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The Uniform Commercial Code Survey: Introduction

By Stephen L. Sepinuck, Robyn L. Meadows, and Russell A. Hakes*

Well, the gloves are off in the revised Article 2 arena and it appears as if the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) has taken the first shot. Efforts to test the opposition to revised Article 2 by targeting enactment in a few key states has left NCCUSL with a bit of a black eye. In Kansas, the bill was referred to the state bar for comment and no action was taken. In Nevada, the bill died in committee after a single hearing in which both industry representatives and at least one academic strongly criticized it.

The revisions to Article 7 have fared better. They did not receive final approval from NCCUSL and the American Law Institute until the summer 2003 but have already been enacted in fifteen states.¹

By far the most interesting legislative developments, though, concern revised Article 1. As of this writing, fourteen states and one territory have enacted it.² Of those, only the U.S. Virgin Islands has enacted the new and controversial choice-of-law rules in section 1-301. Thus, we appear to be headed for substantial uniformity on this point, just not one based on the official text. There will be no uniformity on the second-most controversial issue, however. The enacting jurisdictions have divided on the heightened standard of “good faith.” Five have retained the current Article 1 subjective standard of “honesty in fact.”³ The other

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1. Alabama, Connecticut, Delaware, Hawaii, Idaho, Maryland, Minnesota, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, Texas, and Virginia.

2. Those jurisdictions are Alabama, Arkansas, Connecticut, Delaware, Hawaii, Idaho, Minnesota, Montana, Nebraska, Nevada, New Mexico, Oklahoma, Texas, Virginia, and the U.S. Virgin Islands. See ALA. CODE §§ 7-1-101 to -310 (Supp. 2004); 2005 Ark. Acts 856; 2005 Conn. Legis. Serv. 05-109 (West); DEL. CODE ANN. tit. 6, §§ 1-101 to -310 (Supp. 2004); HAW. REV. STAT. §§ 490:1-101 to -310 (Supp. 2004); IDAHO CODE §§ 28-1-101 to -310 (Supp. 2004); MINN. STAT. ANN. §§ 336.1-101 to -310 (Supp. 2005); 2005 Mont. Laws ch. 575; 2005 Neb. Laws L.B. 570; 2005 Nev. Stat. ch. 233; 2005 N.M. Laws ch. 144; 2005 Okla. Sess. Laws ch. 139; TEX. BUS. & COM. CODE ANN. §§ 1.101 to 1.310 (Vernon Supp. 2004-05); VA. CODE §§ 8.1A-101 to -310 (Supp. 2004); 11A VI. CODE ANN. §§ 1-101 to 1-310 (2002).

3. Alabama, Hawaii, Idaho, Nebraska, and Virginia have all chosen to retain current law on good faith, leaving the standard purely subjective in Article 1, see U.C.C. § 1-201(19) (2000), and bifurcated in Articles 2 and 2A, see U.C.C. §§ 2-103(1)(b); 2A-103(3) (2002).

ten have added to it the objective requirement of “reasonable commercial standards of fair dealing.”⁴

The conventional wisdom is that the change to “good faith” in Article 1 does not matter much because Article 2 has always required reasonable commercial standards of fair dealing for merchants⁵ and the widely enacted revisions to Articles 3, 4, 4A, 8, and 9 have already enhanced the definition of “good faith” in those articles in this manner.⁶ Thus, so the argument goes, the change is relevant merely to the duties of non-merchants under Article 2. However, the conventional wisdom may be wrong. Of the prior revisions, only the one to Article 8 expressly made the heightened standard applicable to the general duty of good faith imposed by Article 1 (in connection with Article 8 transactions). The revisions to Article 9 attempted to do this by comment,⁷ but technically the definition there—as well as in Articles 3, 4 and 4A—applies only to the phrase “good faith” when used in the text of that article.⁸ Thus, a strict reading of the Code in those states which have not enacted the proposed change in the Article 1 revisions would indicate that the standard of mere honesty in fact applies to most contractual and legal duties arising in transactions governed by Articles 3, 4, 4A and 9. Comment 20 to revised section 1-201 initially supported this interpretation. In discussing the significance of the change to the higher standard, it noted that the Article 2 standard for merchants does “not define ‘good faith’ for its most important use—the obligation of good faith imposed by former Section 1-203.” Earlier this year, perhaps fearing the interpretation suggested here, the Permanent Editorial Board surreptitiously excised this language from the comment.⁹

The significance of all this can easily be illustrated with an example. Assume Debtor borrowed \$10,000 from Lender, and in return gave Lender a promissory note for the amount due, in installments, and a security interest in equipment to secure the obligation. The note and security agreement impose numerous duties on Debtor and make Debtor’s failure to satisfy any one of them a default. Upon such a default, Lender has the right, at its option, to accelerate the debt. Some time later, Debtor fails to fulfill one of its duties. Say, for example, it is required to provide Lender with proof that the collateral is insured. Debtor in fact has the insurance, but failed to send proof of it to Lender by the required date.

Under a strict reading of the Code, and prior to enactment of the revisions to Article 1, Lender may accelerate the debt and foreclose on the collateral—all

4. Arkansas, Connecticut, Delaware, Montana, Minnesota, Nevada, New Mexico, Oklahoma, Texas and the Virgin Islands all accepted the heightened standard of good faith in revised U.C.C. § 1-201(b)(20) (2001).

5. See U.C.C. § 2-103(1)(b) (2001).

6. See U.C.C. §§ 3-103, 4-104(c), 4A-105(a)(6), 8-102(a)(10), 9-102(a)(43) (2001).

7. See revised U.C.C. § 9-102 cmt. 19 (2001) (indicating that the enhanced definition is intended to apply to the general duty of good faith imposed by Article 1 in connection with any Article 9 transaction). See also U.C.C. §§ 9-620 cmt. 11; 9-625 cmt. 2 (both applying that point to a specific context).

8. Article 9 uses the phrase “good faith” in sections 9-321(a), 9-330(a)(1), 9-330(b), 9-330(d), 9-403(b), 9-405(a), 9-615(g), and 9-617(b). Article 3 uses it most notably in section 3-302 (defining a “holder in due course”).

9. See U.C.C. § 1-201 cmt. 19 (2005).

without advance notice to Debtor or any inquiry about whether the required insurance is in place—regardless if whether doing so would be consistent with reasonable commercial standards of fair dealing. The heightened standard of good faith in Articles 3 and 9 does not apply to its right to accelerate or to its right to foreclose.¹⁰ Thus, Lender is free to base its decision on whether the loan were still advantageous under current market conditions or even on whether it had immediate need of the money. Absent some common-law duty or contractual restriction on its rights,¹¹ Lender has no duty to act fairly unless and until the relevant jurisdiction enacts the heightened standard of good faith in revised Article 1.

Of course, with states going in different directions on the good faith front, it may be that resolution of any particular question about good faith depends on the parties' choice of law and whatever limits on their freedom to make such a choice the forum state enacts in its version of section 1-301. Stay tuned; it should be entertaining.

In the pages that follow, you will find some further discussion of good faith. In addition, there are reports on an unusually high number of significant cases interpreting Article 2, some conflicting Article 9 cases on what happens if a temporary perfection period expires after the debtor files a bankruptcy petition, and some important regulatory developments on Check 21, which essentially created a whole new category of negotiable instruments.

10. The heightened standard in old section 1-208 and revised section 1-309—which requires a good faith belief that the prospect for payment or performance is impaired—does not apply to defaults such as this one. It applies only when the creditor is acting pursuant to a clause in its agreement authorizing it to accelerate “at will” or whenever it deems itself “insecure.”

11. These might include some common-law duty of fair dealing that supplements the Code, a usage of trade that supplements and colors the parties' agreement, or principles of tort law. *Cf.* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) (imposing a duty of good faith and fair dealing in the performance and enforcement of every contract).