# *Rules of*
# CONTRACT LAW

*Selections from the Uniform Commercial Code, the Convention on Contracts for the International Sale of Goods, and the Restatement (Second) of Contracts*

with Material on Contract Drafting and Sample Examination Questions and Answers

**Charles L. Knapp**
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# The 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 prob-

1. Matters covered in this Note are explored more fully in the following works: Robert Braucher & Robert A. Riegert, Introduction to Commercial Transactions 19-31 (1977); James J. White & Robert S. Summers, Uniform Commercial Code 1-6 (3d ed. 1988); and Nathan M. Crystal, Codification and the Rise of the Restatement Movement, 54 Wash. L. Rev. 239 (1979).

lems 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.

Robert Braucher & Robert A. 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. Revised Official Texts of the Code were published in 1962, 1972, 1978, and 1990. The current official version is the 1990 text.

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. The Code is divided into 13 articles, the last two of which deal with effective date, repealers, and transition from prior law. Article 1 covers a number of general matters; it includes a section containing definitions that apply throughout the Code. UCC §1-201. Article 2, which is the principal part of the Code addressed in most contracts courses, deals with transactions involving the sale of goods. The sales article has remained largely unchanged since the 1962 version of the Code, but preliminary work is now underway for what promises to be a major revision of Article 2. Article 2A deals with various aspects of leases of personal property, including formation of lease contracts, performance, and default. "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. 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. To take one example, the South Carolina legislature has enacted nonuniform versions of UCC §§2-316 (disclaimers of warranties) and 2-318 (privity of contract).

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 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 13-14 (3d ed. 1988). 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 12.

This 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. Text and comments are taken from the 1990 Official Text. The editors are grateful to the Permanent Editorial Board for the Uniform Commercial Code for permission to reprint this material. (UCC Comments) — Copyright 1991 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 who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(10) "Conspicuous": A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: NON-NEGOTIABLE BILL OF LADING) is conspicuous. Language in the body of a form is "conspicuous" if it is in larger or other contrasting type or color. 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) "Contract" means the total legal obligation which results from the parties' agreement as affected by this Act and any other applicable rules of law. (Compare "Agreement.")

(12) "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) "Defendant" includes a person in the position of defendant in a cross-action or counterclaim.

(14) "Delivery" with respect to instruments, documents of title, chattel paper, or certificated securities means voluntary transfer of possession.

(15) "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) "Fault" means wrongful act, omission or breach.

(17) "Fungible" with respect to goods or securities means goods or securities of which any unit is, by nature or usage of trade, the equivalent of any other like unit. 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.

(18) "Genuine" means free of forgery or counterfeiting.

(19) "Good faith" means honesty in fact in the conduct or transaction concerned.

(20) "Holder," with respect to a negotiable instrument, means the person in possession if the instrument is payable to bearer or, in the case of an instrument payable to an identified person, if the identified person is in possession. "Holder" with respect to a document of title means the person in possession if the goods are deliverable 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" includes any assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved.

(23) A person is "insolvent" who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law.

(24) "Money" means a medium of exchange authorized or adopted by a domestic or foreign government and includes a monetary unit of account

established by an intergovernmental organization or by agreement between two or more nations.

(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.

(29) "Party," as distinct from "third party," means a person who has engaged in a transaction or made an agreement within this Act.

(30) "Person" includes an individual or an organization (See Section 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 non-existence.

(32) "Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property.

(33) "Purchaser" means a person who takes by purchase.

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

(35) "Representative" includes 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) "Rights" includes remedies.

(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 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 Article 9. The special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 2-401 is not a "security interest," but a buyer may also acquire a "security interest" by complying with Article 9. Unless a consignment is intended as security, reservation of title thereunder is not a "security interest" but a consignment in any event is subject to the provisions on consignment sales (Section 2-326).

Whether a transaction creates a lease or security is to be determined by the facts of each case. [Detailed provisions on when a lease amounts to a security interest have been omitted.]

(38) "Send" in connection with any writing or notice means 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.

(39) "Signed" includes any symbol executed or adopted by a party with present intention to authenticate a writing.

(40) "Surety" includes guarantor.

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

(42) "Term" means that portion of an agreement which relates to a particular matter.

(43) "Unauthorized" signature means one made without actual, implied or apparent authority and includes a forgery.

(44) "Value." Except as otherwise provided with respect to negotiable instruments and bank collections (Sections 3-303, 4-208 and 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 chargeback is provided for in the event of difficulties in collection; or

(b) as security for or in total or partial satisfaction of a pre-existing claim; or