security entitlement. The Part 5 rules specify the rights and property interest that comprise a security entitlement.

18. "Uncertificated security." The term "uncertificated security" means a security that is not represented by a security certificate. For uncertificated securities, there is no need to draw any distinction between the underlying asset and the means by which a direct holder’s interest in that asset is evidenced. Compare "certificated security" and "security certificate."

SECTION 17. Section 36‑9‑102(a)(43) of the 1976 Code is amended to read:

“(43) ~~‘Good faith’ means honesty in fact and the observance of reasonable commercial standards of fair dealing~~ [Reserved].”

OFFICIAL COMMENT

1. Source. All terms that are defined in Article 9 and used in more than one Section are consolidated in this Section. Note that the definition of "security interest" is found in Section 1‑201, not in this Article, and has been revised. See Appendix I. Many of the definitions in this Section are new; many others derive from those in former Section 9‑105. The following Comments also indicate other Sections of former Article 9 that defined (or explained) terms.

2. Parties to Secured Transactions.

a. "Debtor"; "Obligor"; "Secondary Obligor." Determining whether a person was a "debtor" under former Section 9‑105(1)(d) required a close examination of the context in which the term was used. To reduce the need for this examination, this Article redefines "debtor" and adds new defined terms, "secondary obligor" and "obligor." In the context of Part 6 (default and enforcement), these definitions distinguish among three classes of persons: (i) those persons who may have a stake in the proper enforcement of a security interest by virtue of their non‑lien property interest (typically, an ownership interest) in the collateral, (ii) those persons who may have a stake in the proper enforcement of the security interest because of their obligation to pay the secured debt, and (iii) those persons who have an obligation to pay the secured debt but have no stake in the proper enforcement of the security interest. Persons in the first class are debtors. Persons in the second class are secondary obligors if any portion of the obligation is secondary or if the obligor has a right of recourse against the debtor or another obligor with respect to an obligation secured by collateral. One must consult the law of suretyship to determine whether an obligation is secondary. The Restatement (3d), Suretyship and Guaranty ‘1 (1996), contains a useful explanation of the concept. Obligors in the third class are neither debtors nor secondary obligors. With one exception (Section 9‑616, as it relates to a consumer obligor), the rights and duties provided by Part 6 affect non‑debtor obligors only if they are "secondary obligors."

By including in the definition of "debtor" all persons with a property interest (other than a security interest in or other lien on collateral), the definition includes transferees of collateral, whether or not the secured party knows of the transfer or the transferee’s identity. Exculpatory provisions in Part 6 protect the secured party in that circumstance. See Sections 9‑605 and 9‑628. The definition renders unnecessary former Section 9‑112, which governed situations in which collateral was not owned by the debtor. The definition also includes a "consignee," as defined in this Section, as well as a seller of accounts, chattel paper, payment intangibles, or promissory notes.

Secured parties and other lienholders are excluded from the definition of "debtor" because the interests of those parties normally derive from and encumber a debtor’s interest. However, if in a separate secured transaction a secured party grants, as debtor, a security interest in its own interest (i.e., its security interest and any obligation that it secures), the secured party is a debtor in that transaction. This typically occurs when a secured party with a security interest in specific goods assigns chattel paper.

Consider the following examples:

Example 1: Behnfeldt borrows money and grants a security interest in her Miata to secure the debt. Behnfeldt is a debtor and an obligor.

Example 2: Behnfeldt borrows money and grants a security interest in her Miata to secure the debt. Bruno co‑signs a negotiable note as maker. As before, Behnfeldt is the debtor and an obligor. As an accommodation party (see Section 3‑419), Bruno is a secondary obligor. Bruno has this status even if the note states that her obligation is a primary obligation and that she waives all suretyship defenses.

Example 3: Behnfeldt borrows money on an unsecured basis. Bruno co‑signs the note and grants a security interest in her Honda to secure her obligation. Inasmuch as Behnfeldt does not have a property interest in the Honda, Behnfeldt is not a debtor. Having granted the security interest, Bruno is the debtor. Because Behnfeldt is a principal obligor, she is not a secondary obligor. Whatever the outcome of enforcement of the security interest against the Honda or Bruno’s secondary obligation, Bruno will look to Behnfeldt for her losses. The enforcement will not affect Behnfeldt’s aggregate obligations.

When the principal obligor (borrower) and the secondary obligor (surety) each has granted a security interest in different collateral, the status of each is determined by the collateral involved.

Example 4: Behnfeldt borrows money and grants a security interest in her Miata to secure the debt. Bruno co‑signs the note and grants a security interest in her Honda to secure her obligation. When the secured party enforces the security interest in Behnfeldt’s Miata, Behnfeldt is the debtor, and Bruno is a secondary obligor. When the secured party enforces the security interest in the Honda, Bruno is the "debtor." As in Example 3, Behnfeldt is an obligor, but not a secondary obligor.

b. "Secured Party." The secured party is the person in whose favor the security interest has been created, as determined by reference to the security agreement. This definition controls, among other things, which person has the duties and potential liability that Part 6 imposes upon a secured party. The definition of "secured party" also includes a "consignee," a person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold, and the holder of an agricultural lien.

The definition of "secured party" clarifies the status of various types of representatives. Consider, for example, a multi‑bank facility under which Bank A, Bank B, and Bank C are lenders and Bank A serves as the collateral agent. If the security interest is granted to the banks, then they are the secured parties. If the security interest is granted to Bank A as collateral agent, then Bank A is the secured party.

c. Other Parties. A "consumer obligor" is defined as the obligor in a consumer transaction. Definitions of "new debtor" and "original debtor" are used in the special rules found in Sections 9‑326 and 9‑508.

3. Definitions Relating to Creation of a Security Interest.

a. "Collateral." As under former Section 9‑105, "collateral" is the property subject to a security interest and includes accounts and chattel paper that have been sold. It has been expanded in this Article. The term now explicitly includes proceeds subject to a security interest. It also reflects the broadened scope of the Article. It includes property subject to an agricultural lien as well as payment intangibles and promissory notes that have been sold.

b. "Security Agreement." The definition of "security agreement" is substantially the same as under former Section 9‑105‑an agreement that creates or provides for a security interest. However, the term frequently was used colloquially in former Article 9 to refer to the document or writing that contained a debtor’s security agreement. This Article eliminates that usage, reserving the term for the more precise meaning specified in the definition.

Whether an agreement creates a security interest depends not on whether the parties intend that the law characterize the transaction as a security interest but rather on whether the transaction falls within the definition of "security interest" in Section 1‑201. Thus, an agreement that the parties characterize as a "lease" of goods may be a "security agreement," notwithstanding the parties’ stated intention that the law treat the transaction as a lease and not as a secured transaction. See Section 1‑203.

4. Goods‑Related Definitions.

a. "Goods"; "Consumer Goods"; "Equipment"; "Farm Products"; "Farming Operation"; "Inventory." The definition of "goods" is substantially the same as the definition in former Section 9‑105. This Article also retains the four mutually‑exclusive "types" of collateral that consist of goods: "consumer goods," "equipment," "farm products," and "inventory." The revisions are primarily for clarification.

The classes of goods are mutually exclusive. For example, the same property cannot simultaneously be both equipment and inventory. In borderline cases‑a physician’s car or a farmer’s truck that might be either consumer goods or equipment‑the principal use to which the property is put is determinative. Goods can fall into different classes at different times. For example, a radio may be inventory in the hands of a dealer and consumer goods in the hands of a consumer. As under former Article 9, goods are "equipment" if they do not fall into another category.

The definition of "consumer goods" follows former Section 9‑109. The classification turns on whether the debtor uses or bought the goods for use "primarily for personal, family, or household purposes."

Goods are inventory if they are leased by a lessor or held by a person for sale or lease. The revised definition of "inventory" makes clear that the term includes goods leased by the debtor to others as well as goods held for lease. (The same result should have obtained under the former definition.) Goods to be furnished or furnished under a service contract, raw materials, and work in process also are inventory. Implicit in the definition is the criterion that the sales or leases are or will be in the ordinary course of business. For example, machinery used in manufacturing is equipment, not inventory, even though it is the policy of the debtor to sell machinery when it becomes obsolete or worn. Inventory also includes goods that are consumed in a business (e.g., fuel used in operations). In general, goods used in a business are equipment if they are fixed assets or have, as identifiable units, a relatively long period of use, but are inventory, even though not held for sale or lease, if they are used up or consumed in a short period of time in producing a product or providing a service.

Goods are "farm products" if the debtor is engaged in farming operations with respect to the goods. Animals in a herd of livestock are covered whether the debtor acquires them by purchase or as a result of natural increase. Products of crops or livestock remain farm products as long as they have not been subjected to a manufacturing process. The terms "crops" and "livestock" are not defined. The new definition of "farming operations" is for clarification only.

Crops, livestock, and their products cease to be "farm products" when the debtor ceases to be engaged in farming operations with respect to them. If, for example, they come into the possession of a marketing agency for sale or distribution or of a manufacturer or processor as raw materials, they become inventory. Products of crops or livestock, even though they remain in the possession of a person engaged in farming operations, lose their status as farm products if they are subjected to a manufacturing process. What is and what is not a manufacturing operation is not specified in this Article. At one end of the spectrum, some processes are so closely connected with farming‑such as pasteurizing milk or boiling sap to produce maple syrup or sugar‑that they would not constitute manufacturing. On the other hand an extensive canning operation would be manufacturing. Once farm products have been subjected to a manufacturing operation, they normally become inventory.

The revised definition of "farm products" clarifies the distinction between crops and standing timber and makes clear that aquatic goods produced in aquacultural operations may be either crops or livestock. Although aquatic goods that are vegetable in nature often would be crops and those that are animal would be livestock, this Article leaves the courts free to classify the goods on a case‑by‑case basis. See Section 9‑324, Comment 11.

b. "Accession"; "Manufactured Home"; "Manufactured‑Home Transaction." Other specialized definitions of goods include "accession" (see the special priority and enforcement rules in Section 9‑335), and "manufactured home" (see Section 9‑515, permitting a financing statement in a "manufactured‑home transaction" to be effective for 30 years). The definition of "manufactured home" borrows from the federal Manufactured Housing Act, 42 U.S.C. ‘5401 et seq., and is intended to have the same meaning.

c. "As‑Extracted Collateral." Under this Article, oil, gas, and other minerals that have not been extracted from the ground are treated as real property, to which this Article does not apply. Upon extraction, minerals become personal property (goods) and eligible to be collateral under this Article. See the definition of "goods," which excludes "oil, gas, and other minerals before extraction." To take account of financing practices reflecting the shift from real to personal property, this Article contains special rules for perfecting security interests in minerals which attach upon extraction and in accounts resulting from the sale of minerals at the wellhead or minehead. See, e.g., Sections 9‑301(4) (law governing perfection and priority); 9‑501 (place of filing), 9‑502 (contents of financing statement), 9‑519 (indexing of records). The new term, "as‑extracted collateral," refers to the minerals and related accounts to which the special rules apply. The term "at the wellhead" encompasses arrangements based on a sale of the produce at the moment that it issues from the ground and is measured, without technical distinctions as to whether title passes at the "Christmas tree" of a well, the far side of a gathering tank, or at some other point. The term "at. .. the minehead" is comparable.

The following examples explain the operation of these provisions.

Example 5: Debtor owns an interest in oil that is to be extracted. To secure Debtor’s obligations to Lender, Debtor enters into an authenticated agreement granting Lender an interest in the oil. Although Lender may acquire an interest in the oil under real‑property law, Lender does not acquire a security interest under this Article until the oil becomes personal property, i.e., until is extracted and becomes "goods" to which this Article applies. Because Debtor had an interest in the oil before extraction and Lender’s security interest attached to the oil as extracted, the oil is "as‑extracted collateral."

Example 6: Debtor owns an interest in oil that is to be extracted and contracts to sell the oil to Buyer at the wellhead. In an authenticated agreement, Debtor agrees to sell to Lender the right to payment from Buyer. This right to payment is an account that constitutes "as‑extracted collateral." If Lender then resells the account to Financer, Financer acquires a security interest. However, inasmuch as the debtor‑seller in that transaction, Lender, had no interest in the oil before extraction, Financer’s collateral (the account it owns) is not "as‑extracted collateral."

Example 7: Under the facts of Example 6, before extraction, Buyer grants a security interest in the oil to Bank. Although Bank’s security interest attaches when the oil is extracted, Bank’s security interest is not in "as‑extracted collateral," inasmuch as its debtor, Buyer, did not have an interest in the oil before extraction.

5. Receivables‑related Definitions.

a. "Account"; "Health‑Care‑Insurance Receivable"; "As‑Extracted Collateral." The definition of "account" has been expanded and reformulated. It is no longer limited to rights to payment relating to goods or services. Many categories of rights to payment that were classified as general intangibles under former Article 9 are accounts under this Article. Thus, if they are sold, a financing statement must be filed to perfect the buyer’s interest in them. Among the types of property that are expressly excluded from the definition is "a right to payment for money or funds advanced or sold." As defined in Section 1‑201, "money" is limited essentially to currency. As used in the exclusion from the definition of "account," however, "funds" is a broader concept (although the term is not defined). For example, when a bank‑lender credits a borrower’s deposit account for the amount of a loan, the bank’s advance of funds is not a transaction giving rise to an account.

The definition of "health‑care‑insurance receivable" is new. It is a subset of the definition of "account." However, the rules generally applicable to account debtors on accounts do not apply to insurers obligated on health‑care‑insurance receivables. See Sections 9‑404(e), 9‑405(d), 9‑406(i).

Note that certain accounts also are "as‑extracted collateral." See Comment 4.c., Examples 6 and 7.

b. "Chattel Paper"; "Electronic Chattel Paper"; "Tangible Chattel Paper." "Chattel paper" consists of a monetary obligation together with a security interest in or a lease of specific goods if the obligation and security interest or lease are evidenced by "a record or records." The definition has been expanded from that found in former Article 9 to include records that evidence a monetary obligation and a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods or a lease of specific goods and license of software used in the goods. The expanded definition covers transactions in which the debtor’s or lessee’s monetary obligation includes amounts owed with respect to software used in the goods. The monetary obligation with respect to the software need not be owed under a license from the secured party or lessor, and the secured party or lessor need not be a party to the license transaction itself. Among the types of monetary obligations that are included in "chattel paper" are amounts that have been advanced by the secured party or lessor to enable the debtor or lessee to acquire or obtain financing for a license of the software used in the goods.

Charters of vessels are expressly excluded from the definition of chattel paper; they are accounts. The term "charter" as used in this Section includes bareboat charters, time charters, successive voyage charters, contracts of affreightment, contracts of carriage, and all other arrangements for the use of vessels.

Under former Section 9‑105, only if the evidence of an obligation consisted of "a writing or writings" could an obligation qualify as chattel paper. In this Article, traditional, written chattel paper is included in the definition of "tangible chattel paper." "Electronic chattel paper" is chattel paper that is stored in an electronic medium instead of in tangible form. The concept of an electronic medium should be construed liberally to include electrical, digital, magnetic, optical, electromagnetic, or any other current or similar emerging technologies.

The definition of electronic chattel paper does not dictate that it be created in any particular fashion. For example, a record consisting of a tangible writing may be converted to electronic form (e.g., by creating electronic images of a signed writing). Or, records may be initially created and executed in electronic form (e.g., a lessee might authenticate an electronic record of a lease that is then stored in electronic form). In either case the resulting records are electronic chattel paper.

c. "Instrument"; "Promissory Note." The definition of "instrument" includes a negotiable instrument. As under former Section 9‑105, it also includes any other right to payment of a monetary obligation that is evidenced by a writing of a type that in ordinary course of business is transferred by delivery (and, if necessary, an indorsement or assignment). Except in the case of chattel paper, the fact that an instrument is secured by a security interest or encumbrance on property does not change the character of the instrument as such or convert the combination of the instrument and collateral into a separate classification of personal property. The definition makes clear that rights to payment arising out of credit‑card transactions are not instruments. The definition of "promissory note" is new, necessitated by the inclusion of sales of promissory notes within the scope of Article 9. It explicitly excludes obligations arising out of "orders" to pay (e.g., checks) as opposed to "promises" to pay. See Section 3‑104.

d. "General Intangible"; "Payment Intangible." "General intangible" is the residual category of personal property, including things in action, that is not included in the other defined types of collateral. Examples are various categories of intellectual property and the right to payment of a loan of funds that is not evidenced by chattel paper or an instrument. The definition has been revised to exclude commercial tort claims, deposit accounts, and letter‑of‑credit rights. Each of the three is a separate type of collateral. One important consequence of this exclusion is that tortfeasors (commercial tort claims), banks (deposit accounts), and persons obligated on letters of credit (letter‑of‑credit rights) are not "account debtors" having the rights and obligations set forth in Sections 9‑404, 9‑405, and 9‑406. In particular, tortfeasors, banks, and persons obligated on letters of credit are not obligated to pay an assignee (secured party) upon receipt of the notification described in Section 9‑404(a). See Comment 5.h. Another important consequence relates to the adequacy of the description in the security agreement. See Section 9‑108.

"Payment intangible" is a subset of the definition of "general intangible." The sale of a payment intangible is subject to this Article. See Section 9‑109(a)(3). Virtually any intangible right could give rise to a right to payment of money once one hypothesizes, for example, that the account debtor is in breach of its obligation. The term "payment intangible," however, embraces only those general intangibles "under which the account debtor’s principal obligation is a monetary obligation." (Emphasis added.)

In classifying intangible collateral, a court should begin by identifying the particular rights that have been assigned. The account debtor (promisor) under a particular contract may owe several types of monetary obligations as well as other, nonmonetary obligations. If the promisee’s right to payment of money is assigned separately, the right is an account or payment intangible, depending on how the account debtor’s obligation arose. When all the promisee’s rights are assigned together, an account, a payment intangible, and a general intangible all may be involved, depending on the nature of the rights.

A right to the payment of money is frequently buttressed by ancillary covenants, such as covenants in a purchase agreement, note, or mortgage requiring insurance on the collateral or forbidding removal of the collateral, or covenants to preserve the creditworthiness of the promisor, such as covenants restricting dividends and the like. This Article does not treat these ancillary rights separately from the rights to payment to which they relate. For example, attachment and perfection of an assignment of a right to payment of a monetary obligation, whether it be an account or payment intangible, also carries these ancillary rights.

Every "payment intangible" is also a "general intangible." Likewise, "software" is a "general intangible" for purposes of this Article. See Comment 25. Accordingly, except as otherwise provided, statutory provisions applicable to general intangibles apply to payment intangibles and software.

e. "Letter‑of‑Credit Right." The term "letter‑of‑credit right" embraces the rights to payment and performance under a letter of credit (defined in Section 5‑102). However, it does not include a beneficiary’s right to demand payment or performance. Transfer of those rights to a transferee beneficiary is governed by Article 5. See Sections 9‑107, Comment 4, and 9‑329, Comments 3 and 4.

f. "Supporting Obligation." This new term covers the most common types of credit enhancements‑suretyship obligations (including guarantees) and letter‑of‑credit rights that support one of the types of collateral specified in the definition. As explained in Comment 2.a., suretyship law determines whether an obligation is "secondary" for purposes of this definition. Section 9‑109 generally excludes from this Article transfers of interests in insurance policies. However, the regulation of a secondary obligation as an insurance product does not necessarily mean that it is a "policy of insurance" for purposes of the exclusion in Section 9‑109. Thus, this Article may cover a secondary obligation (as a supporting obligation), even if the obligation is issued by a regulated insurance company and the obligation is subject to regulation as an "insurance" product.

This Article contains rules explicitly governing attachment, perfection, and priority of security interests in supporting obligations. See Sections 9‑203, 9‑308, 9‑310, and 9‑322. These provisions reflect the principle that a supporting obligation is an incident of the collateral it supports.

Collections of or other distributions under a supporting obligation are "proceeds" of the supported collateral as well as "proceeds" of the supporting obligation itself. See Section 9‑102 (defining "proceeds") and Comment 13.b. As such, the collections and distributions are subject to the priority rules applicable to proceeds generally. See Section 9‑322. However, under the special rule governing security interests in a letter‑of‑credit right, a secured party’s failure to obtain control (Section 9‑107) of a letter‑of‑credit right supporting collateral may leave its security interest exposed to a priming interest of a party who does take control. See Section 9‑329 (security interest in a letter‑of‑credit right perfected by control has priority over a conflicting security interest).

g. "Commercial Tort Claim." This term is new. A tort claim may serve as original collateral under this Article only if it is a "commercial tort claim." See Section 9‑109(d). Although security interests in commercial tort claims are within its scope, this Article does not override other applicable law restricting the assignability of a tort claim. See Section 9‑401. A security interest in a tort claim also may exist under this Article if the claim is proceeds of other collateral.

h. "Account Debtor." An "account debtor" is a person obligated on an account, chattel paper, or general intangible. The account debtor’s obligation often is a monetary obligation; however, this is not always the case. For example, if a franchisee uses its rights under a franchise agreement (a general intangible) as collateral, then the franchisor is an "account debtor." As a general matter, Article 3, and not Article 9, governs obligations on negotiable instruments. Accordingly, the definition of "account debtor" excludes obligors on negotiable instruments constituting part of chattel paper. The principal effect of this change from the definition in former Article 9 is that the rules in Sections 9‑403, 9‑404, 9‑405, and 9‑406, dealing with the rights of an assignee and duties of an account debtor, do not apply to an assignment of chattel paper in which the obligation to pay is evidenced by a negotiable instrument. (Section 9‑406(d), however, does apply to promissory notes, including negotiable promissory notes.) Rather, the assignee’s rights are governed by Article 3. Similarly, the duties of an obligor on a nonnegotiable instrument are governed by non‑Article 9 law unless the nonnegotiable instrument is a part of chattel paper, in which case the obligor is an account debtor.

i. Receivables Under Government Entitlement Programs. This Article does not contain a defined term that encompasses specifically rights to payment or performance under the many and varied government entitlement programs. Depending on the nature of a right under a program, it could be an account, a payment intangible, a general intangible other than a payment intangible, or another type of collateral. The right also might be proceeds of collateral (e.g., crops).

6. Investment‑Property‑Related Definitions: "Commodity Account"; "Commodity Contract"; "Commodity Customer"; "Commodity Intermediary"; "Investment Property." These definitions are substantially the same as the corresponding definitions in former Section 9‑115. "Investment property" includes securities, both certificated and uncertificated, securities accounts, security entitlements, commodity accounts, and commodity contracts. The term investment property includes a "securities account" in order to facilitate transactions in which a debtor wishes to create a security interest in all of the investment positions held through a particular account rather than in particular positions carried in the account. Former Section 9‑115 was added in conjunction with Revised Article 8 and contained a variety of rules applicable to security interests in investment property. These rules have been relocated to the appropriate Sections of Article 9. See, e.g., Sections 9‑203 (attachment), 9‑314 (perfection by control), 9‑328 (priority).

The terms "security," "security entitlement," and related terms are defined in Section 8‑102, and the term "securities account" is defined in Section 8‑501. The terms "commodity account," "commodity contract," "commodity customer," and "commodity intermediary" are defined in this Section. Commodity contracts are not "securities" or "financial assets" under Article 8. See Section 8‑103(f). Thus, the relationship between commodity intermediaries and commodity customers is not governed by the indirect‑holding‑system rules of Part 5 of Article 8. For securities, Article 9 contains rules on security interests, and Article 8 contains rules on the rights of transferees, including secured parties, on such matters as the rights of a transferee if the transfer was itself wrongful and gives rise to an adverse claim. For commodity contracts, Article 9 establishes rules on security interests, but questions of the sort dealt with in Article 8 for securities are left to other law.

The indirect‑holding‑system rules of Article 8 are sufficiently flexible to be applied to new developments in the securities and financial markets, where that is appropriate. Accordingly, the definition of "commodity contract" is narrowly drafted to ensure that it does not operate as an obstacle to the application of the Article 8 indirect‑holding‑system rules to new products. The term "commodity contract" covers those contracts that are traded on or subject to the rules of a designated contract market and foreign commodity contracts that are carried on the books of American commodity intermediaries. The effect of this definition is that the category of commodity contracts that are excluded from Article 8 but governed by Article 9 is essentially the same as the category of contracts that fall within the exclusive regulatory jurisdiction of the federal Commodity Futures Trading Commission.

Commodity contracts are different from securities or other financial assets. A person who enters into a commodity futures contract is not buying an asset having a certain value and holding it in anticipation of increase in value. Rather the person is entering into a contract to buy or sell a commodity at set price for delivery at a future time. That contract may become advantageous or disadvantageous as the price of the commodity fluctuates during the term of the contract. The rules of the commodity exchanges require that the contracts be marked to market on a daily basis; that is, the customer pays or receives any increment attributable to that day’s price change. Because commodity customers may incur obligations on their contracts, they are required to provide collateral at the outset, known as "original margin," and may be required to provide additional amounts, known as "variation margin," during the term of the contract.

The most likely setting in which a person would want to take a security interest in a commodity contract is where a lender who is advancing funds to finance an inventory of a physical commodity requires the borrower to enter into a commodity contract as a hedge against the risk of decline in the value of the commodity. The lender will want to take a security interest in both the commodity itself and the hedging commodity contract. Typically, such arrangements are structured as security interests in the entire commodity account in which the borrower carries the hedging contracts, rather than in individual contracts.

One important effect of including commodity contracts and commodity accounts in Article 9 is to provide a clearer legal structure for the analysis of the rights of commodity clearing organizations against their participants and futures commission merchants against their customers. The rules and agreements of commodity clearing organizations generally provide that the clearing organization has the right to liquidate any participant’s positions in order to satisfy obligations of the participant to the clearing corporation. Similarly, agreements between futures commission merchants and their customers generally provide that the futures commission merchant has the right to liquidate a customer’s positions in order to satisfy obligations of the customer to the futures commission merchant.

The main property that a commodity intermediary holds as collateral for the obligations that the commodity customer may incur under its commodity contracts is not other commodity contracts carried by the customer but the other property that the customer has posted as margin. Typically, this property will be securities. The commodity intermediary’s security interest in such securities is governed by the rules of this Article on security interests in securities, not the rules on security interests in commodity contracts or commodity accounts.

Although there are significant analytic and regulatory differences between commodities and securities, the development of commodity contracts on financial products in the past few decades has resulted in a system in which the commodity markets and securities markets are closely linked. The rules on security interests in commodity contracts and commodity accounts provide a structure that may be essential in times of stress in the financial markets. Suppose, for example that a firm has a position in a securities market that is hedged by a position in a commodity market, so that payments that the firm is obligated to make with respect to the securities position will be covered by the receipt of funds from the commodity position. Depending upon the settlement cycles of the different markets, it is possible that the firm could find itself in a position where it is obligated to make the payment with respect to the securities position before it receives the matching funds from the commodity position. If cross‑margining arrangements have not been developed between the two markets, the firm may need to borrow funds temporarily to make the earlier payment. The rules on security interests in investment property would facilitate the use of positions in one market as collateral for loans needed to cover obligations in the other market.

7. Consumer‑Related Definitions: "Consumer Debtor"; "Consumer Goods"; "Consumer‑goods transaction"; "Consumer Obligor"; "Consumer Transaction." The definition of "consumer goods" (discussed above) is substantially the same as the definition in former Section 9‑109. The definitions of "consumer debtor," "consumer obligor," "consumer‑goods transaction," and "consumer transaction" have been added in connection with various new (and old) consumer‑related provisions and to designate certain provisions that are inapplicable in consumer transactions.

"Consumer‑goods transaction" is a subset of "consumer transaction." Under each definition, both the obligation secured and the collateral must have a personal, family, or household purpose. However, "mixed" business and personal transactions also may be characterized as a consumer‑goods transaction or consumer transaction. Subparagraph (A) of the definition of consumer‑goods transactions and clause (i) of the definition of consumer transaction are primary purposes tests. Under these tests, it is necessary to determine the primary purpose of the obligation or obligations secured. Subparagraph (B) and clause (iii) of these definitions are satisfied if any of the collateral is consumer goods, in the case of a consumer‑goods transaction, or "is held or acquired primarily for personal, family, or household purposes," in the case of a consumer transaction. The fact that some of the obligations secured or some of the collateral for the obligation does not satisfy the tests (e.g., some of the collateral is acquired for a business purpose) does not prevent a transaction from being a "consumer transaction" or "consumer‑goods transaction."

8. Filing‑Related Definitions: "Continuation Statement"; "File Number"; "Filing Office"; "Filing‑office Rule"; "Financing Statement"; "Fixture Filing"; "Manufactured‑Home Transaction"; "New Debtor"; "Original Debtor"; "Public‑Finance Transaction"; "Termination Statement"; "Transmitting Utility." These definitions are used exclusively or primarily in the filing‑related provisions in Part 5. Most are self‑explanatory and are discussed in the Comments to Part 5. A financing statement filed in a manufactured‑home transaction or a public‑finance transaction may remain effective for 30 years instead of the 5 years applicable to other financing statements. See Section 9‑515(b). The definitions relating to medium neutrality also are significant for the filing provisions. See Comment 9.

The definition of "transmitting utility" has been revised to embrace the business of transmitting communications generally to take account of new and future types of communications technology. The term designates a special class of debtors for whom separate filing rules are provided in Part 5, thereby obviating the many local fixture filings that would be necessary under the rules of Section 9‑501 for a far‑flung public‑ utility debtor. A transmitting utility will not necessarily be regulated by or operating as such in a jurisdiction where fixtures are located. For example, a utility might own transmission lines in a jurisdiction, although the utility generates no power and has no customers in the jurisdiction.

9. Definitions Relating to Medium Neutrality.

a. "Record." In many, but not all, instances, the term "record" replaces the term "writing" and "written." A "record" includes information that is in intangible form (e.g., electronically stored) as well as tangible form (e.g., written on paper). Given the rapid development and commercial adoption of modern communication and storage technologies, requirements that documents or communications be "written," "in writing," or otherwise in tangible form do not necessarily reflect or aid commercial practices.

A "record" need not be permanent or indestructible, but the term does not include any oral or other communication that is not stored or preserved by any means. The information must be stored on paper or in some other medium. Information that has not been retained other than through human memory does not qualify as a record. Examples of current technologies commercially used to communicate or store information include, but are not limited to, magnetic media, optical discs, digital voice messaging systems, electronic mail, audio tapes, and photographic media, as well as paper. "Record" is an inclusive term that includes all of these methods of storing or communicating information. Any "writing" is a record. A record may be authenticated. See Comment 9.b. A record may be created without the knowledge or intent of a particular person.

Like the terms "written" or "in writing," the term "record" does not establish the purposes, permitted uses, or legal effect that a record may have under any particular provision of law. Whatever is filed in the Article 9 filing system, including financing statements, continuation statements, and termination statements, whether transmitted in tangible or intangible form, would fall within the definition. However, in some instances, statutes or filing‑office rules may require that a paper record be filed. In such cases, even if this Article permits the filing of an electronic record, compliance with those statutes or rules is necessary. Similarly, a filer must comply with a statute or rule that requires a particular type of encoding or formatting for an electronic record.

This Article sometimes uses the terms "for record," "of record," "record or legal title," and "record owner." Some of these are terms traditionally used in real‑ property law. The definition of "record" in this Article now explicitly excepts these usages from the defined term. Also, this Article refers to a record that is filed or recorded in real‑property recording systems to record a mortgage as a "record of a mortgage." This usage recognizes that the defined term "mortgage" means an interest in real property; it does not mean the record that evidences, or is filed or recorded with respect to, the mortgage.

b. "Authenticate"; "Communicate"; "Send." The terms "authenticate" and "authenticated" generally replace "sign" and "signed." "Authenticated" replaces and broadens the definition of "signed," in Section 1‑201, to encompass authentication of all records, not just writings. ( to authentication of, e.g., an agreement, demand, or notification mean, of course, authentication of a record containing an agreement, demand, or notification.) The terms "communicate" and "send" also contemplate the possibility of communication by nonwritten media. These definitions include the act of transmitting both tangible and intangible records. The definition of "send" replaces, for purposes of this Article, the corresponding term in Section 1‑201. The reference to "usual means of communication" in that definition contemplates an inquiry into the appropriateness of the method of transmission used in the particular circumstances involved.

10. Scope‑Related Definitions.

a. Expanded Scope of Article: "Agricultural Lien"; "Consignment"; "Payment Intangible"; "Promissory Note." These new definitions reflect the expanded scope of Article 9, as provided in Section 9‑109(a).

b. Reduced Scope of Exclusions: "Governmental Unit"; "Health‑Care‑Insurance Receivable"; "Commercial Tort Claims." These new definitions reflect the reduced scope of the exclusions, provided in Section 9‑109(c) and (d), of transfers by governmental debtors and assignments of interests in insurance policies and commercial tort claims.

11. Choice‑of‑Law‑Related Definitions: "Certificate of Title"; "Governmental Unit"; "Jurisdiction of Organization"; "Registered Organization"; "State." These new definitions reflect the changes in the law governing perfection and priority of security interests and agricultural liens provided in Part 3, Subpart 1.

Not every organization that may provide information about itself in the public records is a "registered organization." For example, a general partnership is not a "registered organization," even if it files a statement of partnership authority under Section 303 of the Uniform Partnership Act (1994) or an assumed name ("dba") certificate. This is because the State under whose law the partnership is organized is not required to maintain a public record showing that the partnership has been organized. In contrast, corporations, limited liability companies, and limited partnerships are "registered organizations."

12. Deposit‑Account‑Related Definitions: "Deposit Account"; "Bank." The revised definition of "deposit account" incorporates the definition of "bank," which is new. The definition derives from the definitions of "bank" in Sections 4‑105(1) and 4A‑105(a)(2), which focus on whether the organization is "engaged in the business of banking."

Deposit accounts evidenced by Article 9 "instruments" are excluded from the term "deposit account." In contrast, former Section 9‑105 excluded from the former definition "an account evidenced by a certificate of deposit." The revised definition clarifies the proper treatment of nonnegotiable or uncertificated certificates of deposit. Under the definition, an uncertificated certificate of deposit would be a deposit account (assuming there is no writing evidencing the bank’s obligation to pay) whereas a nonnegotiable certificate of deposit would be a deposit account only if it is not an "instrument" as defined in this Section (a question that turns on whether the nonnegotiable certificate of deposit is "of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment.")

A deposit account evidenced by an instrument is subject to the rules applicable to instruments generally. As a consequence, a security interest in such an instrument cannot be perfected by "control" (see Section 9‑104), and the special priority rules applicable to deposit accounts (see Sections 9‑327 and 9‑340) do not apply.

The term "deposit account" does not include "investment property," such as securities and security entitlements. Thus, the term also does not include shares in a money‑market mutual fund, even if the shares are redeemable by check.

13. Proceeds‑Related Definitions: "Cash Proceeds"; "Noncash Proceeds"; "Proceeds." The revised definition of "proceeds" expands the definition beyond that contained in former Section 9‑306 and resolves ambiguities in the former Section.

a. Distributions on Account of Collateral. The phrase "whatever is collected on, or distributed on account of, collateral," in subparagraph (B), is broad enough to cover cash or stock dividends distributed on account of securities or other investment property that is original collateral. Compare former Section 9‑306 ("Any payments or distributions made with respect to investment property collateral are proceeds."). This Section rejects the holding of Hastie v. FDIC, 2 F.3d 1042 (10th Cir. 1993) (postpetition cash dividends on stock subject to a prepetition pledge are not "proceeds" under Bankruptcy Code Section 552(b)), to the extent the holding relies on the Article 9 definition of "proceeds."

b. Distributions on Account of Supporting Obligations. Under subparagraph (B), collections on and distributions on account of collateral consisting of various credit‑support arrangements ("supporting obligations," as defined in Section 9‑102) also are proceeds. Consequently, they are afforded treatment identical to proceeds collected from or distributed by the obligor on the underlying (supported) right to payment or other collateral. Proceeds of supporting obligations also are proceeds of the underlying rights to payment or other collateral.

c. Proceeds of Proceeds. The definition of "proceeds" no longer provides that proceeds of proceeds are themselves proceeds. That idea is expressed in the revised definition of "collateral" in Section 9‑102. No change in meaning is intended.

d. Proceeds Received by Person Who Did Not Create Security Interest. When collateral is sold subject to a security interest and the buyer then resells the collateral, a question arose under former Article 9 concerning whether the "debtor" had "received" what the buyer received on resale and, therefore, whether those receipts were "proceeds" under former Section 9‑306(2). This Article contains no requirement that property be "received" by the debtor for the property to qualify as proceeds. It is necessary only that the property be traceable, directly or indirectly, to the original collateral.

e. Cash Proceeds and Noncash Proceeds. The definition of "cash proceeds" is substantially the same as the corresponding definition in former Section 9‑306. The phrase "and the like" covers property that is functionally equivalent to "money, checks, or deposit accounts," such as some money‑market accounts that are securities or part of securities entitlements. Proceeds other than cash proceeds are noncash proceeds.

14. Consignment‑Related Definitions: "Consignee"; "Consignment"; "Consignor." The definition of "consignment" excludes, in subparagraphs (B) and (C), transactions for which filing would be inappropriate or of insufficient benefit to justify the costs. A consignment excluded from the application of this Article by one of those subparagraphs may still be a true consignment; however, it is governed by non‑Article 9 law. The definition also excludes, in subparagraph (D), what have been called "consignments intended for security." These "consignments" are not bailments but secured transactions. Accordingly, all of Article 9 applies to them. See Sections 1‑201(b)(35), 9‑109(a)(1). The "consignor" is the person who delivers goods to the "consignee" in a consignment.

The definition of "consignment" requires that the goods be delivered "to a merchant for the purpose of sale." If the goods are delivered for another purpose as well, such as milling or processing, the transaction is a consignment nonetheless because a purpose of the delivery is "sale." On the other hand, if a merchant‑processor‑bailee will not be selling the goods itself but will be delivering to buyers to which the owner‑bailor agreed to sell the goods, the transaction would not be a consignment.

15. "Accounting." This definition describes the record and information that a debtor is entitled to request under Section 9‑210.

16. "Document." The definition of "document" is unchanged in substance from the corresponding definitions in former Section 9‑105. See Section 1‑201‑(b)(16) and Comment 15.

17. "Encumbrance"; "Mortgage." The definitions of "encumbrance" and "mortgage" are unchanged in substance from the corresponding definitions in former Section 9‑105. They are used primarily in the special real‑property‑related priority and other provisions relating to crops, fixtures, and accessions.

18. "Fixtures." This definition is unchanged in substance from the corresponding definition in former Section 9‑313. See Section 9‑334 (priority of security interests in fixtures and crops).

~~19. "Good Faith." This Article expands the definition of "good faith" to include "the observance of reasonable commercial standards of fair dealing." The definition in this Section applies when the term is used in this Article, and the same concept applies in the context of this Article for purposes of the obligation of good faith imposed by Section 1‑203. See subsection (c).~~

20. "Lien Creditor" This definition is unchanged in substance from the corresponding definition in former Section 9‑301.

21. "New Value." This Article deletes former Section 9‑108. Its broad formulation of new value, which embraced the taking of after‑acquired collateral for a pre‑existing claim, was unnecessary, counterintuitive, and ineffective for its original purpose of sheltering after‑acquired collateral from attack as a voidable preference in bankruptcy. The new definition derives from Bankruptcy Code Section 547(a). The term is used with respect to temporary perfection of security interests in instruments, certificated securities, or negotiable documents under Section 9‑312(e) and with respect to chattel paper priority in Section 9‑330.

22. "Person Related To." Section 9‑615 provides a special method for calculating a deficiency or surplus when "the secured party, a person related to the secured party, or a secondary obligor" acquires the collateral at a foreclosure disposition. Separate definitions of the term are provided with respect to an individual secured party and with respect to a secured party that is an organization. The definitions are patterned on the corresponding definition in Section 1.301(32) of the Uniform Consumer Credit Code (1974).

23. "Proposal." This definition describes a record that is sufficient to propose to retain collateral in full or partial satisfaction of a secured obligation. See Sections 9‑620, 9‑621, 9‑622.

24. "Pursuant to Commitment." This definition is unchanged in substance from the corresponding definition in former Section 9‑105. It is used in connection with special priority rules applicable to future advances. See Section 9‑323.

25. "Software." The definition of "software" is used in connection with the priority rules applicable to purchase‑money security interests. See Sections 9‑103, 9‑324. Software, like a payment intangible, is a type of general intangible for purposes of this Article.

26. Terminology: "Assignment" and "Transfer." In numerous provisions, this Article refers to the "assignment" or the "transfer" of property interests. These terms and their derivatives are not defined. This Article generally follows common usage by using the terms "assignment" and "assign" to refer to transfers of rights to payment, claims, and liens and other security interests. It generally uses the term "transfer" to refer to other transfers of interests in property. Except when used in connection with a letter‑of‑credit transaction ( see Section 9‑107, Comment 4), no significance should be placed on the use of one term or the other. Depending on the context, each term may refer to the assignment or transfer of an outright ownership interest or to the assignment or transfer of a limited interest, such as a security interest.

SECTION 18. Sections 36‑2‑208 and 36‑2A‑207 of the 1976 Code are repealed.

SECTION 19. This act takes effect upon approval by the Governor.

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