2003-2004

# Rules of Contract Law

## Selections from the Uniform Commercial Code, the CISG, the Restatement (Second) of Contracts, and the UNIDROIT Principles, with Material on Contract Drafting

Charles L. Knapp
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## 2003–2004 Statutory Supplement

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# Uniform Commercial Code

## *EDITORS' NOTE*[1]

As the United States developed a national market economy during the nineteenth century, the number of business transactions across state lines increased dramatically. Many of these transactions were cumbersome, however, because of differences among the states on commercial subjects, such as negotiable instruments, sales, and warehousing. Recognizing these problems, a number of business lawyers suggested the need for greater uniformity among the states in commercial law.

In 1889 the legislature of New York, the leading commercial state at that time, passed a statute providing for the appointment of commissioners who were authorized to solicit the appointment of commissioners from other states for the purpose of preparing uniform state laws. In 1892 the first meeting of the National Conference of Commissioners on Uniform State Laws (NCCUSL) was held in connection with the annual meeting of the American Bar Association. At first the Commissioners concentrated on technical questions, such as standardized forms for acknowledgement of instruments, but they soon ventured into more substantive areas. By the early part of the twentieth century, the Commissioners had prepared uniform acts on a number of commercial subjects: negotiable instruments, sales, warehouse receipts, bills of lading, and trust receipts, to name just a few.

Adopted in many states, the uniform acts did foster the cause of uniformity to some extent. A number of factors, however, limited the success of the National Conference. Professor and later Judge Robert Braucher summarized the problems as follows:

> [The history of the uniform acts] provides an illustration of four major difficulties which have afflicted uniform legislation: (1) difficulty in obtaining original enactment, (2) a tendency toward deviation from the official text at the time of the original adoption, (3) nonuniform judicial interpretation, and (4) difficulty in promulgating and obtaining enactment of uniform amendments.

1. Matters covered in this Note are explored more fully in the following works: R. Braucher & Robert R. Riegert, Introduction to Commercial Transactions 19-31 (1977); J. White & R. Summers, Uniform Commercial Code Handbook 1-7 (5th ed. 2000); and Nathan M. Crystal, Codification and the Rise of the Restatement Movement, 54 Wash. L. Rev. 239 (1979).

Robert Braucher & Robert Riegert, Introduction to Commercial Transactions 21-22 (1977).

By 1940 it was apparent that many of the uniform acts adopted early in the century required revision. At the fiftieth annual meeting of the National Conference of Commissioners, William A. Schnader, the president of the Conference, called for the creation of a uniform commercial code. The Conference quickly adopted his suggestion, subject to obtaining funding. In 1944 the Conference combined forces with the American Law Institute (ALI) to sponsor the project, with Professor Karl Llewellyn of Columbia Law School as Chief Reporter.

After a lengthy process, involving circulation of drafts among advisors, business groups, and others, The National Conference and the ALI issued an official text of the proposed Code in 1951. Pennsylvania became the first state to adopt the Code, in 1953. The project received a major setback in 1956, however, when the New York Law Revision Commission, after a three-year study, advised the New York Legislature that the Code "is not satisfactory in its present form." The New York Law Revision Commission's study has been published in a six-volume set and remains an important source of information about the Code.

The New York study caused the ALI and the National Conference to reexamine the Code. In 1958 the sponsoring organizations issued a revised Official Text. New York adopted this new version of the Code in 1962, and other states quickly followed suit. By 1968 the Code was in force in all jurisdictions except Louisiana, where only certain articles have been enacted. Even to this day, however, the process of revision goes on. In 1961 the ALI and the National Conference created a Permanent Editorial Board for the Uniform Commercial Code to monitor developments in commercial law and propose revisions of the Code.

Although titled a commercial code, the name is somewhat of a misnomer because the Code fails to cover a number of important commercial subjects. Transactions involving real estate and personal services are generally outside the scope of the Code. In addition, even for transactions subject to the Code, many aspects are regulated by other bodies of law. For example, Article 8 of the Code deals with title and transfer of investment securities, such as common stock. Most of the law governing transactions in securities, however, lies outside the Code. Moreover, common law principles continue to govern transactions to which the Code is applicable unless specifically displaced by Code provision. UCC §1-103.

Rather than a comprehensive code of commercial law, the UCC instead consists of a loosely related collection of revised versions of the most significant uniform acts adopted earlier this century by the National Conference of Commissioners. Article 1 covers a number of general matters; it includes a section containing definitions that apply throughout the Code. UCC §1-201. A substantial revision of Article 1 was completed in 2001 but it had been enacted only in the U.S. Virgin Islands as of March 1, 2003. Thus, the version of Article 1 contained in this part of the Supplement continues to be the applicable law in almost every jurisdiction. Many sections from Revised Article 1 are included in a later part of this Supplement.

Article 2, which is the principal part of the Code addressed in most contracts courses, deals with transactions involving the sale of goods. A major revision of Article 2 was nearing completion at the time this Supplement was written and many sections from Proposed Article 2 are included in a subsequent part. Article 2A deals with various aspects of leases of personal property, including formation of lease contracts, performance, and default. For several years the ALI and National Conference worked on

a proposed Article 2B, dealing with computer information transactions. After much controversy over the provisions, the ALI and the National Conference decided that such rules should not be proposed as part of the UCC but would be incorporated instead into a separate Uniform Computer Information Transactions Act (UCITA). The Act was adopted by the National Conference in 1999, but not by the ALI. A more detailed discussion of UCITA is included in the Materials on Electronic Contracts later in this Supplement.

"Commercial paper" — checks, notes, and drafts — is the focus of Article 3; the processing of such instruments through the banking system is the subject of Article 4; fund transfers are the topic of Article 4A. Article 5 deals with the rights and liabilities of parties to "letters of credit." Article 6 establishes rules for "bulk sales," transactions in which the owner of a certain type of business sells substantially all of the assets of that business. On recommendation of the NCCUSL, a majority of states have now repealed Article 6. Article 7 governs "documents of title," such as bills of lading issued by carriers of goods, or warehouse receipts issued by companies that are involved in the storage of goods. Article 8 regulates the ownership and transfer of investment securities. Finally, Article 9 provides for the creation and protection of security interests in personal property.

Unlike the Restatements, which have only persuasive weight, the UCC is a statute, having the force of law. It is important to remember, however, that in each state the "law" is not the official text of the Code promulgated by the ALI and the National Conference of Commissioners, but that state's own enacted version of the Official Code. Most states have made nonuniform changes in certain provisions of the Official Text. See U.C.C. Rep. Serv., State U.C.C. Variations.

Each section of the Official Text of the Code is followed by an Official Comment, which includes reference to prior law, discussion of the purposes of the section, and definitional cross references. What weight should be given to the discussion in the official comments? Since the state legislatures have not enacted the comments, they do not have the force of law. Do they have at least the persuasive status of "legislative history"? Two well-known commentators on the Code have made the following observations:

> Certainly the comments are not entitled to as much weight as ordinary legislative history. In some states the comments were not placed before the enacting body prior to adoption of the Code. Indeed, some of the present comments were not even in existence at the time the section to which they are now appended was adopted. Furthermore, much of the Code is highly technical "lawyer's" law. If the average legislator who voted to enact the Code in a given state did not understand the intricacies of Article Four or Article Nine at the time of enactment, it is likely that he did not grasp the relevant comments either.

James J. White & Robert S. Summers, Uniform Commercial Code 14 (5th ed. 2000). Nonetheless, court opinions frequently have given the comments substantial weight. Indeed, White and Summers suggest that the courts have taken to use of the comments "like ducks to water." Id. at 13. See, e.g., Carlund Corp. v. Crown Center Redevelopment, 849 S.W.2d 647, 650 (Mo. Ct. App. 1993); B & W Glass, Inc. v. Weather Shield Mfg., Inc., 829 P.2d 809, 816 (Wyo. 1992) (comments treated as persuasive authority).

This part of the Supplement includes the text of a number of sections from Article 2 of the Code, along with a few provisions from Articles 1, 3, and 9. Official Comments for the most significant sections are included as well. The editors are grateful to

the Permanent Editorial Board for the Uniform Commercial Code for permission to reprint this material. — Copyright various dates by the American Law Institute and the National Conference of Commissioners on Uniform State Laws.

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# ARTICLE 1. GENERAL PROVISIONS

## *Part 1. Short Title, Construction, Application and Subject Matter of the Act*

### §1-102. Purposes; Rules of Construction; Variation by Agreement

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.

(2) Underlying purposes and policies of this Act are

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

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

(c) 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.

### §1-103. Supplementary General Principles of Law Applicable

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.

### §1-105. Territorial Application of the Act; Parties' Power to Choose Applicable Law

(1) Except as provided hereafter 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. Failing such agreement this Act applies to transactions bearing an appropriate relation to this state.

(2) . . .

### §1-106. Remedies to Be Liberally Administered

(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.

### §1-107. Waiver or Renunciation of Claim or Right After Breach

Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.

## *Part 2. General Definitions and Principles of Interpretation*

### §1-201. General Definitions

Subject to additional definitions contained in the subsequent Articles of this Act which are applicable to specific Articles 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 in which rights are determined.

(2) "Aggrieved party" means a party entitled to resort to a remedy.

(3) "Agreement" means 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 as provided in this Act (Sections 1-205 and 2-208). Whether an agreement has legal consequences is determined by the provisions of this Act, if applicable; otherwise by the law of contracts (Section 1-103). (Compare "Contract.")

(4) "Bank" means any person engaged in the business of banking.

(5) "Bearer" means the person in possession of an instrument, document of title, or certificated security 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 of fact that the existence of the fact is more probable than its non-existence.

(9) "Buyer in ordinary course of business" means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the