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Chapter 1. Introduction to the Uniform Commercial Code and Article 1

1.1. History of the UCC. As interstate commerce grew, so did the need for national uniformity in laws applicable to commercial transactions. Under the leadership of Professor Karl Llewellyn, the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL) (which is now known as the Uniform Law Commission or ULC) promulgated the Uniform Commercial Code (UCC or Code), which was first enacted by a state in 1953. Today, all states have enacted most parts of the UCC, although there are some variations. Louisiana is the only state that has not enacted Article 2.

1.1.1. Article 1 of the UCC contains general provisions that, according to Revised § 1-102, apply when a transaction is governed by another article of the UCC. For example, statements of purpose, rules of construction, and general definitions are contained in Article 1. In 2001, the ULC promulgated changes to Article 1; these changes are known as Revised Article 1. Most states have adopted Revised Article 1, although none has enacted it in its uniform version. For a tally of adopting states, see the web site of the Uniform Law Commission at http://www.uniformlaws.org.

Note the three significant changes that Revised Article 1 made to former Article 1. It (1) clarifies that Article 1 applies only to Code transactions, (2) clarifies that the concept of course of performance applies throughout the Code, and (3) redefines good faith. When a jurisdiction enacts Revised Article 1, it also makes a few changes to Article 2 to coordinate with the changes in Article 1.

1.1.2. In 1999, the ALI voted to support a draft Revised Article 2, but the ULC did not support it, probably because of the perceived difficulty of enacting such a substantial

revision in the states. In 2003, the ULC drafted a less radical version known as Amended Article 2. In May 2011, the ULC and the ALI agreed to withdraw Amended Article 2 from consideration by the states. No state has enacted either Revised Article 2 or Amended Article 2. Nevertheless, reference to the proposed revisions may be valuable for seeing the clarifications that were made to the existing text.

The bottom line is that a statute more than 50 years old governs modern commercial transactions. As we will see, the Code has a great deal of flexibility in the joints to accommodate change, but there will be many strains put on it.

1.1.3. Unless otherwise indicated, when these materials cite sections from Article 1 and Article 2, this refers to the sections as found in Revised Article 1 and the pre-2003 version of Article 2 as amended to reflect Revised Article 1. When researching the law of a particular jurisdiction, you will have to determine (1) whether that jurisdiction has enacted Revised Article 1, and (2) whether that jurisdiction adopted any nonuniform provisions when it enacted the Code.

1.1.4. Most of the Code sections are followed by Official Comments (which we often simply refer to as "Comment" throughout these materials). In most jurisdictions, these have not been enacted by the legislature. Therefore, they are only persuasive authority. However, because they are promulgated by the drafters of the statute, they are highly persuasive. The Official Comments can be useful for (1) putting the section in context, (2) elaborating on the principles involved in the section, and (3) guiding interpretation to preserve uniformity.

1.2. Purposes of the UCC. Always keep in mind the general *purposes* of the UCC, as set forth at § 1-103:

> (1) To *simplify, clarify, and modernize* the law governing commercial transactions;
>
> (2) To permit the continued expansion of commercial practices through *custom, usage, and agreement* of the parties; and
>
> (3) To *make uniform* the law among various jurisdictions.

Regarding this last purpose, consider this analysis by Judge Posner in *Northrop Corp. v. Litronic Industries*, 29 F.3d 1173, 1175, 1178 (7th Cir. 1994):

> Unfortunately, the Illinois courts – whose understanding of Article 2 of the UCC is binding on us because this is a diversity suit governed, all agree, by Illinois law – have had no occasion to choose among the different positions on the consequences of an acceptance that contains "different" terms from the offer. We shall have to choose....

> The Uniform Commercial Code, as we have said, does not say what the terms of the contract are if the offer and acceptance contain different terms, as distinct from cases in which the acceptance merely contains additional terms to those in the offer. The majority view is that the discrepant terms fall out and are replaced by a suitable UCC gap-filler.… The leading minority view is that the discrepant terms *in the acceptance* are to be ignored.… Our own preferred view – the view that assimilates "different" to "additional," so that the terms in the offer prevail over the different terms in the acceptance only if the latter are materially different, has as yet been adopted by only one state, California….
>
> Because Illinois in other UCC cases has tended to adopt majority rules …, and because the interest in the uniform nationwide application of the Code – an interest asserted in the Code itself (see [§ 1-103(a)(3)]) – argues for nudging majority views, even if imperfect (but not downright bad), toward unanimity, we start with a presumption that Illinois, whose position we are trying to predict, would adopt the majority view.…

[1-1]

1.3. Variation of UCC Provisions by Agreement. Although some provisions of the UCC are mandatory and cannot be varied (discussed below), most provisions are intended to be "default" provisions that govern in the absence of a differing agreement by the parties.

1.3.1. The principle of *freedom of contract* (which you should always be prepared to argue to a court) is alive and well under the UCC. Section 1-302(a) provides:

> Except as otherwise provided in subsection (b) or elsewhere in the UCC, the effect of provisions of the UCC *may be varied by agreement*. (emphasis added)

After they finished, the Code drafters realized that sometimes they stated that a provision governed "unless otherwise agreed" and sometimes they didn't. They then included § 1-302(c) to make clear that when they failed to say it, they did not mean that the parties cannot otherwise agree.

[1-2]

1.3.2. Although § 1-302(a) provides the general rule that the parties may vary the UCC default rules by agreement, under § 1-302(b) the parties *may not* disclaim any of the following obligations prescribed by the UCC:

> (1) *good faith* (see § 1-304);
>
> (2) *diligence* (see, for example, the use of *"due diligence"* in the context of notice at § 1-202(f) and "*reasonable diligence*" in the context of notice of dishonor at § 3-504);

(3) *reasonableness* (see, for example, the requirement of reasonable notice of termination at § 2-309(3)); and

(4) *care* (see, for example, buyer's duty to hold rejected goods with reasonable care at § 2-602(b)).

Although these obligations cannot be disclaimed by agreement of the parties, standards of performance intended to satisfy these requirements may be specified, as long as such standards are not manifestly unreasonable.

[1-3]

1.3.3. In addition to providing that the obligations of good faith, diligence, reasonableness and care prescribed by the UCC may not be disclaimed, § 1-302(a) contains a second limitation on the parties' freedom to contract: "except as otherwise provided ... *elsewhere* in the UCC." (emphasis added) In other words, throughout the UCC there are mandatory provisions which may not be modified by contract. Some provisions expressly state that they may not be varied by contract. However, others may not be so labeled.

[1-4]

1.3A. Hierarchy of Construction. The UCC provides rules of construction in interpreting the terms of the parties' contract.

First, you need to understand the definition of both *contract* and *agreement* under the UCC. Let's start with the term *agreement*, which is defined at § 1-201(b)(3) as comprising the following elements:

(1) the bargain of the parties in fact as determined from their language and the circumstances;

(2) course of performance;

(3) course of dealing; and

(4) usage of trade.

Under § 1-201(b)(12), a *contract*, as distinguished from an *agreement*, means the total legal obligation that results from the agreement as determined by the UCC (such as gap-fillers) and supplemental laws. For example, if I say that I will sell you ten grams of cocaine for $1,000 and you agree, we have made an agreement on those terms and you have probably impliedly agreed to pay cash on delivery, but we have not made a contract.

Note that the definitions in § 1-201 apply throughout the UCC, including, for example, Article 2A (Leases), Article 3 (Commercial Paper), and Article 9 (Secured Transactions). A separate list of definitions also appears within each Article. See, for example, §§ 2-103 through 2-106. If you run across an unfamiliar term, *always* check for a definition provided elsewhere in the UCC. You should even check for definitions of familiar terms. You might assume, for example, what constitutes a writing or what the term "signed" means. Now look at how those terms are defined at § 1-201. Look also at the Official

Comment for the term "signed" for further insight. Note, however, that § 1-201(a) provides that the definition applies "unless the context requires otherwise."

Now, let's go back to the term "agreement." In addition to the "bargain of the parties," (*i.e.*, terms specifically agreed upon by language, conduct, or other circumstances), the UCC incorporates three important other sources of terms into the parties' agreement: *course of performance*, *course of dealing*, and *usage of trade*. These terms are defined at § 1-303:

Course of performance arises when there are repeated occasions for performance of *this particular contract* by the parties, and the repeated performance by one party is accepted by or acquiesced in by the other. For example, an installment contract would give rise to course of performance. See § 1-303(a).

Course of dealing is a sequence of conduct concerning *previous transactions* between the parties that is fairly to be regarded as establishing a common basis of understanding for interpreting a future agreement. See § 1-303(b).

Usage of trade is any practice or method of dealing having such regularity of observation in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question. See § 1-303(c).

[1-7 – 1-10]

1.4. Supplementation by Other Law. Section 1-103(b) provides that *unless displaced* by a particular provision of the UCC, the principles of law and equity supplement the provisions of the UCC. Specific examples given of such supplementing laws and equitable principles include:

(1) the law merchant (what the heck is that?);

(2) capacity to contract, duress, coercion, mistake (issues going to the validity of a contract);

(3) estoppel;

(4) fraud and misrepresentation;

(5) bankruptcy;

(6) principal and agency relationships; and

(7) "other validating or invalidating cause" (huh?).

For example, in *Daniels-Sheridan Federal Credit Union v. Bellanger*, 36 P.3d 397 (Mont. 2001), Smith, a seller of cattle on credit who did not secure his interest under Article 9, claimed that he had an "equitable" interest in the cattle that was superior to the interest of a creditor who had a perfected security interest in the cattle pursuant to Article 9, and that the secured creditor would be "unjustly enriched" if Smith's prior equitable interest were not recognized. In rejecting his arguments, the court stated:

> ¶40 In *Northwest Potato Sales, Inc. v. Beck* (1984), 208 Mont. 310, 678 P.2d 1138, a potato dealer appealed a district court's dismissal of its breach of contract claim which was based on Charles Beck's failure to honor a contract to

sell it seed potatoes. Beck asserted a statute of frauds defense on the basis he had never signed the written contract signed by the potato dealer and forwarded to him. The potato dealer raised estoppel as a bar to the defense. We reversed, holding that Beck had both actively and passively led the potato dealer to believe the written contract would be honored and, as a result, Beck was estopped from asserting a statute of frauds defense to the contract action. In doing so, we rejected Beck's argument that estoppel cannot apply to a UCC statute of frauds transaction, noting that § 30-1-103, MCA, expressly mentions estoppel as one of the general principles of law that supplements the UCC, absent an express displacement of the principle elsewhere. We ultimately determined that no provision of the UCC precludes application of estoppel to defeat a statute of frauds defense.…

¶41 Smith attempts to apply our recognition in *Northwest* that equitable remedies can supplement the UCC to the present case, but *Northwest* is readily distinguishable. *Northwest* did not address the priority of secured interests and, indeed, did not relate to secured interests in any way. Moreover, unlike in *Northwest*, the equitable principle of unjust enrichment urged by Smith – and adopted by the District Court – is not mentioned in the UCC as one of the general principles of law which can supplement the UCC's specific hierarchy of priorities for security interests at issue here.

1.5. Choice of Law. The UCC, under § 1-301, allows the parties to designate a jurisdiction whose law governs the contract if the transaction bears a "reasonable relation" to that jurisdiction. As noted in a relevant official comment, any jurisdiction in which "a significant enough portion of the making or performance of the contract is to occur" is appropriate. For example, if a seller of goods enters into a contract at its headquarters in Delaware, has a California warehouse from which goods are to be shipped under the contract, the goods are manufactured in South Dakota, the buyer is located in Montana, and the goods are to be shipped to Texas, any one of those jurisdictions would have a "reasonable relation" to the contract, and the parties could choose to apply the law of any of those jurisdictions.

A historical note: The ULC at one point proposed a revision that would have allowed parties to a transaction that did not involve a consumer to choose the applicable law without limitation, but this proposal was completely rejected by legislatures. The ULC gave in and stopped pursuing the revision.

1.5.1. Section 1-301(c) sets forth a narrow list of limitations on the parties' right to designate their choice of governing law. For example, under § 2A-106(1), a consumer lease may only designate the law of the jurisdiction where the consumer resides or in which the goods are to be used.

1.5.2. In the absence of an effective choice of law, § 1-301(b) directs the courts to apply the UCC to transactions having an "appropriate relationship" to that jurisdiction. Official Comment 1 notes that it would not be appropriate to apply the UCC if, for example, the parties have "clearly contracted on the basis of some other law." Due to the uniformity and widespread adoption of the UCC, its application by the forum state

should not present difficulties, unless the forum state has adopted a non-uniform version of the applicable UCC provisions that may affect the outcome of the case.

1.5.3. Note that choice of law differs from choice of forum. *Choice of forum* resolves the issue of where the case will be heard. Once that is determined, either by the parties or by the rules of civil procedure, then *choice of law* determines the law that the court will apply to the transaction. If the parties have not exercised their freedom of contract to determine the applicable law, then the courts will use principles of conflict of laws to make the determination.

1.5.4. Recall that § 1-103(b) provides that principles of law and equity supplement the UCC, unless displaced. *Restatement (Second) of Conflict of Laws* § 187(2) sets forth a widely accepted principle:

> (2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied …, unless either
>
> (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
>
> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which … would be the state of the applicable law in the absence of an effective choice of law by the parties.

[1-5]