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Basic Uniform Commercial Code: Teaching Materials

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BASIC UNIFORM COMMERCIAL CODE

TEACHING MATERIALS

Third Edition

By

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AMERICAN CASEBOOK SERIES



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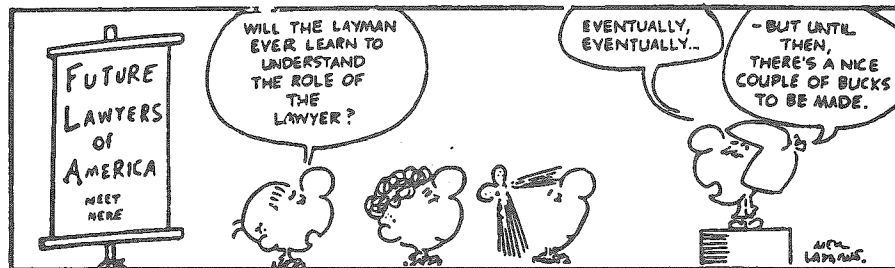
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Preface

• MISS PEACH by Mel Lazarus



A number of students end their first year of law school asking "Will law students ever learn to understand the role of the Uniform Commercial Code?" Like Marcia in Miss Peach, we believe that the answer is "eventually, eventually." We further believe that "there's a nice couple of bucks to be made" by writing a book that facilitates this understanding. Hopefully, Basic Uniform Commercial Code Teaching Materials will be such a book.

These materials cover extensions of credit secured by a lien on personal property, sales of goods, commercial paper, credit cards, electronic funds transfer systems, and letters of credit. Some aspects of these subjects are regulated by federal statutes; some aspects are covered only by judicial decisions. Notwithstanding the important body of federal law and common law, the Uniform Commercial Code dominates this book. And, if you are not careful, the Uniform Commercial Code will dominate you. Watch your tokus.

DAVID G. EPSTEIN
WILLIAM H. HENNING
STEVE H. NICKLES

January, 1988

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Chapter 1

INTRODUCTION TO THE UNIFORM COMMERCIAL CODE

A. HISTORY

Legislatures in every state except Louisiana have enacted the Uniform Commercial Code, and the Louisiana legislature has enacted all of the Code except Articles 2, 6, and 9. The UCC is the most widely adopted uniform law.

The UCC was a joint project of the National Conference of Commissioners on Uniform State Laws* and the American Law Institute.** The UCC was not the Commissioners' first commercial law project. From 1896 to 1933, the National Conference of Commissioners on Uniform State Laws drafted and recommended for adoption a number of commercial laws including the Uniform Negotiable Instruments Law (NIL), the Uniform Sales Act, and the Uniform Conditional Sales Act. While the NIL was adopted by all states, only 34 states adopted the Uniform Sales Act and only 10 states adopted the Uniform Conditional Sales Act.

Work was begun on the UCC in 1945. William Schnader, a Philadelphia lawyer and President of the National Conference of Commissioners on Uniform State Laws, describes the drafting process as follows:

"The drafting organization was such as to require any proposed provision of the Code to run the gauntlet of several expert bodies

* The National Conference of Commissioners on Uniform State Laws was organized in 1892 to promote uniformity in law, particularly in commercial transactions, through voluntary state action. Each state has at least three Commissioners. The Commissioners are appointed by state officials, usually the governor. The Commissioners meet once a year; each state votes as a unit on each proposal. The work of the Conference is financed primarily by the proportional assessment paid by

each state. See generally Dunham, A History of the National Conference of Commissioners on Uniform State Laws, 30 Law & Contemp.Prob. 233 (1965).

** The American Law Institute was formed in 1923 for the purpose of preparing Restatements of the common law. See generally H. Goodrich & P. Wolkin, The Story of the American Law Institute (1961).

before it could be brought before the Institute and the Conference for consideration and final approval.

"At the top of the drafting organization chart was an Editorial Board consisting of Judge Herbert F. Goodrich of the Third Circuit Court of Appeals and Director of the Institute and two representatives apiece from the Conference and the Institute. Next was a Chief Reporter whose duties were essentially those of the Editor-in-Chief of the Code. There was also an Assistant Chief Reporter. Then came Reporters, one for each Article of the Code. Each Reporter was required to submit his work to a group of advisers before it could go further. If the advisers were satisfied, then the draft could be presented to the Council of the Institute and either to the Commercial Acts Section of the Conference or to the Property Acts Section, as might be appropriate. Each of these bodies considered each draft in detail, often made amendments and sometimes recommitted the draft to the Reporter and his advisers for further study and revision.

"There was no difficulty in finding a 'Chief Reporter'. The outstanding man in the United States to undertake this task was Professor Karl N. Llewellyn of the Columbia University Law School. Not only was Professor Llewellyn a student of commercial law as it appeared in the law books, but he was the type of law professor who was never satisfied unless he knew exactly how commercial transactions were carried on in the market place. He insisted that the provisions of the Code should be drafted from the standpoint of what actually takes place from day to day in the commercial world rather than from the standpoint of what appeared in statutes and decisions.

"Let me state here that the consideration of the provisions of the Code by the Council of the Institute, by the Commercial Acts Section and the Property Acts Section of the Conference, and by the Annual Meetings of both bodies was by no means a perfunctory matter. There were vigorous debates and differences of opinion on the Code's many provisions, all of which had to be settled by majority vote when they came before the two sponsoring bodies for final adoption.

"I can also state that what Professor Llewellyn believed should be the articles of an ideal commercial code were not the articles as they emerged from the crucible of debate when the Code was promulgated."

Schnader, *A Short History of the Preparation and Enactment of the Uniform Commercial Code*, 22 U.Miami L.Rev. 1 (1967).*

A final text of the UCC was completed in 1951; an official edition of the Code with explanatory comments was published as the 1952 Official Text. Pennsylvania was the only state to adopt this version of the Code. The New York State Law Revision Commission studied the 1952 Official Text from 1953-56 and issued a lengthy report recommending that New York not adopt the 1952 Official Text of the UCC. This report resulted in a revised version of the Code which was

* In editing cases and excerpts from books and articles, we have regularly and without indication omitted citations and

footnotes. We have retained the numbering from the original text for those footnotes that we have reproduced.

published as the 1958 Official Text. The UCC was again revised in 1962. By 1967, every state except Louisiana had enacted the 1962 Official Text of the Uniform Commercial Code. In 1972, Article 9 of the UCC was substantially revised. Most states have now adopted the 1972 amendments to Article 9. Article 8 on investment securities was revised substantially in 1977, primarily to deal with uncertificated securities. A new Article 2A dealing with leases was promulgated in 1987. And, Articles 3 and 4, covering negotiable instruments and bank deposits and collections, are presently under review.

Notes

1. Karl Llewellyn, Chief Reporter for the Uniform Commercial Code, was not only a leading commercial law expert but also a leading legal realist. Professor Gilmore described Llewellyn's legal philosophy as follows:

"Karl's version of realism was affirmative, not negative, a labor of love and not of hate. He had a life-long love for the process and craft of judging, to which his last book bears eloquent witness. Appropriately, the title of that book repeats a phrase which we may take as a key to much of his work: *The Common Law Tradition*. Revolutionary as his early writings were thought to be, Karl abhorred abrupt departures, sudden breaks and the revealed certainty of novel illumination. He was a man of tradition, of continuity, of ordered growth and gradual change.

"There may appear to be an element of paradox in my insistence on Karl's dislike of system-building, on his preference for the particular over the general, on his fascination with judge-made law. Over many years his energies were devoted to the drafting of statutes; this aspect of his work culminated in the fifteen-year ordeal of drafting the Commercial Code. Make no mistake: this Code was Llewellyn's Code; there is not a section, there is hardly a line, which does not bear his stamp and impress; from beginning to end he inspired, directed and controlled it. The statute-man, one assumes, must be, as I have said Karl was not, a system-builder, a generalizer, a despiser of the fumbling approximations of case law.

"It was, I believe, Karl's non-systematic, particularizing cast of mind and his case-law orientation which gave to the statutes he drafted, and particularly to the Code, their profound originality. He was a remarkable draftsman and took a never-failing interest in even the minutiae of the trade. His instinct appeared to be to draft in a loose, open-ended style; his preferred solutions turned on questions of fact (reasonableness, good faith, usage of trade) rather than on rules of law. He had clearly in mind the idea of a case-law Code: one that would furnish guide-lines for a fresh start, would accommodate itself to changing circumstances, would not so much contain the law as free it for a new growth. The tastes of the practicing lawyers who advised the draftsmen were, in most cases, opposed to the flexible ideas of the Chief Reporter: they preferred, they insisted on, a tightly-drawn stat-

ute, precise, detailed and rigid. Among the many drafts of the Code which appeared, beginning in 1946, the early drafts were in many ways closer to Karl's conception of the Code than were the final drafts. In the concluding phase of the drafting, concessions were inevitably made to what might be called political pressures: I do not mean to suggest that these pressures were in any sense evil or malevolent. I have come to feel that Karl saw more clearly than his critics and that the Code as he initially conceived it might better have served the purposes of the next fifty years. Yet Karl never lost sight of the fact that his job was to produce, not the best Code which could ideally be put together by a band of scholarly angels, but the best Code which stood a chance of passage in the imperfect world of men. He cheerfully gave ground when he had to: the final product was indubitably his and will remain an enduring tribute to his memory."

See Gilmore, In Memoriam: Karl Llewellyn, 71 Yale L.J. 813 (1962); see generally W. Twining, Karl Llewellyn and the Realist Movement (1973).

2. Llewellyn prepared the following description of commercial law practice for lawyers returning from World War II:

"The law" of commercial transactions divides for the practicing lawyer into three rough groupings of material which he must view and use in sharply distinct ways * * *.

There is first the body of rules of law which one may call counsellor's rules or rules seen from the angle of the counsellor. These have to do with the shaping of a transaction while it is still capable of being shaped, and they run in terms of the degree of safety with which one can rely on the courts to act in particular predictable fashion if this particular transaction in hand should come to be presented to them.

For the counsellor has found that there are some solid, settled, clear rules on which he can build; they are safe, they are bedrock. But there are not as many of them as one might wish. * * * Rules of law from a counsellor's angle set themselves up according to the degree of solidity and reliability which they offer as foundation and tools for building, or else according to the nature and degree of the danger which they offer of producing an upset or other undesired result.

The second grouping of material is the body of rules of law seen from the angle not of a counsellor to whom the transaction has come early enough for him to shape the facts, but from the angle of an advocate to whom the transaction is brought only after the trouble has occurred. Bedrock law, so far as any of it is applicable, of course becomes important to such an advocate as setting the legal framework and pattern on and with the help of which he arranges the facts; in so far, the advocate views it much as does the counsellor. But that vast range of law which is not so clear or not so settled, of rules whose application is uneven, of "trends" in decision, of rules which courts commonly recite only to find a way around them if their direct application appears unfortunate—that vast range is to the advocate not merely an area of risk, as it is to the counsellor; it is also to the advocate an area of opportunity: he may be able to win his case with

the help of one or more of these available though far from wholly reliable rules. The advocate sees such rules not merely as threatening "chanciness", but also as offering chances; not chances in general and in the abstract, but chances in terms of what *he* can manage to do with them in this particular case in the particular available courts and, perhaps, against a particular known adversary. The advocate has his own single and utterly concrete case in hand; the counsellor has a concrete situation, but it is one which he must commonly view as affected by the hazard of bad advocacy in future litigation on a similar point which may result in a rule of law that can upset his transaction retroactively.

The third grouping of material for the lawyer who meets commercial transactions would appear to many not to involve "law" at all. It consists of the bodies of practical problems which present themselves for solution in counselling, and of the lines of practical technique which are being worked out for solution of those problems: it consists of the background, purposes, nature, legal techniques, of the commercial transactions themselves.

Llewellyn, *The Modern Approach to Counselling and Advocacy—Especially in Commercial Transactions*, 46 *Colum.L.Rev.* 167-170 (1946).

B. NATURE OF THE UNIFORM COMMERCIAL CODE

What is the nature of the Uniform Commercial Code? It is not "uniform." States have adopted numerous local variations. Similarly, the Uniform Commercial Code is not purely "commercial." For example, Article 2 of the UCC would apply to Johnny Mack Brown buying a new suit at the Alexander Julian Shop. Is the Uniform Commercial Code at least a true "code"?

What is a "code"? As Professor Gilmore points out, not all statutes are codes.

"Code" is often used as a loose synonym for 'Statute': when the legislature passes a statute which regulates an area previously left to the decisional law, lawyers are apt to say that the area has been 'codified.' I think that we can make a better use of the two terms: A 'statute,' let us say, is a legislative enactment which goes as far as it goes and no further: that is to say, when a case arises which is not within the precise statutory language, which reveals a gap in the statutory scheme or a situation not foreseen by the draftsmen (even though the situation is within the general area covered by the statute), then the court should put the statute out of mind and reason its way to decision according to the basic principles of the common law. A 'code,' let us say, is a legislative enactment which entirely pre-empts the field and which is assumed to carry within it the answers to all possible questions: thus when a court comes to a gap or an unforeseen situation, its duty is to find, by extrapolation and analogy, a solution consistent with the policy of the codifying law; the pre-Code common

law is no longer available as an authoritative source. We may take another, subsidiary distinction between 'statute' and 'code.' When a 'statute,' having been in force for a time, has been interpreted in a series of judicial opinions, those opinions themselves become part of the statutory complex: the meaning of the statute must now be sought not merely in the statutory text but in the statute plus the cases that have been decided under it. A 'code,' on the other hand, remains at all times its own best evidence of what it means: cases decided under it may be interesting, persuasive, cogent, but each new case must be referred for decision to the undefiled code text."

Gilmore, *Legal Realism: Its Cause and Cure*, 70 *Yale L.J.* 1037, 1042-43 (1961).

Please keep this definition of a "code" in mind while reading the cases in this book and consider whether courts are treating the UCC like a "code."

Questions

1. What does Professor Gilmore mean by the phrase "case-law Code" in note 1 on p. 3?
2. Did the authors of the UCC intend for it to be a "Code"? Are sections 1-102, 1-103 and 1-104 helpful in answering this question?
3. Who cares if the UCC is a case law code, true code or no code at all? Isn't this just one of those questions of interest to law professors and no one else? See generally Hillman, McDonnell & Nickles, *Common Law and Equity Under the Uniform Commercial Code* (1984).

C. WORKING WITH THE UNIFORM COMMERCIAL CODE

Whether or not the Uniform Commercial Code is a "true code," it is a true statute. It is the first place to look for answers; its answers control. The preceding sentence raises two problems: (1) how do you find "answers" in the Uniform Commercial Code and (2) how do you understand the "answers" you find?

If there is a "secret trick" to finding answers in the Uniform Commercial Code, it's still secret. We don't know any magic words or phrases—any easy way to find relevant provisions of the Code. We do know that students seem to get the knack of finding answers in the UCC as a result of having to use it again and again.

Of course, finding the relevant Code provision is, at best, only half the battle. It is still necessary to interpret the Code provision and apply it to the particular problem. The next two pages deal with tools of interpretation of the UCC. The remainder of the book deals with problems of application.

1. DEFINITIONS

Because "debtor" can include people who are not indebted (9-105(1)(d)) and "farm products" can include gasoline (9-109(3)), the first step in interpreting or construing a Code provision is defining the key terms.

There are a number of places in the Code to check for such definitions. Section 1-201 contains 46 definitions; section 1-201 is applicable to every article of the Code. Additionally, each article contains definitions of terms for purposes of that article; such definitional provisions usually are near the beginning of the article. E.g., sections 2-103; 3-102; 4-104; 5-103; 6-102. Finally, there are definitional cross references at the end of the "Official Comment" to each section. Please do not depend on these citations as exhaustive. For example, section 2-316, dealing with exclusion or modification of warranties provides that any written disclaimer of an implied warranty of merchantability must, inter alia, be "conspicuous." The definitional cross references neglect to indicate that "conspicuous" is defined in section 1-201.

Notwithstanding all of the above places to check for definitions, many key UCC terms are defined nowhere in the Code. For example, article 6 of the Code applies to "bulk transfers" as that term is defined in section 6-102. Section 6-102 speaks of transfer of a "major part" of inventory. "Major part" is nowhere defined. More than 50%? If so, more than 50% of what? Market value? Quantity?

2. COMMENTS

Law students, lawyers, and *judges* naturally look to the "Official Comments" for assistance in interpreting and construing Code provision. The comments are generally easier to read than the Code section, contain examples, and are "official." Why wrestle with the language of the Code when the language of the official comments is so much clearer?

It should first be noted that the label "*official* comments" is something of a misnomer. The comments were not drafted by or enacted by any legislative body. Rather, the comments were written by the committees that proposed the UCC. Second, the comments do not completely coincide with the Code. As noted, by Professor Skilton in the leading article on the role of the comments, "Some comments obviously, some comments subtly, add to or take away from the text. It is often hard to determine the point at which 'explanation' begins to take over the work that should be done by the text." Skilton, *Some Comments on the Comments to the Uniform Commercial Code, 1966 Wisc.L.Rev.* 597, 631.

The purpose of the preceding paragraph is not to convince you to abstain from using the comments. Use of the comments will not cause insanity, or even pimples. The most popular student text on the UCC describes the comments as "by far the most useful aids to interpretation and construction." J. White and R. Summers, *Handbook of the*

Law on the Uniform Commercial Code 12 (2d ed. 1980).^{*} Professor Skilton's article concludes:

"Study of the comments is indispensable to a knowledge of the Code. The writer acknowledges a great debt to the comments. Many times they have given him insight into the meaning of a section. Their presence is comforting—the points they treat and the cross references which follow reinforce understanding. Perhaps the most difficult question of all confronting one who seeks answers under the Uniform Commercial Code is: have I hit upon all provisions of the Code which relate to the question at issue, and have I properly evaluated all of them? It would be false and dangerous to assume that the comments (and the cross references) can furnish a complete check list. But they help if used with care. As aids toward understanding and uniform application of the Code, courts^{**} may be expected to pay very serious attention to what the comments have to say."

3. CASES

In interpreting and construing the Uniform Commercial Code, courts regularly cite and rely on earlier reported cases. Since the Uniform Commercial Code is a uniform law (with variations from state to state), precedent in one state can be very persuasive in another state. Section 1-102(2)(c) provides "Underlying purposes and policies of the Act are * * * to make uniform the law among the various jurisdictions." The best collection of Uniform Commercial Code cases is the Uniform Commercial Code Reporting Service which is indexed by Code section number.

^{*} The White and Summers hornbook is the UCC text judges cite most often. It is probably also the UCC text that commercial law casebook authors cite most often. It is certainly the secondary source that we have cited most often. We will generally

refer to the book as simply "White & Summers 2d ed."

^{**} [For example, *In re Yale Express System, Inc.*, 370 F.2d 433, 437 (2d Cir.1966) states that the Comments are "powerful dicta."]]