HB

67

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: HB 67
PUBLISH DATE: HOUSE 1/9/89

FISCAL NOTE

REQUEST:

Revision Date:
Title: An Act relating to leases of personal property under the Uniform Commercial Code
Sponsor: Rules Committee
Requestor: Governor

Agency Affected: Commerce & Econ. Dev.
BRU: Banking, Securities & Corporations
Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Prepared by: Willis F. Kirkpatrick, Director
Division: Banking, Securities & Corporations
Phone: 465-2521
Date: 12-23-88

Approved by Commissioner:
Agency: Commerce and Economic Development
Date: 12/23/88

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

2830D/101788a

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: HB 67
PUBLISH DATE: HOUSE 1/9/89

FISCAL NOTE

REQUEST:

Revision Date: _____
Title: "An Act relating to leases of personal property under the Uniform Commercial Code."
Sponsor: Rules Committee
Requestor: Governor

Agency Affected: Department of Law
BRU: Legal Services

Components: Operations

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND	-0-	-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME	-0-	-0-	-0-	-0-	-0-	-0-
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Please see the attached analysis.

Richard L. Pegues

Prepared by: Richard L. Pegues, Director
Phone: 465-3672
Division: Administrative Services
Date: October 21, 1988

Richard L. Pegues /FOR/

Approved by Commissioner: Grace Berg Schaible, Attorney General
Date: October 21, 1988
Agency: Department of Law

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

Fiscal Note Analysis

This bill, which has been recommended by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Legal Institute (ALI), adds an entire new chapter to the state's Uniform Commercial Code contained in Title 45, dealing with personal property leasing.

Changes in leasing transactions in recent years have made it clear that modernization is long overdue. Leasing personal property has become a major business in this country covering an extremely wide range of kinds of property and raising numerous legal issues. States now depend on the common law to resolve disputes over lease contracts. This creates great uncertainty, particularly for companies that conduct business in more than one state, because case law conflicts from state to state. Additionally, some important issues have never been adequately addressed in the common law, and this bill is intended to answer these immediate needs.

This proposed bill provides for the fundamentals of the leasing contract including the formation of the contract, provisions for express and implied warranties, and damages for breach of a leasing contract. This framework of remedies for lessors and lessees is currently absent from the state s UCC.

Most of the transactions contemplated by this bill involve commercial transactions between private parties. Consequently, a fiscal impact on the Department of Law is not anticipated. The state's UCC does supplement the state's Procurement Act in Title 36. To the extent that the bill's provisions serve their intended purpose, to clarify personal property leasing rights, state procurement disputes involving such leases should be resolved more easily.

No. 3

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: HB 67
PUBLISH DATE: HOUSE 1/9/89

FISCAL NOTE

REQUEST:

Revision Date:
Title: Leases of Personal Property under the Uniform Commercial Code
Sponsor: Rules
Requestor: Governor

Agency Affected: Department of Revenue
BRU: Treasury
Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	C	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

Prepared By: Milt Barker MB
Phone: 465-2350
Division: Treasury
Date: December 29, 1988

Approved by Commissioner: Hugh Malone Roger Wilbur for
Date: December 29, 1988
Agency: Department of Revenue

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: HB 67 No. 4
PUBLISH DATE: HOUSE 1/9/89

FISCAL NOTE

OC

REQUEST:

Revision Date: _____
Title: Leasing under UCC

Sponsor: Rules Committee
Requestor: Governor Cowper

Agency Affected: Natural Resources
BRU: Management and Administration

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-
CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	-0-	-0-	-0-	-0-	-0	-0-

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

This bill does not affect the Deaprtment of Natural Resources.

Prepared by: Carol Wilson
Phone: 465-2400
Division: Commissioner's Office
Date: 11/28/88

Approved by Commissioner: Dennie Gorsuch
Date: 11-28-88
Agency: Natural Resources

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

STEVE COWPER, GOVERNOR

REPLY TO:

☐ *1031 W 4th AVENUE*
SUITE 200
ANCHORAGE, ALASKA 99501-1994
PHONE: (907) 276-3550

☐ *1st NATIONAL CENTER*
100 CUSHMAN ST.
SUITE 400
FAIRBANKS, ALASKA 99701-4679

☑ *P.O. BOX K—STATE CAPITOL*
JUNEAU, ALASKA 99811-0300
PHONE: (907) 465-3600

April 12, 1989

Honorable Dave Donley, Chair
House Labor and Commerce Committee
Alaska State Legislature
P.O. Box V
Juneau, Alaska 99811

Re: Amendment of HB 67 (UCC, leasing of personal property)
Our file: 773-89-0061

Dear Representative Donley:

Continuing review of this bill has brought to light the advisability of amending proposed AS 45.12.104, regarding leases subject to other statutes. To assure that there is no conflict between the provisions of this bill and the provisions of the State Procurement Code (AS 36.30), we have prepared the attached amendment. It makes the procurement code control.

We urge your committee to adopt this amendment and favorably report out HB 67. Thank you.

Yours truly,

DOUGLAS B. BAILY
ATTORNEY GENERAL

By: Art Peterson
Arthur H. Peterson
Assistant Attorney General

AHP:cb

Enclosure

cc w/encl: Robert A. Evans
Legislative Liaison
Office of the Governor

Bob Link, Director
Div. of General Services & Supply
Department of Administration

James L. Baldwin
Assistant Attorney General
Juneau

A M E N D M E N T

OFFERED IN THE HOUSE BY _____

TO: HB 67

Page 10, line 29:

Delete the "or."

Page 11, line 1:

Change the period to a semi-colon, and add "or."

Page 11, between lines 1 and 2:

Insert "(5) provision of the State Procurement Code (AS 36.30)."

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

STEVE COWPER, GOVERNOR

REPLY TO:

☐ *1031 W 4th AVENUE*
SUITE 200
ANCHORAGE, ALASKA 99501-1994
PHONE: (907) 276-3550

☐ *1st NATIONAL CENTER*
100 CUSHMAN ST.
SUITE 400
FAIRBANKS, ALASKA 99701-4679

☒ *P.O. BOX K—STATE CAPITOL*
JUNEAU, ALASKA 99811-0300
PHONE: (907) 465-3600

6.
fyi

January 19, 1989

Honorable Dave Donley, Chair
House Labor and Commerce Committee
Alaska State Legislature
P.O. Box V
Juneau, Alaska 99811

Re: HB 67 -- Leases of personal property under Uniform Commercial Code
(Our file: 773-89-0061)

Dear Representative Donley:

When you and I discussed this bill by telephone on January 12, 1989, you mentioned that you wanted to read the bill before asking me for the background material from the National Conference of Commissioners on Uniform State Laws. I thought you might find it helpful to see the following list of material that I have readily available:

-- a fact sheet on the new UCC Article 2A, leasing;

-- a four-page summary of the new article;

-- a four-page explanation of why states should adopt the new article;

-- a magazine article entitle "Old Wine in New Bottles: UCC Article 2A-Leases," by Edwin E. Huddleson, III, Esq., from The Journal of Equipment Lease Financing;

-- the National Conference of Commissioners on Uniform State Laws' and American Law Institute's publication of the new Article 2A, including the official commentary.

To provide the Alaska Legislature with the best information on this bill and with the best expertise on this subject,

it will be necessary for me to coordinate committee hearings with the National Conference.

Please let me know when you would like to discuss this matter. Thanks.

Yours truly,

GRACE BERG SCHAIBLE
ATTORNEY GENERAL

By: Art Peterson
Arthur H. Peterson
Assistant Attorney General

AHP/lg

cc: Bob Evans
Legislative Liaison
Office of the Governor

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: HB 67
PUBLISH DATE: HOUSE 1/9/89

FISCAL NOTE

REQUEST:

Revision Date:
Title: An Act relating to leases of personal property under the Uniform Commercial Code
Sponsor: Rules Committee
Requestor: Governor

Agency Affected: Commerce & Econ. Dev.
BRU: Banking, Securities & Corporations
Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

Prepared by: Willis F. Kirkpatrick, Director
Division: Banking, Securities & Corporations
Phone: 465-2521
Date: 12-23-88

Approved by Commissioner:
Agency: Commerce and Economic Development
Date: 12/23/88

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

2830D/101788a

No. 2

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: HB 67
PUBLISH DATE: HOUSE 1/9/89

FISCAL NOTE

REQUEST:

Revision Date: _____
Title: "An Act relating to leases of personal property under the Uniform Commercial Code."
Sponsor: Rules Committee
Requestor: Governor

Agency Affected: Department of Law
BRU: Legal Services

Components: Operations

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND	-0-	-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME	-0-	-0-	-0-	-0-	-0-	-0-
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Please see the attached analysis.

Richard L. Pegues

Prepared by: Richard L. Pegues, Director — Phone: 465-3672
Division: Administrative Services — Date: October 21, 1988

Richard L. Pegues /FOR/

Approved by Commissioner: Grace Berg Schaible, Attorney General — Date: October 21, 1988
Agency: Department of Law

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

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STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: HB 67
PUBLISH DATE: HOUSE 1/9/89

FISCAL NOTE

REQUEST:

Revision Date:
Title: Leases of Personal Property under the Uniform Commercial Code
Sponsor: Rules
Requestor: Governor

Agency Affected: Department of Revenue
BRU: Treasury
Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

Prepared By: Milt Barker MB
Division: Treasury
Phone: 465-2350
Date: December 29, 1988

Approved by Commissioner: Hugh Malone Roger Wells for
Agency: Department of Revenue
Date: December 29, 1988

Distribution (by preparer):
- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: HB 67 No. 4
PUBLISH DATE: HOUSE 1/9/89

FISCAL NOTE

REQUEST:

Revision Date: _____
Title: Leasing under UCC

Agency Affected: Natural Resources
BRU: Management and Administration

Sponsor: Rules Committee
Requestor: Governor Cowper

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-
CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

This bill does not affect the Deaprtment of Natural Resources.

Prepared by: Carol Wilson
Phone: 465-2400
Division: Commissioner's Office
Date: 11/28/88

Approved by Commissioner: Dennie Gorsuch
Date: 11-28-88
Agency: Natural Resources

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

MEMORANDUM (Brief Communications) **State of Alaska**

	Name	Dept./Div./Sect.	Mail Stop
TO:	Ginger Baim	Legislature / Hse. Lab. + Com. Com.	
FROM:	Art Peterson	Law / Civil / Legis. + Regs.	Telephone 465-3600
SUBJ.:	HB 67 (UCC, leasing) - background matl.	Date	April 12, 1989

As you requested this morning, you will find attached a copy of each of the 5 items mentioned in my January 19, 1989 letter to Rep. Donley, pertaining to H-B 67.

02-001C(12/80)

A Few Facts About

THE UNIFORM COMMERCIAL CODE, ARTICLE 2A - LEASES

PURPOSE: To provide states with a legal framework for any transaction, regardless of form, that creates a lease.

ORIGIN: Completed by the Uniform Law Commissioners in 1986.

ENDORSED BY: American Bar Association
American Law Institute

STATE ADOPTIONS: Oklahoma

1988 INTRODUCTIONS:

California	Minnesota
Colorado	New Hampshire
Delaware	New York
Illinois	Rhode Island
Massachusetts	Utah
Michigan	Washington
	West Virginia

NEED A SPEAKER? These persons are available to provide testimony or give presentations on the Article 2A Amendments:

Marion Benfield, Jr.	Fred H. Miller
Champaign, Illinois	Norman, Oklahoma
Drafting Committee	Drafting Committee

For information on arranging a speaker, contact John McCabe or Katie Robinson at 312-915-0195.

UNIFORM COMMERCIAL CODE, ARTICLE 2A - LEASES

The Uniform Commercial Code (UCC) Article 2A - Leases, governs any lease of personal property, whether the transaction is a "true lease" or a "finance lease." The former occurs when the lessor gives possession and right to use the personal property to the lessee for a fixed period of time in return for rent. The title to the property remains with the lessor.

A "finance lease" occurs when the lessor is not the fundamental supplier of the goods leased, but leases goods to lessees as a means of financing their sale.

UCC - 2A is largely derived from the sales article of the UCC - Article 2. It provides basic contract rules, including matters of offer and acceptance, statutes of frauds, warranties, assignment of interests, and remedies upon breach of contract. There are five parts to the UCC - 2A: (1) General Provisions, (2) Formation and Construction of a Lease Contract, (3) Effect of a Lease Contract, (4) Performance of a Lease Contract, and (5) Default.

GENERAL PROVISIONS

The General Provisions include the large, general definitions section and general rules pertaining to the construction of leasing contracts, including conflict of law provisions, choice of forum rules, and interpretation of remedies. Most of these provisions are drawn from Article 2 of the UCC.

UCC - 2A creates an entity called the "lessee in the ordinary course of business." The definition parallels the "buyer in the ordinary course of business" in the UCC. Both take property free of prior encumbrances, under the appropriate conditions, and are essential to commercial enterprise.

UCC - 2A also defines "supplier" as "a person from whom a lessor buys or leases goods to be leased under a finance lease." This definition is important because goods in a "finance lease" must come from another source than a lessor.

FORMATION AND CONSTRUCTION OF A LEASE CONTRACT

In a sale transaction, the UCC provides warranties of title and against infringement by any claims of another person. There are similar warranties in UCC - 2A, although title is not protected, since title remains in the lessor. But the lessor does warrant the lessee's enjoyment of the leasehold interest against "a claim to or interest in the goods that arose from an

act or omission of the lessor. " This warranty applies to all lease contracts. Infringement, however, is not warranted against in finance leases, and this warranty only binds a merchant-lessor, who deals regularly in goods of the kind.

Implied warranties are of two kinds, merchantability and fitness for a particular purpose. Both kinds of implied warranty are directly derived from the Article 2 of the UCC. The warranty of merchantability operates between merchants, and assures the resalability of goods. The fitness warranty presumes a purpose and reliance upon the lessor to supply goods fit for the purpose. Both kinds of implied warranties can be excluded or modified by agreement.

Implied warranties do not, however, apply to finance leases. Remember that the lessor in a finance lease is more like a lender than a supplier. Therefore UCC - 2A passes the implied warranties of the supplier-seller to the lessor-buyer to the lessee. The lessor warrants nothing, directly.

EFFECT OF A LEASE CONTRACT

Generally, a lessee's rights under a lease contract or the residual rights of a lessor are freely transferable, unless the contract prohibits the transfer or unless transfer risks the other party's contract rights. An assignment, so-called, of lease rights is treated as any transfer is, and is presumed to transfer both rights and obligation, unless otherwise specified in the agreement.

If a subsequent lease is entered when there is an existing lease, the subsequent lease is subject to the prior lease. However, a subsequent "lessee in the ordinary course of business," who deals with a lessor who is a merchant dealing in goods of the kind leased and to whom the goods are entrusted under the prior lease, will take goods free of the prior, existing lease contract.

Another third party issue dealt with in Part 3 of UCC - 2A is lien priorities. Here, UCC - 2A becomes analogous to provisions in UCC, Article 9. A statutory materialmen's lien has priority over any interest in a lease contract, unless other law sets a different priority. Otherwise, lessee's creditors take subject to the lease contract. Lessor's creditors with prior interests to those arising under a lease contract, generally, take priority over interests arising under the contract.

However, a "lessee in the ordinary course of business" takes free of any prior perfected security interests, unless the lessee has specific knowledge of their existence. A prior interest of a lessee takes priority over a subsequent interest of a lessor's creditor. But there are special instances in which a creditor of a lessor has priority over a lessee's interest, even though the

lease interest is prior in time. Included are instances in which depriving the creditor of possession of the collateral would be fraudulent to the creditor "under any statute or rule of law."

Goods that become fixtures present priority problems when leased. Fixtures are defined as goods "so related to particular real estate that an interest in them arises under real estate law." Who has priority between the lessor and those holding the real estate interests?

Generally, if goods are leased and become fixtures, the lessor with prior interest in them has priority over those with the real estate interests - if the lessor perfects his or her prior interest with a fixture filing under Article 9 of the UCC. A fixture filing is made by placing an appropriate financing statement in the real estate records. There are instances in which a lessor can retain an interest against the real estate holder without filing, but a fixture filing will generally be essential.

"Accessions" also present a special problem. An "accession" occurs when leased goods "are installed in or affixed to other goods." Any existing rights in a lease contract are superior to any rights in the whole in which leased goods become accession after the lease contract is entered. If the lease contract arises at the time goods become accessions or after, earlier interests in the whole have priority, If someone purchases the whole after a lease contract, rights under the lease contract take priority over the purchaser's rights. However, a "buyer in the ordinary course of business," or a prior creditor who makes advances without knowledge of the lease contract, takes priority over a lessor or lessee, even though the lease contract precedes the purchase or advance in time.

PERFORMANCE OF A LEASE CONTRACT

Part 4 of UCC - 2A deals with performance and repudiation of a contract, with substituted performance and with excused performance. If performance is to be impaired, however, UCC - 2A gives contracting parties the latitude to minimize losses.

For example, a party to a lease contract who has reasonable grounds for insecurity as to the performance of the other party, may demand written assurance of performance. Until written assurance is provided, the demanding party may suspend his or her performance. If assurance is not given in a reasonable time, the contract may be treated as repudiated.

When performance is impaired without the fault of either party, because of such events as failure of an agreed means of transport, a commercially reasonable substitute must be accepted. There are instances in which performance may be excused: "If performance as agreed has been made impracticable by the

occurrence of a contingency the non-occurrence of which was basic assumption on which the lease contract was made." The lessor must notify the lessee (and the supplier if there is a finance lease) of delay or non-delivery. These are examples of the options open to contracting parties.

DEFAULT

Upon default, UCC - 2A provides remedies in Part 5, including damages and equitable remedies, such as specific performance. UCC - 2A permits cover. That is, a party may seek goods from another source to limit losses. Mitigation of damages is encouraged. The general measure of any damage is actual loss.

LEASE TRANSACTIONS AS SECURED TRANSACTIONS

The last issue of importance addressed in UCC - 2A is an added appendix, consisting of a crucial amendment to Section 1-201(37) of the UCC, which defines the term security interest. If a lease involves a "security interest," it is subject to Article 9 of the UCC. A lease involves a security interest, dependent upon four alternative factors or characteristics.

If the term of the lease is equal or greater than the remaining economic life of the goods; if there is a renewal option for no additional consideration or nominal consideration; if there is mandatory renewal or the lessee becomes owner at the end of the lease term; or if the lessee has the option to purchase at the end of the lease term for no additional consideration, or any combination of these factors, the lease would tend to be treated as creating a security interest and would be subject to Article 9.

CONCLUSION

UCC - 2A is comprehensive, dealing with every phase of leasing transactions. It draws a great share of its concepts from Article 2 of the UCC, but it is adapted to the peculiarities of the leasing form. It is an important advance in commercial law.

WHY STATES SHOULD ADOPT ARTICLE 2A

OF THE UNIFORM COMMERCIAL CODE - LEASES

The leasing of large scale items ranging from oil-drilling platforms to automobiles is big business in this country, with an estimated dollar volume reaching $150 billion. Yet the laws governing leasing have not kept pace with the intricacies of today's leasing arrangements, resulting in considerable uncertainty for lessors and lessees alike.

To fill this gap, the Uniform Law Commissioners approved a new amendment to the Uniform Commercial Code: Article 2A - Leases. UCC-2A provides for the fundamentals of the leasing contract, including the formation of the contract, provisions for express and implied warranties, and damages for breach of a leasing contract.

Historically, we have thought of financed purchase transactions as conditional sales. As sales, such transactions fall under the UCC, particularly Articles 2 and 9. But a leasing transaction, even though very similar to a conditional sale in many ways, is not clearly subject to the UCC. The rights and remedies of the lessor and lessee, therefore, are not well defined, and courts have characterized these transactions differently from jurisdiction to jurisdiction. Many troubling issues have been extensively and confusingly litigated.

UCC-2A gives leasing transactions an appropriate underpinning in the law. Because of the broad similarities between lease and sales transactions, that underpinning is largely derived from the sales article of the UCC - Article 2. Hence the new article is 2A, indicating its relationship to Article 2. Article 2 has been adopted in every state except Louisiana.

There are a number of reasons all states should adopt UCC - Article 2A, Leases:

LEASES SHOULD BE A PART OF THE UCC

Since leases are an important part of business and commercial law, they should be governed by the Uniform Commercial Code. Further, the leasing business is interstate in character. Uniformity is as important to the conduct of leasing transactions as it is to sales transactions.

LEASES AS SECURED TRANSACTIONS

Perhaps the most important question answered in UCC-2A is when leases are subject to UCC-Article 9 on "Secured Transactions." Certain lease contracts establish what effectively are conditional sales, in which the lessor is no different from a creditor subject to Article 9.

The prior law has never effectively dealt with the issue, and concrete standards are established in UCC-2A and an accompanying amendment to UCC-1-201(37), which is a basic definition section in the UCC. Under these provisions, a secured transaction occurs when the lessor has no meaningful residual rights in goods when the lease expires. In a true lease, the rights to the goods revert to the lessor when the lease term ends. But if the contract terms indicate that the rights to this residue are valueless, then it can be inferred that the lease really amounted to a conditional sale of the goods. Article 9 then should and would apply.

FINANCE LEASES

UCC-2A creates a separate category of leases called "finance leases" to eliminate existing confusion over the rights of parties in such leases. Finance leases are characterized by the unique position of the lessor - as purchaser of goods only for the purpose of delivering them to a lessee pursuant to a lease contract.

Because the lessor is not the real supplier of the goods, and acts merely to finance the goods in the hands of the lessee, certain of lessee's rights are best served by imposing obligations on the real supplier and by limiting some rights against the lessor. UCC-2A does not give a lessee implied warranties against a lessor in a finance lease, but passes the lessor's warranties against the real supplier under Article 2 on the lessee.

UCC-2A also further limits a lessee's already limited rights to reject goods, once accepted under the contract, or to cancel, terminate, modify, excuse or substitute performance under the lease contract. The lessee relies upon warranty rights against the supplier, and the lessor is treated as the financing entity it really is.

REMEDIES

Prior law does not provide clear remedies for leasing transactions. Because the parties to lease contracts share substantial characteristics with the parties to sales contracts,

the full panoply of UCC-Article 2 remedies can easily be translated and applied to lease contracts.

UCC-2A not only provides clear measures of damages upon breach of contract, but also provides: clear standards for anticipatory repudiation by a party to a contract when anticipated performance by another party becomes insecure; for rejection of goods that do not conform to the contract; for excused non-performance of the contract; and for specific performance under appropriate circumstances.

UCC-2A remedies carry over the original Article 2 policies of encouraging cure of default without litigation and of mitigation of damages whenever and wherever possible.

WARRANTIES

UCC-2A establishes and standardizes warranties for true leases. It follows closely Article 2 of the UCC, but it does not protect title, since title remains with the lessor. Rather than title, UCC-2A warrants against infringement with lease rights.

There are two kinds of implied warranties: merchantability and fitness for a particular purpose. Both are directly derived from Article 2 of the UCC. The warranty of merchantability assures the resalability of goods between merchants. The fitness warranty presumes a purpose and reliance upon the lessor to supply goods fit for the purpose. These warranties can be excluded or modified by agreement.

UCC-2A implied warranties do not apply to finance leases. In that case the implied warranties under Article 2 of the supplier to the lessor are passed on to the lessee.

CONSUMER LEASES

UCC-2A defines a consumer lease as a lease in which the lessee takes the lease primarily for a personal, family or household purpose, when the total payments do not exceed $25,000.

UCC-2A does provide some protection for lessees in a consumer lease. Among other things, there is a burden on the lessor to justify acceleration of rentals in a consumer lease. But most consumer protection is left to other laws.

FIXTURE AND ACCESSION PROBLEM

UCC-2A settles recurring problems of what to do with leased goods that become fixtures and accessions and who has priority in each case.

Fixtures are defined as "goods so related to particular real estate that an interest in them arises under real estate law." Generally, if goods are leased and become fixtures, the lessor with prior interest in them has priority over those with the real estate interests - if the lessor perfects his or her prior interest with a fixture filing under UCC - Article 9.

An accession occurs when leased goods are "installed in or affixed to other goods." Any existing rights in a lease contract are superior to any rights in the whole in which leased goods become accession after the lease contract is entered.

CONCLUSION

The changes in leasing transactions in recent years make it clear that modernization is long overdue. States now depend on the common law to resolve disputes over lease contracts. This creates great uncertainty, particularly for companies that conduct business in more than one state, since case law conflicts from state to state. Additionally, some important issues have never been adequately addressed in the common law, and UCC - 2A answers these immediate needs.

Old Wine in New Bottles: UCC Article 2A-Leases

Edwin E. Huddleson, III, Esq.

Introduction

Over the past decade, commentators and practicing lawyers have debated the desirability of a uniform state law on equipment leasing. The "statutory codification" movement was a natural reaction to the explosive growth of equipment leasing after World War II. Beginning in 1980, the American Bar Association undertook serious studies to define the scope and substance of a uniform state law on the leasing of goods.

The Commissioners on Uniform State Laws, acting in 1985 after three years of restudy by a drafting committee of law professors and attorneys, approved a proposed state law on equipment leasing: the Uniform Personal Property Leasing Act (UPPLA). UPPLA was then rewritten stylistically to make it a part of the Uniform Commercial Code (UCC). Today a new UCC Article 2A-Leases has been approved by the commissioners and is awaiting approval by the American Law Institute in May 1987. Thereafter, the new statute will be formally presented for enactment to the state legislatures.

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Overview of the Statute

UCC Article 2A-Leases is a uniform state law on equipment leasing, with standardized provisions on warranties and remedies that are variable by agreement between the lessor and lessee. The statute expands the scope of the UCC to cover leases of goods. But it is not a comprehensive code. It leaves several areas of state law to be developed by other law, particularly consumer protection statutes and so-called "products liability" case law. To avoid conflict with state certificate of title statutes (which cover automobiles, trailers, boats and other often-leased goods), the new statute defers to those other statutes. Within its own sphere, however, it addresses several issues that are important for equipment leasing.

The statute is divided into six parts: (1) General provisions. These include definitions ("consumer lease," statutory "finance lease,") as well as provisions governing choice of law in consumer leases, unconscionability, and options to accelerate at will. (2) Formation and construction of lease contract. Warranties, both express and implied, are dealt with here. Other Provisions in Part 2 address statute of frauds, when the lessee obtains an insurable interest, risk of loss and the special status of "finance leases" in the law of warranties. (3) Effect of lease contract. Third party rights are covered here, as are priority disputes between lien creditors or secured parties and lessees, and competing claims in fixtures. (4) Performance of lease contract: repudiated, substituted and excused. One provision here (§2A-404) imposes an automatic "hell or high water" obligation on lessees to pay rent under a statutory "finance lease" that is not a consumer lease. Other sections in Part 4 cover topics such as adequate assurance of performance, anticipatory repudiation, and substituted and excused performance. (5) Default. Outlined in Part 5 are general provisions concerning default (statute of limitations, procedure in event of default), as well as the statutory (not contracted for) remedies of both the lessee and the lessor on the other party's default. (6) "Exhibit A to Article 2A-Leases" contains an amendment to old UCC §1-201(37), clarifying the definition of a true lease.

Within reasonable limits, the new statute preserves the freedom of contract of the lessor and the lessee to write specific lease agreements that vary or differ from UCC Article 2A-Leases.[1] The statute's standardized provisions on warranties and remedies, not affecting the rights of third parties, are variable by agreement between the lessor and the lessee. This is a powerful rebuttal to critics: Lessors and lessees who don't like the standardized provisions in the new statute can write their lease agreement to provide otherwise.

UCC Article 2A-Leases: Its Central Provisions

The core issues covered by UCC Article 2A-Leases include the definition of a true lease, remedies and measure of damages after default, warranties, the special status of "finance leases," "consumer lease" issues, the rejection of mandatory UCC filing (or public notice) requirements for true leases, and fixtures. These provisions, which are the subject of this article, will largely determine the success or failure of the new statute. Threats of stormy opposition to UCC Article 2A-Leases already have arisen, particularly from some vehicle lessors who are engaged in "open-end" "finance leasing" to consumers.[2] Overall, however, the new statute succeeds remarkably well in capturing the best of earlier commercial law decisions on equipment leasing. To a great extent, UCC Article 2A-Leases simply mirrors the common law on bailments for hire—that classic benchmark of reasonableness and gut equity in the law of equipment leasing.

True Leases of Goods Distinguished from Conditional Sales

One threshold issue confronting the drafters of new UCC Article 2A-Leases was how to define a true lease of goods, as opposed to a conditional sale or disguised security interest. True leases have long been distinguished from sales for many purposes in commercial law, including determining remedies on default, a lessor's rights under §365 of the Bankruptcy Code,[3] and whether a transaction is covered by state usury laws.[4] Moreover, a secured sale, unlike a lease, is subject to UCC Article 9, which sets rules of priority and generally requires the filing of a financing statement for secured interests. True leases henceforth will generally be governed by the provisions of new UCC Article 2A-Leases, while secured sales will be covered by UCC Article 9.

The commissioners on Uniform State Laws, after considering a variety of suggestions, decided to clarify the definition of a true lease with an amendment to old UCC §1-201(37) suggested by AAEL. The thrust of the AAEL proposal was to preserve common law principles and reaffirm the importance of the residual as a source of potential gain or loss in the business of equipment leasing.

The old common law principles, elaborated in the new amendment to UCC §1-201(37), provide significantly more guidance than current law as to what is the essence of a true lease. True leases are still defined by reference to and comparison with "security interests." The structure of the amended statutory definition is to first state the general rule:

> "Whether a transaction creates a lease or security interest is determined by the facts of each case."

Then, several specific factors are identified that will *destroy* true lease status and create a "security interest." Finally, other factors are listed that are consistent with true lease status.

Where the lessee cannot terminate the obligation to pay rents for the lease term, there are two basic factors, either of which will destroy true lease status: (1) where the term of the lease extends for the full economic life of the goods; or (2) where the lessee has an option to become the owner for "nominal" additional consideration. Where either factor exists, the transaction is not a true lease, because the lessor will receive no meaningful residual. The comment emphasizes that "these tests focus on economics, not the intent of the parties."[5]

Other factors are specified, in the final part of amended §1-201(37), which are consistent with true lease status. These include:

- a "full payout" lease (where the present value of the lessee's payments are substantially equal to the fair market value of the goods at the outset of the lease);
- typical "net lease" provisions where the lessee assumes the risk of loss, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs;
- the mere existence of an option to renew the lease or buy the goods; and
- options to renew or buy at a fixed price equal to or greater than reasonably predictable fair market value (as predicted at the outset of the lease).

Moreover, the amended statutory definition deletes all reference to "the parties' intent." The comment explains that most of the criteria that courts have relied upon to show intent—including "typical net lease provisions, a purported lessor's lack of storage facilities or its character as a financing party rather than a dealer in goods"—are "as relevant to true leases as to security interests." Objective criteria, not a search for subjective intention, is the order of the day.

These are significant clarifications of the law. Yet no attempt was made to answer all questions, since the variety of transactions that parties to a "lease" can produce is almost unlimited. The overall general standard is that whether a transaction is a lease, or a "security interest," will be determined on the basis of all the facts and circumstances.

Options to Renew or Buy

One linchpin in the definition of a true lease is the subject of options. Originally, the drafting committee considered tying the definition of an option in a true lease to artificial percentages and formulas for determining what constitutes "nominal consideration" for options to renew or buy. But AAEL objected to this approach. The commissioners then adopted the functional approach suggested by AAEL, tracking the earlier common law.

Where the option price in a lease is "*stated to be the fair market value of the goods*," the statute creates a safe harbor validating such options as consistent with true lease status. On the other hand, another part of the new statute repeats old UCC §1-201(37) by stating that, where the lessee cannot terminate the lease (simply walk away from it), a transaction creates a "security interest" (and not a true lease) if:

> "(d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement."

Transactions are not true leases where the parties anticipate, when they enter into a transaction, that the option will

be irresistible in the sense that the option price is extremely low in comparison to the value of the property.[6] As noted above, another part of the amended true lease definition validates certain *fixed-price options* as clearly consistent with "true lease" status by stating:

> "A transaction does not create a security interest merely because it provides that..."
>
> "(e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed."

This safe harbor for true leases with fixed-priced purchase options should be helpful to equipment lessors, particularly in bankruptcy and usury cases.

One criticism leveled at the new, amended UCC §1-201(37) is that it fails to validate, as clearly consistent with true lease status, agreements with fixed-price options whenever the fixed-price option

> "approximates reasonably predictable fair marked value."

But this criticism is unsound. The only purpose of substituting "approximates" for "equal to or greater than" would be to attempt to validate, as clearly consistent with true lease status, agreements with fixed-price options at *less* than predictable fair market value. This is unwarranted. When the lessor and the lessee agree at the outset to give the lessee a discount on the option price (so that the option is less than reasonably predictable fair market value), they have written a "bargain" option agreement that "tilts the scales" to encourage exercise of the option. That sort of agreement may not be a true lease.

Moreover, it makes no sense to use a vague word like "approximates" in what is supposed to be a bright-line safe harbor test for valid fixed-price options in a true lease. No business justification exists: The safe harbor validating fixed-price options "equal to or greater than reasonably predictable fair market value" covers a wide range of predicted option values.[7] This should give businessmen all the flexibility they need.

TRAC Leases

"Open-end" leases, with terminal rental adjustment clauses (TRAC), have been widely used in the motor vehicle leasing industry for over 30 years. TRAC motor vehicle leases are specifically recognized as true leases by the federal tax laws. But the case law is divided on whether TRAC leases are true leases under state law. The commissioners decided that amended UCC §1-201(37) would be silent on whether TRAC leases are true leases.

"Open-end" leases also raise the issue of whether TRAC provisions (or some variations of them) are validated by the liberal provisions of new §2A-504 on "liquidation of damages" (see part III b *infra*). Viewed as liquidated damage formulas, some narrowly-drawn TRAC provisions may be reasonable: One common lease provision, according to the comment in new §2A-504, leaves the lessor with potential profits from a residual sale, while essentially making the lessee a guarantor of the estimated residual value set out in the lease. This "one-sided" TRAC provision leaves the lessor with a meaningful interest in the residual. Other kinds of narrowly-drafted TRAC-like provisions, which charge the lessee for excessive use or poor maintenance (as opposed to changes in value due to market trends), also seem consistent with true lease status.

Outspoken critics of new UCC Article 2A-Leases include some motor vehicle lessors who fault the new statute for failing to specifically validate "open-end" TRAC leases true leases. But the statute mirrors common law. To this date, the weight of the case law has not recognized broadly-phrased "open-end" TRAC leases as true leases under state law. Moreover, some equipment lessors in the past have opposed according true lease status to "open-end" TRAC leases outside the specific context of motor vehicle leasing. The commissioners acted reasonably in simply preserving the status quo with respect to "open-end" leases.

Remedies

One major impetus for the new statute was dissatisfaction among equipment lessors, and their lawyers, with inconsistent and unpredictable

court decisions on the *remedies* available under a true lease. UCC Article 2A clarifies the law on lease remedies: Ordinarily, the lessor's remedies available for breach of a true lease will be those specified in the lease agreement. Yet UCC Article 2A provides a minimum safety net set of remedies (including a measure of damages for the lessee's breach), which will apply if the lease agreement is silent (or held invalid) on remedies issues.

Repossession and Disposition

Whether a default has occurred, as well as issues about repossession and other post-default rights and remedies under a true lease, are to be decided in the first instance by reference to the lease agreement. (UCC §2A-501, §2A-503). Both judicial and self-help remedies are available (§2A-501). Within wide limits, the statute allows the parties in a true lease to craft their own set of rights and remedies in the lease agreement.[8]

UCC §2A-525 specifically confirms the lessor's right to repossess the goods on the lessee's default. Advance notice of default or enforcement need not be given to the defaulting party (§2A-502). Ordinarily, the lessor is expected to mitigate damages by re-leasing or selling the repossessed goods. But where it proves impractical for the lessor to dispose of the goods at a reasonable price after repossession, he may hold the goods and recover accelerated rentals as damages (§2A-529(1)(b)).

Two types of provisions exist, in UCC Article 2A, on the lessor's damage remedies for the lessee's default: those that apply to contractual liquidated damage clauses; and those provisions that apply where the lease contract is silent (or invalid) on damages.

Contractually specified damages. UCC §2A-504(1) validates liquidated damages clauses that comply with this basic "reasonableness" test:

> "Damages payable by either party for default, or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default or other act or omission."

This validates formulas as well as amounts, and drops some of the limitations on liquidated damage clauses that appeared in the old law of sales.

The comments provide little specific guidance on how the "reasonableness" standard in new UCC §2A-504 should be applied. The courts are left to wrestle with several recurring questions, as best they can, under the general standard of "reasonableness."

Residual risks on lessees. One question concerns the validity of default remedies that essentially push the whole residual risk onto the lessee. This issue may arise particularly for sweeping liquidated damages clauses in short-term consumer leases: especially where the lease runs for only a short time in relation to the expected useful life of the goods, it may not be "reasonable" (§2A-504) to stick the lessee with the risk that the market value of the lessor's residual may drop.

Cumulative remedies. There are some old cases holding that "cumulative remedy" provisions, in and of themselves, may render a liquidated damages clause invalid. But such provisions should pass muster under the new leasing statute so long as the total cumulative remedy sought is simply one satisfaction (not a double recovery) and is "reasonable in light of the then anticipated harm caused by the default or other act or omission" (§2A-504).

Accelerated rentals. Ordinarily, a liquidated damages clause with provision for accelerated rentals is enforceable by the lessor, if coupled with a contractual provision requiring the lessor to mitigate damages by sale or re-lease after repossession.[9] Without strong proof of reasonableness, however, a liquidated damage clause providing for acceleration of future rentals (without mitigation) is likely to be struck down. Moreover, at least in contested cases, the courts are likely to continue past precedent by holding, under the "reasonableness" test in new §2A-504, that the lessor's recovery for future lost rentals must be discounted to present value.[10] UCC §2A-109 specifies that the lessor can invoke an acceleration clause only when he "in good faith believes that the prospect of payment or performance is impaired."[11]

Election of remedies. Where a liquidated damages clause is otherwise valid, the "reasonableness" test in UCC §2A-504 should overrule earlier cases that required a lessor under a true lease to elect between repossessing the equipment, on the one hand, or suing for the accelerated rent and leaving the equipment in place, on the other. These old cases improperly extended the rule against double recovery. But the lessor's repossession and simultaneous recovery of accelerated rents does *not* necessarily result in double recovery or unjust enrichment. No double recovery results, for example, where a defaulting lessee is credited with proceeds from the sale or re-lease of equipment after repossession.[12]

Partial invalidity. Will the invalidity of *part* of a liquidated damage clause invalidate the whole clause, throwing the lessor back onto the statutory (non-contract) remedies in UCC Article 2A? Section 2A-504(2) states:

> "If the lease agreement provides for liquidation of damages, and such provision does not comply with [the "reasonableness" test in] subsection (1), or such provision is an exclusive or limited remedy that circumstances cause to fail of its essential purpose, remedy may be had as provided in this Article."

Equipment lease liquidated damages clauses often set out alternative damage measures, so that no single alternative is "an exclusive or limited remedy" (§2A-504(2)). For such multipart liquidated damages clauses, partial invalidity may not always be fatal to the whole clause, if the invalid part is written to be reasonably segregable from the rest. This result would be consistent with the new statutory section on "unconscionability" (§2A-108): It states where a court finds a clause unconscionable, it has discretion under §2A-108 to refuse to enforce the whole contract or it may simply "blue pencil" out the offending clause and enforce the remainder of the lease contract.

(b) *Where the lease agreement is silent (or held invalid) on damages remedies*

The only time UCC Article 2A will control measure of damages

remedies is when the lease agreement is silent (or held invalid) on damages remedies. Two basic statutory (not contracted for) measure of damages standards are spelled out for the lessor. These apply in different situations: (1) where the lessor repossesses and then sells or re-leases the goods (§2A-527(2), §2A-528)); and (2) where the lessor repossesses and holds the goods for the lessee for the remainder of the lease term (§2A-529).

1. Where the lessor repossesses and then sells or re-leases the goods, after the lessee's default, the lessor's statutory (non-contract) damages consist of the sum of (1) past unpaid rentals, plus (2) reasonable lost future rentals (measured by the present value of the difference between total scheduled future rentals and the "market rent" for future use of the goods)[13], plus (3) incidental damages less "expenses saved in consequence of the lessee's default." UCC §2A-507, 52A-528. The concept of "market rent," defined in new 52A-507, is essentially fair market rent as determined "at the time of the default."

One objection to the "rent-to-rent" comparison in this standard is that it makes it difficult to prove damages where the lessor repossesses and then sells the goods. The statutory "rent-to-rent" comparison has been employed in California statutes to measure damages under a lease of goods.[14] Yet the "rent-to-rent" comparison clearly takes a different approach to damages than "finance lease" liquidated damage clauses that define the lessor's measure of damages as the sum of (1) past unpaid rentals, plus (2) the present value of accelerated future rentals, plus (3) the lessor's estimated residual value, minus (4) the net proceeds from a commercially reasonable sale of the goods on the lessor's default, up to the point where such proceeds equal the sum of (2) plus (3). This sort of contract clause puts the risk on the *lessee* (not the lessor) that the value of the goods will drop after one enters into the lease.

True lessors own the residual and, on the lessee's default, the lessor's remedies should include recovery of the residual or its value. UCC Article 2A's statutory (noncontract) damages scheme clearly allows this recovery. And new §2A-527(5) makes it clear that the "lessor is not accountable to the lessee for any profit made on any disposition." But the new statute puts the burden on the lessor to recover the value of the residual through sale or re-lease. And it puts the risk on the *lessor* (not the lessee) that the value of the residual might drop after entering into the lease.

The commissioners decided that this is exactly where the risk belongs for statutory (noncontract) measure of damages. Where goods are leased for only a short time in relation to their useful life, it seems unfair (as not in accord with the common expectancies of the parties, in the absence of any agreement on the point) to stick the *lessee* with the risk that the value of the goods will drop after the lease is transacted. The only situations where it might be fair to saddle the lessee with that risk—*by statutory fiat in the absence of any contractual agreement on the point*—are those involving "long-term" true leases.[15] This category might be difficult to define in a statute. Moreover, the statutory (non-contract) measure of damages in UCC Article 2A applies only where the contract is silent or is struck down (as unconscionable or otherwise unenforceable) on measure of damages. The commissioners decided that there was no warrant to *guarantee* "long-term" true lessors a "home run" measure of damages in the statute, when all lessors could readily protect themselves by writing appropriate liquidated damages clauses in their lease agreements.

UCC §2A-528(2) provides an important alternative measure of damages—lost profits "including reasonable overhead" plus incidental damages—for lessors who repossess and then sell or re-lease the goods, but who (under the statutory rent-to-rent measure of damages) would not wind up "in as good a position as performance would have" put them. Though this measure of damages is phrased as an alternative, it may frequently be available to the merchant lessor.

2. Where the lessor repossesses, and it proves impractical to dispose of the goods at a reasonable price, he has the option of holding the goods for the

lessee for the remainder of the lease term, and recovering damages equal to the sum of (1) past rents due, plus (2) the present value of accelerated future rentals, plus (3) incidental damages "less expenses saved in consequence of the lessee's default." UCC §2A-529(1)(b).[16] This statutory (noncontract) measure of damages may be particularly important for "merchant lessors" who have more equipment in inventory than customers.

Over several years, commentators have debated whether such "merchant lessors" should be under a duty to mitigate damages by selling or re-leasing the goods after the lessee's default and repossession by the lessor. UCC §2A-529(1)(b) accords the merchant lessor (or any other lessor) the full present value of accelerated rentals, without offset, where it is impractical for the lessor to dispose of repossessed goods at a reasonable price. Yet the statute tracks earlier law by requiring the lessor to mitigate damages, where practical, before recovery will be allowed for accelerated rentals.

The same statutory (noncontract) recovery for accelerated rentals (without offset) is also generally available to statutory "finance lessors," without special efforts at mitigation of damages, for goods accepted by the lessee. §2A-529(1)(a). This seems appropriate. Typically the finance lessee selects the goods, which often are uniquely suited for the finance lessee's business (and no other).

Warranties

The old common law, as well as UCC §2-314 and 2-315, recognized two implied warranties—merchantability and fitness for a particular purpose—for transactions involving goods. These implied warranties impose strict liability, without regard to negligence or fault. The weight of authority is that these implied warranties apply to merchant lessors, under true leases as well as sales. Well-drafted lease agreements, as a consequence, have long been based on the assumption that these warranties would apply at least to merchant lessors (who dealt in goods), if not to "finance lessors" (who advanced money but had no special knowledge of the goods).

One salutary effect of new UCC Article 2A is to clarify and standardize the law of warranties for true leases. There are special statutory provisions dealing with warranties in the case of statutory "finance leases"—where the lessor does not select, manufacture or supply the goods out of inventory (see part III D *infra*). Otherwise, the new statute tracks the old sales article concerning the creation of express warranties (§2A-210), implied warranties of fitness, title and merchantability (§2A-211 through §2A-213), and accumulation of warranties (§2A-215).

The old sales article's requirements for conspicuous disclaimers of warranties are also repeated in the new leasing statute (§2A-214). Waiver of defense clauses—whereby the lessee agrees not to assert certain types of claims or defenses against the lessor's assignee—are approved by the new leasing statute to the same extent as allowed by old UCC Article 9.

With respect to breach of warranty issues, there are again special provisions for statutory "finance leases" (discussed in part III D *infra*). Otherwise, UCC Article 2A essentially tracks the old sales article. This is true, for example, for the lessee's remedies and damages (§2A-508, 2A-518, 2A-519, 2A-520), and the lessee's rights to reject the leased goods (§2A-509 and 2A-517).

UCC Article 2A's provisions do not spell out the relationship between Article 2A and the case law on strict liability in tort.[17] This reflects the commissioners' recognition that products liability is a rapidly developing field, as well as the view that Article 2A is basically a statement of "contract" (rather than "tort") principles. The whole area of products liability of merchant lessors will be left for the courts to develop.

Treatment of Finance Leases

Traditionally, a finance lessor has been thought of as a passive lessor, whose transactions remain functionally the equivalent of an extension of credit. It is typically the lessee (not the lessor) who selects the goods in a "finance lease," without relying upon the lessor. Moreover, a finance lessor often has neither the opportunity nor

the expertise to inspect the goods to discover any defects in them. Recognizing these special circumstances, the cases and authorities consistently held that finance lessors did not owe implied warranties of fitness and merchantability with respect to the leased goods.

The impact of new UCC Article 2A on "finance leases" is limited. Where a lessor qualifies under UCC Article 2A as a *statutory* finance lessor, the new statute basically provides him with automatic exemptions by statute from implied warranties of fitness and merchantability. But a lessor always can write a lease contract to exclude warranties, making himself a finance lessor *by contract*. Where a lessor writes the lease contract to exclude such warranties, and in addition qualifies as a new UCC Article 2A *statutory* finance lessor, he will have two independent grounds (or double protection) for exempting himself from such warranties. These new statutory provisions, of course, only apply to "finance leases" that are true leases.

Definition of Statutory "Finance Lease."

To create a *statutory* "finance lease," the lessor essentially must have no function in picking the goods for the lessee's use. The statutory definition in new UCC §2A-103(1)(g) is:

> "Finance lease" means a lease in which (i) the lessor does not select, manufacture or supply the goods, (ii) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease, and (iii) either the lessee receives a copy of the contract evidencing the lessor's purchase of the goods on or before signing the lease contract, or the lessee's approval of the contract evidencing the lessor's purchase of the goods is a condition to effectiveness of the lease contract."

There is no limitation that a statutory finance lessor can supply only money, or that he must not perform maintenance.[18] To ensure the lessee's reliance on the supplier, not the lessor, the lessor must acquire the goods "in connection with the lease." The scope of this phrase, "in connection with," is to be determined by the courts on a case-by-case basis.

One controversial part of UCC Article 2A is the third requirement in the definition of a statutory "finance lease:" the lessee must receive a copy of (or approve) the lessor's purchase contract with the manufacturer or supplier. No earlier authorities contained this requirement. But its purpose is to ensure that the lessee receives specific notice of the supplier's warranties covering the goods. This seems only fair before cutting off the lessee's warranty rights against the lessor and subjecting the lessee to automatic statutory "hell or high water" clause liability under a statutory "finance lease" (§2A-407). The commissioners decided that—particularly in light of a lessor's ability to make himself a "finance lessor" *by contract*—the new statute should be conservative in giving lessors an automatic exemption *by statute* from warranties.

The comments to §2A-103(1)(g) state that the leasebacks in many sales-and-leaseback transactions will qualify as statutory finance leases. Moreover, lessors who are merchants may qualify as statutory finance lessors. The comment to §2A-103(1)(g) also says that "where the lessor is an affiliate of the supplier no special rule applies; whether the transaction qualifies as a finance lease will be determined by the facts of each case." Excluded from *statutory* finance lessor status are manufacturers and individuals who are regular dealers in the leased asset. Also excluded is the lessor who obtains the asset out of inventory, since he did not acquire the asset for a particular lease transaction. Yet an independent automobile dealer/lessor, who obtains a car for a particular lessee, for example, may be able to qualify as a *statutory* finance lessor under new UCC §2A-103(g).

Statutory "Finance Leases:" Special Provisions.

UCC Article 2A makes it clear that a statutory finance lessor does not assume any implied warranties with respect to the lease. He is held only to express warranties (§2A-210) and the warranty of title (§2A-211(1)). Moreover, under a statutory finance lease that is not a consumer lease, the lessee's promises (especially to pay rent) are made irrevocable and independent (§2A-407, §2A-508(6)).

Only *commercial* finance leases (not consumer leases) qualify for the statutory imposition of automatic "hell or high water" obligations on the lessee under new UCC §2A-407. The comments to §2A-407 leave open the possibility that the parties to a "consumer lease" might *agree* to a hell-or-high-water clause in the lease agreement. But the comments also make it clear that other "consumer protection" statutes and evolving case law on consumer rights put severe restraints on the enforceability of such clauses in consumer leases.

The statutory finance lessee is the automatic beneficiary of all warranties under the supply contract (§2A-209(1)). But such a lessee generally cannot revoke acceptance of the goods (§2A-516, §2A-517(1)). To have any rights against the lessor, the finance lessee would have to reject goods immediately. Other special rules dealing with statutory "finance leases" include the provision (§2A-219) that risk of loss passes to the lessee (not the lessor).

These special provisions in the new statute, for statutory "finance leases," mirror the provisions commonly found in most finance lease contracts.

Two separate and independent kinds of "finance leases" will exist in the wake of UCC Article 2A: contractual "finance leases" and statutory "finance leases." One effect of this new regime is to short-circuit the courts' development of a common law definition of "finance lease" in the law of warranties. Where the written lease agreement does not cover warranties, a transaction must fall within the narrow Article 2A definition of a statutory "finance lease" to exempt the lessor from warranty liability. But this seems of minimal practical significance: The nearly universal practice of finance lessors is to "contract out" of warranties in their lease agreements.

Overall, the "finance lease" provisions in new Article 2A will provide certainty, and some additional protections, for lessors able to qualify as statutory finance lessors. Other lessors can protect themselves as finance lessors by contract.

"Consumer Lease" Issues

UCC Article 2A-Leases in general does not deal with consumer protec-

tion. This is left to other laws. But the new statute does contain some protections for lessees in "consumer leases," which are defined in new UCC §2A-103(1)(e):

> "Consumer lease" means a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee, except an organization, who takes under the lease primarily for a personal, family, or household purpose, if the total payments to be made under the lease contract, excluding payments for options to renew or buy, do not exceed $25,000.

Whereas the federal Consumer Leasing Act of 1976 defines "consumer lease" in terms of leases "for a period of time exceeding four months" (15 U.S.C. §1667(1)), new UCC Article 2A covers even shorter-term "consumer leases." A lease primarily for an agricultural purpose falls outside the "consumer lease" protections of UCC Article 2A.

The major "consumer lease" provisions in the new statute include new UCC §2A-106 (limiting abusive choice-of-law and choice-of-forum clauses in consumer leases); new UCC §2A-108 (2), (4) (where court finds consumer lease contract or claim collection activity under consumer lease to be "unconscionable," it may grant appropriate relief including attorneys' fees); new UCC §2A-109 (burden on lessor to justify acceleration of rentals in a consumer lease). The commissioners and the drafting committee rejected proposals for including other, more sweeping "consumer protection" provisions.

UCC Filings (or Notice) Not Required for Leased Personal Property

Yet another major issue was whether to establish a mandatory system requiring the filing of UCC financing statements for personal property covered by a true lease. UCC Article 2A was made subject to state certificate of title statutes, with the result that goods covered by those statutes generally must comply only with the filing (or notice) requirements in those statutes. The more general question remained whether there should be a general filing (or notice) requirement for leased goods, with a list of exceptions covering short-term leases and other "special cases" where filing was impractical.

Traditionally, equipment lessors have *not* been required to file UCC financing statements, or to give other public notice of their interests in the goods under a true lease.[19] The drafting committee heard conflicting views on whether current law on filing and notice should be changed. But the majority of businessmen and practicing lawyers in the field of equipment leasing seemed to favor the status quo. Technical faults in filing (misdescription of goods or failing to file in all the right places, for example) should not be controlling on a lessor's rights to multimillion dollar equipment, AAEL argued. To be sure, mandatory UCC filings might cut down on litigation concerning the "true lease" status of questioned transactions. But such litigation would not disappear: Even where a true lease was covered by mandatory UCC filings, the true lease/security interest determination would still have to be made by the courts in a variety of contexts (*e.g.*, bankruptcy law, remedies, usury law). Moreover, additional filings of UCC financing statements might overwhelm an already over-burdened UCC filing system. When the issue of mandatory UCC filings for leased goods was discussed within the American Bar Association, the majority of lawyers polled was opposed to the concept.

Taking these factors into account, the commissioners concluded that existing law on UCC filings (or notice) was working reasonably well. There was no compelling reason to overthrow it. UCC Article 2A therefore generally rejects the concept of mandatory UCC filings (or other required notice) for personal property covered by a true lease. The only exception concerns "fixture filings" (discussed below).

"Vendor in possession" doctrine for sales-and-leasebacks abolished. The new statute also *abolishes* the so-called "vendor in possession doctrine" which has long created state law difficulties for sales-and-leasebacks of equipment. This will be welcome news to lessors. The old "vendor in possession" doctrine (making retention of possession by the vendor fraudulent *per se* or *prima facie* fraudulent) is an ancient anachronism

that has been recognized in one form or another in many states.[20] New UCC §2A-308(3) abolishes it for transactions in which the buyer "bought for value and in good faith."[21] The statute also expressly provides in §2A-302 that separation of ownership and possession *per se* does not affect the enforceability of a lease contract. The old, unlamented "vendor in possession" doctrine for leases is no more.

Optional UCC filings permitted. Optional filing of UCC financing statements is still permitted under new Article 2A, as under current law, for any true (or doubtful) lease. Incentives remain for lessors to file UCC financing statements: Though new amended UCC §1-201(37) clarifies the definition of a true lease, it does not eliminate all ambiguities. UCC filings for leases provide protection to the person filing if it is later determined that the "lease" was a secured sale. Moreover, the filing of a UCC financing statement may not be considered as a factor in determining whether or not the transaction is a true lease or a secured sale (see UCC §9-408 (1972)).

Fixtures: Modest Reform

Over the years the subject of "fixtures" has triggered many battles between real estate interests and equipment lessors. New UCC Article 2A attempts to resolve some of the recurring problems in this area by imposing new UCC filing requirements for leased fixtures.

Two basic sets of priority rules are set forth in the new statute to determine the priority of competing interests in fixtures: one for unfiled lessors, the other for lessors who have made a "fixture filing." Traditional common law protections for unfiled lessors of fixtures are generally preserved in §2A-309(5).[22] Unfiled lessors obtain the benefit of a very modest reform expanding the category of "readily removable" goods.[23] The statute gives more rights, however, to the fixture lessor who makes a "fixture filing" in the office where a mortgage on the real estate would be recorded. Without such a "fixture filing," the lessor may lose out to real estate interests, since under new UCC §2A-309(7) the priority of the lessor's interest will be determined by real estate priority rules.

This imposes, in effect, a new "fixture filing" requirement for lessors of fixtures. But double filings in both personal property and real estate records have long been industry practice. The statute's new requirement for a "fixture filing" in real estate records implements the views of thoughtful commentators.[24] And new §2A-309(8) makes it clear that, where a lessor of fixtures has priority over conflicting real estate interests, the lessor (or the lessee) may *remove* the goods on the lessee's default (as well as in other circumstances), as long as he pays "the cost of repair of any physical injury."[25]

The commissioners may well revisit the subject of "fixtures" again in the future. Though the search continues for the most reasonable balance between competing real estate interests and lessors of fixtures, new UCC Article 2A provides some helpful clarification in this overly-technical area of the law.

Conclusion

The impact of new UCC Article 2A-Leases will underline the importance of careful drafting for leases of motor vehicles and equipment. The statute clarifies the differences between a true lease and a "security interest." Moreover, it provides some helpful clarification and uniformity in the law of warranties and lessors' remedies.

Threatened stormy opposition to the new UCC Article 2A seems overstated and unwarranted. Bernard J. McKenna, chairman of AAEL, went to the heart of the matter: "The new statute rejects a simplistic approach which might have blurred the distinction between a true lease and a financing. The short of the matter is that if you can't write a good solid lease agreement, you're in trouble. That's always been true and it always will be true, with or without the new UCC provisions on leasing."

Footnotes:

[1] Other statutes and case law (particularly in the area of "consumer protection") may limit the unbridled "contractual freedom" of the parties, of course. Yet the main limitations on "contractual freedom" in UCC Article 2A-Leases itself is the injunction against unconscionable lease clauses (2A-108). Other well established limits on "contractual freedom"—such as the requirement that contractual waivers of implied warranties be "conspicuous"—are picked up in the new statute (§2A-214). There are also scattered provisions according protection to lessees in "consumer leases," such as §2A-106 (limiting abusive choice-of-law and choice-of-forum clauses in consumer leases) and §2A-109 (placing burden on the lessor to justify acceleration of rentals in a consumer lease). Moreover, the new statute incorporates the general UCC rules that the obligations of good faith, diligence, reasonableness and care are not disclaimable by agreement.

[2] "THREAT OF NEW UNIFORM PERSONAL PROPERTY LEASING ACT" trumpeted the front-page headline of CAR RENTAL/LEASING INSIDER, Weekly Newsletter (June 9, 1986). "Open-end" vehicle lessors have criticized the new statute's failure to validate "open-end" leases of vehicles as true leases, as well as the provisions in UCC Article 2A-Leases covering "finance leases" and warranties and remedies in leases to consumers. *See* CAR RENTAL/LEASING INSIDER, Weekly Newsletter (June 16, 1986); AUTOMOTIVE FLEET MAGAZINE p. 130 (August 1986). These issues are discussed in parts III A, C, D and E *infra*.

[3] True lessors under §365 of the Bankruptcy Code generally have a better chance than secured lenders of obtaining current payments, as well as repossessing the goods, when the lessee/debtor is in bankruptcy. Under §365 of the Bankruptcy Code, the lessee (or bankruptcy trustee) must assume a true lease or reject it in its entirety, and if assumed, must give "adequate assurances" that prior defaults will be cured and that performance (payment of rentals) will take place in the future. The secured creditor, on the other hand, is covered by §361-§363 (not §365) of the Bankruptcy Code: The buyer-debtor in bankruptcy has the right to continue to use any of the collateral property, with or without the consent of the seller-lender, so long as the secured lender is given "adequate protection" that the *value* of the property will be preserved. Cf. *In re American Mariner Industries*, 734 F.2d 426 (9th Cir. 1984.)

[4] True leases (as opposed to disguised loans or "forebearances" of money) may be exempt from state usury laws.

[5] Throughout this article, references to the comments denote the Official Comments to new UCC Article 2A-Leases in ALI Council Draft No. 1 (December 1, 1986), now being revised.

[6] One theme that runs through the cases and authorities is that the owner/lessor in a true lease must have, at the outset, some legitimate possibility for return or other disposition of the leased property before the end of the economic life of the property. See, e.g., *In re Marhoefer Packing Co.*, 674 F.2d 1139, 1143, 1145 (7th Cir. 1982). With respect to options to renew or buy, under state law, the essence of a true lease may be that the *original agreement* should leave the lessor with a significant economic stake in the residual and should not "tilt the scales" to require or encourage the lessee to exercise the option for the remaining economic life of the property. Cf. *id.* at 1144-1145; Mooney, *True Lease or Lease "Intended as Security"*, in Coogan, Hogan, Vagts & McDonnell, *Secured Transactions Under the UCC* (Matthew Bender 1986).

[7] This is because the economic uncertainties of life (such as changes in the rate of inflation, and technological obsolescence) are such that a wide range of values should qualify as "reasonably predictable" option prices in any given transaction.

[8] One important issue for counsel drafting a lease agreement is raised by new §2A-508(5), which authorizes the lessee to sell the goods, if the lease agreement says nothing to the contrary, where the lessee rightfully rejects the goods, or justifiably revokes acceptance.

[9] DeKoven, *Proceedings After Default By the Lessee Under a True Lease of Equipment* in 1C Coogan, Hogan, Vagts & McDonnell, *Secured Transactions Under the UCC*, §29B.06[5](b) (Matthew Bender 1986).

[10] *See, e.g., Heller Financial v. Burry*, 633 F.Supp. 706 (N.D.Ill. 1986) [court reduces accelerated future rentals to present value]; *In re Winston Mills, Inc.*, 6 B.R. 587 (Bkrpt S.D.N.Y. 1980) [same].

[11] With respect to a consumer lease, the burden of establishing good faith is on the party invoking the acceleration clause; otherwise the burden of establishing lack of good faith is on the lessee. UCC §2A-109(2).

[12] DeKoven, *Leases of Equipment: Puritan Leasing Co. v. August, A Dangerous Decision*, 12 U.San Fran.L.Rev.257,277-278 (1978).

[13] Where the goods are re-leased "by lease contract substantially similar to the original lease contract and the lease contract is made in good faith and in a commercially reasonable manner," then the lessor's *lost future rentals* (apart from other damages) are measured by the present value of the the difference between the "total rent for the remaining lease term of the original lease" and the "total rent for the lease term of the new lease contract." UCC §2A-527(2).

[14] California Civil Code §3308 permits liquidated damage clauses in a lease providing that, after the lessee defaults and the lease has been terminated, the lessor may recover the present value of accelerated future rentals minus the "reasonable rental value" of the goods for the remainder of the lease term. Where this measure of damages is selected, it is exclusive.

[15] Of course, if the original term of the lease runs for essentially the entire remaining economic life of the goods, and the lessee is obligated throughout the term so that he cannot simply "walk away" from the lease, then the transaction is not a true lease at all but a security interest covered by UCC Article 9.

[16] This statutory measure of damages applies "for goods identified to the lease contract if the lessor is unable after reasonable effort to dispose of them at a reasonable price or the circumstances reasonably indicate that effort will be unavailing." UCC 2A-529 (1) (b). This statutory remedy is optional. At any time before the collection of the judgment for this statutory remedy (accelerated rents), the lessor may choose to dispose of the goods by sale or re-lease, in which case his remedies are limited by the "rent-to-rent" test discussed above. 2A-529 (3). If the lessee pays the judgment for accelerated rents, then the lessee is entitled to "use and possession of the goods not then disposed of for the remaining lease term of the lease agreement." 2A-529 (4).

[17] One commentator on products liability has explained that the true lease/sale distinction "has no bearing on product liability. Instead, the criterion of superior knowledge of a merchant is the prerequisite to nonconsensual product liability. A merchant-lessor, as one who deals in goods and thus has superior knowledge, should be a target defendant. In contrast, a finance-lessor should remain immune from product liability as one who, in the ordinary course of business, makes advances against goods but is not a merchant." Carlin, *Product Liability for the Equipment Lessor? Merchant-Lessor versus Finance-Lessor* printed in ch 8 of *Equipment Leasing-Leveraged Leasing* (2d ed. Fritch & Reisman 1980) p. 848.

[18] Where the lessor does perform maintenance, or other functions other than the supply of money, the comment to §2A-103 (1) (g) states that "express warranties, covenants and the common law will protect the lessee." This leaves open the possibility that a statutory finance lessor who performs maintenance, under a so-called "operating lease," may be held liable for negligently failing to discover defects during maintenance.

[19] *See, e.g., In re Marhoefer Packing Co.*, 674 F.2d 1139 (7th Cir. 1982); *In re Leasing Consultants, Inc.*, 486 F.2d 367 (2d Cir. 1973); *Allen v. Cohen*, 310 F. 2d 312 (2d Cir. 1962).

[20] *See* Coogan, *Leasing and the Uniform Commercial Code* in *Equipment Leasing-Leveraged Leasing* pp. 827-846 (2d ed. Fritch & Reisman 1980).

[21] The statute states in pertinent part: §2A-308. SPECIAL RIGHTS OF CREDITORS * * *

(3) A creditor of a seller may treat a sale or an indentification of goods to a contract for sale as void if as against the creditor retention of possession by the seller is fraudulent under any statute or rule of law, *but retention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith.* [Emphasis added]. The Comment to §2A-308 confirms: "Notwithstanding any statute or rule of law that would treat such retention as fraud, whether *per se*, *prima facie*, or otherwise, the retention is not fraudulent if the buyer bought for value and in good faith. This provision overrides Section 2-402 (2) to the extent it would otherwise apply to a sale-leaseback transaction."

[22] Thus, for example, new UCC §2A-309 (5)(d) reflects the earlier UCC Article 9 and common law provisions allowing removal of trade fixtures. *See* UCC §9-313 (5)(b); *Lemmons v. United States*, 496 F.2d 864, 869-872 (Ct.Cl. 1974); *see also* 3 Witkin, Summary of California Law, *Personal Property* §§60-66, *Real Property* §469-470.

[23] New UCC §2A-309 (5)(a) gives an *unfiled* lessor of fixtures priority over competing real estate interests if "the fixtures are readily removable factory or office machines, *readily removable equipment that is not primarily used or leased for use in the operation of the real estate*, or readily removable replacements of domestic appliances that are goods subject to a consumer lease, and before the goods become fixtures the lease contract is enforceable" [new provisions in italics]. The Comment to §2A-309 indicates that, aside from leased equipment that is "integral to the operation of real estate e.g., heating and air conditioning equipment" other "readily removable equipment" constituting fixtures can be repossessed by an unfiled lessor. Owners and encumbrancers of real estate, on the other hand, will be able to rely on the continuing availability of fixtures that are essential to the operation of the land and building itself.

[24] *See* Leary, *The Procrustean Bed of Finance Leasing*, 56 N.Y.U.L. Rev. 1061, 1089-1093 (1981); Gilmore, *Security Interests in Personal Property* §30.5 (1965).

[25] The specific language of new §2A-309(8) gives the lessor or the lessee the right to remove the goods from the real estate, on the other party's default (as well as in other circumstances), but requires that he or she "must reimburse any encumbrancer or owner of the real estate who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation."

A Few Facts About

THE ARTICLE 8 AMENDMENTS TO THE UNIFORM COMMERCIAL CODE

PURPOSE: To provide states with a legal framework for the transfer of uncertificated securities, similar to the rules for certificates found in the original Article 8.

ORIGIN: Completed by the Uniform Law Commissioners in 1977, in cooperation with the American Bar Association and the American Law Institute.

ENDORSED BY: New York Stock Exchange
Securities Industry Association
American Society of Corporate Secretaries

STATE ADOPTIONS:

Arkansas	Kentucky	Ohio
California	Maine*	Oklahoma
Colorado	Maryland	Oregon
Connecticut	Massachusetts	Rhode Island
Delaware	Michigan	South Dakota
Florida	Minnesota	Tennessee
Hawaii	Montana	Texas
Idaho	Nevada	Virginia
Illinois*	New Hampshire	Washington
Indiana	New Mexico	West Virginia
Kansas	New York	Wisconsin
	North Dakota	Wyoming

1988 INTRODUCTIONS: District of Columbia
New Jersey

NEED A SPEAKER? These persons are avaible to provide testimony or give presentations on the Article 8 Amendments:

Martin J. Aronstein
Univ. of Pennsylvania
Permanent Editorial
Board for the UCC

Robert Haydock
Boston, Mass.
Permanent Editorial
Board for the UCC

William E. Hogan
New York University
Permanent Editorial
Board for the UCC

Donald Scott
Philadelphia, PA
Permanent Editorial
Board for the UCC

For information on arranging a speaker, contact John McCabe or Katie Robinson at 312-915-0195.

* 1988 Adoptions

WHY EVERY STATE NEEDS THE ARTICLE 8 AMENDMENTS -- NOW!

In each of the 50 states, the trading of corporate securities, typically stocks and bonds, is governed by transfer rules found in Article 8 of the Uniform Commercial Code.

The transfer system established by the original Article 8 is based on the "certificate"; transfer takes place when the certificate is endorsed and delivered by one party to another. The original Article 8 provides:

- Rules for endorsement and delivery of the certificate;
- "Warranties of transfer", or guarantees of the transfer's validity;
- Rules for the use of securities to secure debts.

While the certificated system still dominates securities transfers, electronic transfers may ultimately make the certificate obsolete. The 1977 Amendments to Article 8 were therefore drafted to establish regulations for the newer system that is evolving -- one which eliminates certificates and instead accomplishes transfers by entry on the issue books and appropriate notices to the parties involved.

The Amendments include the same features as the original Article 8, with the important exception of the certificate requirements, and have been carefully integrated into the older Article. They parallel the legal framework the original Article 8 established for certificates, and give priority in the law to neither system of transfer.

But the practical advantages of an uncertificated system are clear: they allow issuers to take advantage of the efficiency and speed of computer technology that can eliminate the sea of paper that afflicts the securities market.

A majority of states have already recognized the need to adopt the Amendments. They include New York, the nation's trading capitol; Delaware, the state of incorporation for large businesses across the country, and most recently Massachusetts. In states which do not adopt the amendments:

- Traders will be less equipped to do business with uncertificated companies.

(over)

. New firms desiring the benefits of certificateless transfer may choose to go elsewhere to incorporate.

Another potential disadvantage for states which don't adopt the Article 8 Amendments stems from the practice of pledging securities to obtain credit. Lenders in any state need an adequate legal basis for transactions involving uncertificated transactions before entering into them. Otherwise, they will withhold credit secured by perfectly valid collateral, and business will suffer.

States should also consider the advantages certificateless securities offer to small and close corporations, whose internal securities transactions are often simple enough that certificates just create unnecessary paperwork. These firms should welcome a simpler, more efficient system of transfer.

QUESTIONS AND ANSWERS ON THE 1977 AMENDMENTS TO ARTICLE 8 OF THE UNIFORM COMMERCIAL CODE

Q: What do the 1977 Amendments to the Uniform Commercial Code (UCC) provide?

A: They permit entities creating investment securities (stocks and bonds are the commonest examples) to issue "uncertificated" securities. This kind of security would not be represented by a "certificate" and would not be transferred by passing a certificate from one person to another. Transfer would take place when the issuer creating the security records the transfer on its books.

Q: How does such a transfer take place?

A: In most instances transfers of uncertificated securities will require computerized records and electronic communications systems. In small corporations that have limited numbers of stockholders and are not publicly traded, uncertificated securities might be created without these technical advances. Under the Amendments, a transfer of any kind follows this basic sequence:

1. The current owner (transferor) of the uncertificated security sends an instruction to the issuer to record a transfer to another person (transferee). The instruction must be in the form required by the issuer.

2. The issuer records the transfer on its records.

3. The issuer returns an identical document to both the transferor and transferee confirming the transfer. This document, called an Initial Transaction Statement (ITS), must be returned within two days after the receipt of instruction. Receipt of the ITS assures that the transaction is complete.

Q: How are uncertificated securities pledged as collateral for a debt?

A: A pledge is a type of transfer under the Amendments. It requires the same sequence as any other transfer, such as a sale or a gift, except that the effect is to preserve on the issuer's books the rights of the creditor in the securities as collateral. A pledge can be recorded in two ways. The creditor can be shown on the issuer's records as the owner of the securities, as collateral for the debt. The pledge, itself, can also be recorded without an actual transfer of ownership, In either case, the creditor's

rights will be protected from any further transfer, since the issuer cannot record any subsequent transfer that conflicts with, or is superior to, the creditor's interest until that interest is removed from the record.

Q: What happens to securities represented by certificates when the Amendments are adopted?

A: There is no change in the legal status of securities represented by certificates. Issuers can continue to offer existing securities and certificates and new issues can be created with certificated securities. The Amendments do not repeal the existing rules, but establish a parallel set of rules for uncertificated securities. It is intended that the law favors neither certificated nor uncertificated securities. When an issuer considers which option to take, the choice will not be influenced by some inherent advantage or disadvantage built into the law, but only by the issuer's perception of the marketing efficiency to be gained. The Amendments expand choices for creating securities. They do not take away anything that is already available.

Q: Can an issuer create both certificated and uncertificated securities at the same time?

A: Yes. It is anticipated that corporations which convert from certificated to uncertificated securities will make the transition over an extended period of time. They will probably have stock issues that are certificated as well as uncertificated. Many issuers may choose a mixed system indefinitely. The Amendments do not restrict any system that an issuer may want to put into effect.

Q: What if the investor wants to have certificates when issued uncertificated securities?

A: If the issuer has a mixed system, with both certificated and uncertificated securities, an investor may demand, and must receive, certificates. If the issuer issues no certificated securities, they do not have to be created to meet the demand of an individual investor. The investor will have to invest elsewhere. This situation arises primarily with stocks, and investors who feel comfortable with the traditional certificates. In most cases, corporations will have mixed systems, and certificates will be available for those who want them.

There are issuers, such as mutual funds, that have never made certificates available - their customers do not expect what has never been offered. Most investors who deal through brokers maintain accounts and never see certificates, even though the large bulk of stocks and bonds are currently certificated. The majority of investors don't expect certificates anymore, and it is likely that the demand will be rare, though they will be available.

Q: Aren't computerized records and electronic transfers more open to fraud and deception than certificated transfers?

A: Securities are valuable property and targets of the unscrupulous and dishonest. Certificates are stolen, signatures are forged; paper may be counterfeited, even after the most elaborate precautions. In short, there are risks inherent for certificated securities, and issuers, financial institutions, brokers, and investors have to take precautions to protect rights represented by certificates. The UCC was never concerned with these problems, except to establish certain basic liabilities. The practices of the securities industry, bolstered by the establishment of these liabilities. The practices of the securities industry, the criminal law, have been primarily responsible for protecting these valuable interests. The system has worked very well, though never perfectly.

The Amendments treat uncertificated securities the same way the UCC has treated certificated securities. Certain basic liabilities are established, but the practices of the securities industry, backed by the criminal law, is the primary defense against fraud and deception. The risks are different with computers and electronic transfer systems, but they are not insurmountable. The banking system already operates largely on electronic transfers of money and while no system of transfers will ever be perfect, it appears that a high level of safety is possible and probable. Indeed, if the market place did not have a high level of safety, nobody would enter the market. That is the best guarantee that systems adopted will be very safe before they are utilized.

Q: Do the 1977 Amendments to the UCC affect securities regulation at the state or federal level?

A: The short answer is no. The UCC has provided the basic transfer rules for investment securities. It has never been concerned with issues of regulation, such as registration of securities issues or disclosure to investors. The Amendments make no change in this pattern. Uncertificated securities are subject to the same regulatory requirements as certificated securities, and the existence or non-existence of the certificate makes no difference whatsoever.

Q: How many states have adopted the 1977 Amendments to the UCC?

A: To date, 35 states, including California, Delaware, Massachusetts, New York, Illinois, and Texas - all states that rank high in quantity of securities trading. With the adoption of the Amendments in Delaware and New York, the opportunity for issues of uncertificated securities expanded enormously. No state that wishes to stay current with the fundamental law respecting investment securities can afford to delay adopting these Amendments.

Q: What will a state gain by enacting the 1977 Amendments to the UCC?

A: Corporations, brokers, financial institutions, mutual funds, and others involved in the creation and sale of investment securities will have the most up-to-date law available to them. They will be able to take immediate advantage of these Amendments. Brokers will also be able to deal in uncertificated securities issued by out-of-state issuers of securities without thought as to the validity of such transfers on behalf of local customers.

ARTICLE 8 AMENDMENTS TO THE

UNIFORM COMMERCIAL CODE

Article 8 of the Uniform Commercial Code is entitled "Investment Securities." A "security" is broadly defined as an instrument which:

(1) is issued in bearer or registered form;

(2) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment;

(3) is either one of a class or series or by its terms is divisible into a class or series of instruments; and

(4) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

The commonest examples are stocks and bonds. They have a market and are bought and sold, as are "goods" under Article 2 of the UCC, and negotiable instruments under Article 3. The UCC sought to cover all the major kinds of markets in its conception of "commercial transactions." Thus, Article 8 provided a fundamental law for the buying and selling of securities.

Note, however, one aspect of this basic definition. It states that a security is an "instrument." It implies a piece of paper with appropriate writing to identify the obligation the security manifests. Therein lies the kernel for the present revision - paper. The new Article 8 contemplates the elimination of the paper. The term instrument will no longer imply the existence of specific pieces of paper which act as evidence of obligations between people.

There are a number of reasons for this anti-paper revolution. In the late 1960s, the brokers and the exchanges became overburdened with paper. The sheer load hampered the markets. Also, automation has progressed far enough to make the revolution feasible. It is easier and faster to record transfers in the computer. It is efficient and more economical. Thus, the nature of the transactions in securities is fundamentally changing.

Under the revised Article 8, an immediate distinction is made between types of securities. There are "certificated" securities and "uncertificated" securities. The "certificated" security is the one we have long known, represented on and by a piece of paper, an instrument. That piece of paper has been, and remains, the means of transfer and the evidence of obligation - when it exists. But it no longer always exists.

The "uncertificated" security is not evidenced by any piece of paper at all. It exists on its issuer's records. Its key characteristics are found in the definition. It "is not represented by an instrument and the transfer of which is registered upon books maintained for the purpose by or on behalf of the issuer.. ." Without the instrument, the mechanics of a transfer change. Also changed are the manners in which obligations are manifested.

Where there is a certificate, it physically participates in any transfer of the obligations it contains. A security passes upon proper endorsement and physical delivery of the instrument. The instrument takes part in pledges made by owners of the security to secure their own debts. It is also the foundation of the warranties each of the parties gives in a transaction involving a security. The paper is fundamental, and when it is eliminated, some changes commensurate with its elimination must take place.

When a transfer, or registration of a pledge, occurs in the case of an "uncertificated" security, it does so only on the books of the issuer. This means that an "instruction" must be given to the issuer by the appropriate person. The "instruction" normally will be in writing, and obligates the issuer to make the necessary entry on the books. The evidence of completion is a statement back from the issuer within two business days after the registration occurs. It goes to transferror, transferee, and any pledgee.

These two items are the only pieces of paper involved in the transfer, and are designed to be much simpler than the "certificated" security. The last of the two, the "Initial Transaction Statement," is the most important. It provides notice of terms, restrictions, and adverse claims to the addressee, and runs against the issuer if it does not. This is a similar function to the written instrument which constitutes a "certificated" security. The rights of purchasers which depend on this information are affected almost exactly as a purchaser's rights are affected by a "certificated" security.

There are differences, however. A purchaser of an "uncertificated" security, in general, can rise no higher than his transferror in terms of his rights. He takes as if he had his transferror's knowledge, even if he doesn't. A "certificated" security does not hold a purchaser to the knowledge of his transferror, but bases his rights on his own

knowledge. That is a distinct difference between the two forms of security.

Further, an Initial Transfer Statement warrants only that the acknowledged owner is so at the time of its issuance. It does not do so for any following time period. In contrast, a purchaser may normally assume that the holder of a "certificated" security is the owner and entitled to transfer it. In these respects, the Initial Transfer Statement does not offer the assurances of a "certificated" security.

It is perhaps anomalous to think of security interests in a security, which itself may represent a debt of the issuer. People who own securities, which are valuable property, may pledge them for their debts. They create a security interest in the creditor by so doing.

A "certificated" security is merely delivered to the pledgee with a proper endorsement. That creates the security interest. Where "uncertificated" securities are concerned, the security interest must be registered. The procedure for doing this is identical to the procedure for a transfer. An instruction is sent to, and a confirmatory statement returned from, the issuer of the security. Once registered, the owner continues all powers with respect to the security except the power of transfer. That belongs to the registered pledgee.

The "uncertificated" security offers a bit more protection to the pledgee than a "certificated" security does. If a pledge of a "certificated" security is not registered, additional securities and dividends will be distributed to the owner, not the pledgee. The procedure relating to "uncertificated" securities precludes the problem. It is also to be noted that perfection of the security interest is by possession of the instrument for a "certificated" security, and by the mere procedure of creating the interest for "uncertificated" securities. Perfection is the means of determining the priority between competing security interests.

Warranties also differ between "certificated" and "uncertificated" securities. The face of the instrument provides a basis of warranties f : "certificated" securities. The presenter to an issuer for registration, the transferror to a purchaser, all warrant aspects of the transaction because of the instrument and its enforcements and signature guarantees. For "uncertificated" securities, the only warranty can be on the part of the originator of an instruction to the issuer. That person warrants that the registration is proper to the issuer, and that the transfer has no defects to a purchaser for value.

Signature guarantees, an essential part of the transfer process for widely held securities, also cannot be the same for "certificated" and "uncertificated" securities. The guarantor of

a "certificated" security warrants that the endorser is an appropriate person acting for the owner. This is evident to the guarantor from the instrument. Without the instrument, the guarantees, are limited to the genuineness of the signature, and that the endorser purports to act for owner or pledgee. There are special, boarder guarantees of an "uncertificated" security which cannot be demanded by an issuer, but which can be made to further secure a transaction.

The difference between a "certificated" security and the items of paper relating to registration of an "uncertificated" security cause a difference in the treatment of a bona fide purchaser for value, also. Essentially, a bona fide purchaser for value is held for only those things on the instrument with respect to a "certificated" security. The bona fide purchaser for value of an "uncertificated" security essentially takes free of what does not appear on the initial transaction statement. Practically, this may expose him to greater liability, but also forces him to seek a clean transaction statement before accepting liability.

Third party claims also provide a difference. For "certificated" securities, notice in writing to the issuer suffices. For "uncertificated" securities, the claim must be in the legal process before the issuer has notice. Judicial liens are also treated differently. Seizure of the security works for "certificated" securities, but not for all the "uncertificated" breed. It is necessary to serve process on the issuer.

These are some of the differences which result from the addition of the "uncertificated" security to the security markets. There has been no need to change the basic pattern of Article 8, which has served its purpose well. The amendments seek to incorporate the "uncertificated" security with the least disturbance possible.

ALASKA CODE REVISION COMMISSION

ALASKA STATE LEGISLATURE
P.O. BOX Y · STATE CAPITOL
JUNEAU, ALASKA 99811
(907) 465-2450

March 2, 1989

The Honorable Tim Kelly,
Senate President
Alaska State Legislature
P.O. Box V
Juneau, Alaska 99811

Re: SB 88 (Uniform Commercial Code, investment securities).

Dear Senator Kelly:

The Alaska Code Revision Commission has quickly reviewed this bill, and wishes to express its general support of it. The central idea presented by this bill is the recognition of "uncertificated" securities, i.e. securities that exist without a piece of paper identifying the obligation that the security manifests.

The concept of uncertificated securities avoids the earlier paperwork overburden, takes advantage of modern technological advances, and provides the legal basis for an easier, faster, and more efficient and economical way of dealing with transfers of securities. It is necessary for Alaska to recognize this development in the law and acceptance of this practice in the marketplace. Without these amendments, securities traders will be less equipped to do business in Alaska and new firms desiring the benefits of certificateless transfers might go elsewhere to incorporate. This bill thus promotes the economic development of Alaska.

The commission notes that 35 states have enacted these Uniform Commercial Code amendments in virtually identical form. The 35 states include the West Coast states and the major incorporation and securities-trading states. The amendments were developed by the Permanent Editorial Board for the UCC, indicating development by the National Conference of Commissioners on Uniform State Laws, the American Bar Association, and the American Law Institute. In addition, the amendments have been endorsed by the New York Stock Exchange, the Securities Industry Association, and the American

Society of Corporate Secretaries.

The Alaska Code Revision Commission has not conducted a line-by-line analysis of SB 88, but believes that it is now time for these amendments, promulgated in 1977, to receive full scrutiny by the Alaska Legislature and public. We urge an early hearing on SB 88. Experts of national standing are available to testify, either in person or by telephone, on this bill.

Thank you for your consideration of this bill.

Very truly yours,

John W. Abbott

JOHN W. ABBOTT, Chair
Alaska Code Revision Commission

cc: The Honorable Dick Eliason, Chair, Senate Labor and Commerce Committee, Alaska State Legislature
The Honorable Sam Cotten, Speaker of the House, Alaska State Legislature
The Honorable Dave Donley, Chair, House Labor and Commerce Committee, Alaska State Legislature

AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC.

1270 AVENUE OF THE AMERICAS • NEW YORK 10020 • TELEPHONE: 212-765-2620

April 25, 1985

Mr. John M. McCabe
Legislative Director
National Conference of Commissioners
on Uniform State Laws
645 North Michigan Avenue
Suite 510
Chicago, Illinois 60611

Dear Mr. McCabe:

The Securities Industry Committee of the American Society of Corporate Secretaries endorsed the 1977 Amendments to Article 8 of the Uniform Commercial Code at its meeting in New York on October 18, 1983. The Society supports the adoption of these Amendments by all states in the near future so that the laws of the various states pertaining to the transfer of securities can be made wholly uniform.

Very truly yours,

Stephen P. Norman
Chairman
Securities Industry Committee
American Society of Corporate
Secretaries Inc.

SPN:ldk

No. 6

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: SB 88 (a)
PUBLISH DATE: 1/9/89

FISCAL NOTE

REQUEST:

Revision Date:
Title: "An Act relating to investment securities under the Uniform Commercial Code."
Sponsor: Rules Committee
Requestor: Governor

Agency Affected: Department of Law
BRU: Legal Services
Components: Operations

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND	-0-	-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME	-0-	-0-	-0-	-0-	-0-	-0-
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Please see attached

Richard L. Pegues

Prepared by: Richard I. Pegues, Director
Phone: 465-3672
Division: Administrative Services
Date: November 10, 1988

Richard L. Pegues/FOR/

Approved by Commissioner: Grace Berg Schaible, Attorney General
Date: November 10, 1988
Agency: Department of Law

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

. No. 6 .

CONTINUATION of FISCAL NOTE ANALYSIS

For Bill/Resolution No. _____

This bill substantially amended Article 8 of the Uniform Commercial Code (AS 45.08 in Alaska's version) in accordance with recommendations of the National Conference of Commissioners on Uniform State Laws (NCCUSL) in cooperation with the American Law Institute and the American Bar Association. This amended version of Article 8 modernizes the regulation of investment securities by recognizing the existence of uncertificated securities that have resulted from computerized securities transactions. Many of the investment securities financial transactions that take place today are accomplished by electronic means, without the issuance of certificates, because of the shear load of paper certificates that have hampered and burdened the financial markets. The amendments to Article 8 contemplate the elimination of much of the paper certificates formerly used in financial transactions. These amendments have been endorsed by the Securities Industry Committee of the American Society of Corporate Secretaries, and they have already been adopted by 35 states. It is not anticipated that the changes proposed in the UCC will have any direct fiscal impact on the Department of Law, because they deal with private sector transactions.

No. 6

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: SB 88 (b)
PUBLISH DATE: 1/9/89

FISCAL NOTE

REQUEST:

Revision Date:
Title: Investment Securities under the Uniform Commercial Code
Sponsor: Rules
Requestor: Governor

Agency Affected: Department of Revenue
BRU: Treasury

Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

Prepared By: Milt Barker MB
Division: Treasury
Phone: 465-2350
Date: December 29, 1988

Approved by Commissioner: Hugh Malone Hugh Malone for
Agency: Department of Revenue
Date: December 29, 1988

Distribution (by preparer):
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Legislative Sponsor
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Office of Management and Budget
Impacted Agency(ies)

No. 6

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: SB 88 (
PUBLISH DATE: 1/9/89

FISCAL NOTE

REQUEST:

Revision Date:
Title: UCC investment securities

Sponsor: Rules Committee
Requestor: Governor Cowper

Agency Affected: Natural Resources
BRU: Management and Administration

Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-
CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

This bill does not affect the Department of Natural Resources.

Prepared by: Carol Wilson
Phone: 465-2400
Division: ~~Commissioner's Office~~
Date: 11/23/88

Approved by Commissioner: Dennie Gorsuch
Date: 11-28-88
Agency: Natural Resources

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

UNIFORM COMMERCIAL CODE

THE AMERICAN LAW INSTITUTE

NATIONAL CONFERENCE OF
COMMISSIONERS ON UNIFORM
STATE LAWS

ARTICLE 2A. LEASES

(with Conforming Amendments to
Articles 1 and 9)

1987 OFFICIAL TEXT
WITH COMMENTS

SUBJECTS COVERED:

Part 1. General Provisions
Part 2. Formation and Construction of Lease Contract
Part 3. Effect of Lease Contract
Part 4. Performance of Lease Contract
Part 5. Default

Conforming Amendments to Sections 1-105, 1-201(37), and 9-113

The Executive Office
The American Law Institute
4025 Chestnut Street
Philadelphia
Pennsylvania 19104

National Conference of
Commissioners on Uniform
State Laws
645 North Michigan Avenue
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Uniform Commercial Code
Article 2A. Leases

National Conference of Commissioners on Uniform State Laws

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William M. Toomajian, Cleveland, Ohio

FOREWORD

Article 2A of the Uniform Commercial Code, along with Conforming Amendments to Articles 1 and 9, is presented, upon the recommendation of the Permanent Editorial Board for the Uniform Commercial Code, by the National Conference for Commissioners on Uniform State Laws and the American Law Institute. It represents a major development in commercial law, addressing a type of business transaction, the leasing of personal property, that has long existed. Under present law, transactions of this type are governed partly by common law principles relating to personal property, partly by principles relating to real estate leases, and partly by reference to Articles 2 and 9 of the Uniform Commercial Code, dealing with Sales and Secured Transactions respectively. The legal rules and concepts derived from these sources imperfectly fit a transaction that involves personal property rather than realty, and a lease rather than either a sale or a security interest as such. A statute directly addressing the personal property lease is therefore appropriate.

Such a statute has become especially appropriate with the exponential expansion of the number and scale of personal property lease transactions. Article 2A will apply to transactions involving billions of dollars annually. It will apply to consumer's rental of automobiles or do-it-yourself equipment, on the one hand, and to leases of such items as commercial aircraft (to the extent not preempted by federal law) and industrial machinery, on the other. The text recognizes the differences between consumer and business leasing, while resting upon concepts that apply generally to any personal property lease transactions.

The final product represents an important undertaking of the Conference and the Institute. It has proceeded, following recommendations by the Conference's Study Committee in 1981, through preparation and review by the Conference's Drafting Committee first of a proposed free-standing Uniform Personal Property Leasing Act, which was approved by the Conference, and later of Article 2A, which proceeded through the Permanent Editorial Board, the Executive Committee of the Conference, the Conference, and the Council of the Institute and the Annual Meeting of the members of the Institute. Carrying the text through these several stages has required coordination of somewhat different procedures, and continued patience and mutual forbearance. At the same time, the text has been subjected to analysis and criticism from many points of view and thereby steadily improved.

The resulting product borrows from both Articles 2 and 9. These existing Articles of the Uniform Commercial Code have certain imperfections revealed by the long experience since their adoption. Article 2A cannot overcome those imperfections but seeks to minimize their significance as applied to leases. More fundamentally, there is important conceptual dissonance between Article 2 and Article 9. The formulation of Article 2A takes Articles 2 and 9 as they are for the time being and hence has required careful adjustment to this dissonance.

The drafting task has been complicated both as a matter of substance and as a matter of process. The Reporter, Ronald DeKoven, has been a master of substance and a steady and receptive principal in the process. We join with the Conference and the Institute in expressing our admiration and appreciation for his contribution to this important field of law.

Geoffrey C. Hazard, Jr., Chairman
Permanent Editorial
Board for the Uniform
Commercial Code

October 1, 1987

ARTICLE 2A. LEASES

PART 1. GENERAL PROVISIONS

2A-101.	Short Title	1
2A-102.	Scope	6
2A-103.	Definitions and Index of Definitions	7
2A-104.	Leases Subject to Other Statutes	21
2A-105.	Territorial Application of Article to Goods Covered by Certificate of Title	23
2A-106.	Limitation on Power of Parties to Consumer Lease to Choose Applicable Law and Judicial Forum	24
2A-107.	Waiver or Renunciation of Claim or Right After Default	26
2A-108.	Unconscionability	27
2A-109.	Option to Accelerate at Will	29

PART 2. FORMATION AND CONSTRUCTION OF LEASE CONTRACT

2A-201.	Statute of Frauds	31
2A-202.	Final Written Expression: Parol or Extrinsic Evidence	34
2A-203.	Seals Inoperative	35
2A-204.	Formation in General	35
2A-205.	Firm Offers	36
2A-206.	Offer and Acceptance in Formation of Lease Contract	37

2A-207.	Course of Performance or Practical Construction	38
2A-208.	Modification, Rescission and Waiver	39
2A-209.	Lessee Under Finance Lease as Beneficiary of Supply Contract	41
2A-210.	Express Warranties	44
2A-211.	Warranties Against Interference and Against Infringement; Lessee's Obligation Against Infringement	45
2A-212.	Implied Warranty of Merchantability	47
2A-213.	Implied Warranty of Fitness for Particular Purpose	49
2A-214.	Exclusion or Modification of Warranties	49
2A-215.	Cumulation and Conflict of Warranties Express or Implied	52
2A-216.	Third-Party Beneficiaries of Express and Implied Warranties	53
2A-217.	Identification	56
2A-218.	Insurance and Proceeds	57
2A-219.	Risk of Loss	59
2A-220.	Effect of Default on Risk of Loss	61
2A-221.	Casualty to Identified Goods	63

PART 3. EFFECT OF LEASE CONTRACT

2A-301.	Enforceability of Lease Contract	64
2A-302.	Title to and Possession of Goods	69

2A-303. Alienability of Party's Interest under Lease Contract or of Lessor's Residual Interest in Goods; Delegation of Performance; Assignment of Rights..... 70

2A-304. Subsequent Lease of Goods by Lessor..... 75

2A-305. Sale or Sublease of Goods by Lessee..... 79

2A-306. Priority of Certain Liens Arising by Operation of Law..... 82

2A-307. Priority of Liens Arising by Attachment or Levy on, Security Interests in, and Other Claims to Goods..... 83

2A-308. Special Rights of Creditors..... 87

2A-309. Lessor's and Lessee's Rights When Goods Become Fixtures..... 89

2A-310. Lessor's and Lessee's Rights When Goods Become Accessions..... 96

PART 4. PERFORMANCE OF LEASE CONTRACT: REPUDIATED, SUBSTITUTED AND EXCUSED

2A-401. Insecurity: Adequate Assurance of Performance..... 99

2A-402. Anticipatory Repudiation..... 100

2A-403. Retraction of Anticipatory Repudiation..... 102

2A-404. Substituted Performance..... 103

2A-405. Excused Performance..... 104

2A-406. Procedure on Excused Performance..... 106

2A-407. Irrevocable Promises: Finance Leases..... 107

PART 5. DEFAULT

A. In General

2A-501. Default: Procedure..... 110

2A-502. Notice After Default..... 113

2A-503. Modification or Impairment of Rights and Remedies..... 114

2A-504. Liquidation of Damages..... 116

2A-505. Cancellation and Termination and Effect of Cancellation, Termination, Rescission, or Fraud on Rights and Remedies..... 120

2A-506. Statute of Limitations..... 121

2A-507. Proof of Market Rent: Time and Place..... 123

B. Default by Lessor

2A-508. Lessee's Remedies..... 125

2A-509. Lessee's Rights on Improper Delivery; Rightful Rejection..... 129

2A-510. Installment Lease Contracts: Rejection and Default..... 130

2A-511. Merchant Lessee's Duties as to Rightfully Rejected Goods..... 132

2A-512. Lessee's Duties as to Rightfully Rejected Goods..... 134

2A-513. Cure by Lessor of Improper Tender or Delivery; Replacement..... 135

2A-514. Waiver of Lessee's Objections..... 136

2A-515. Acceptance of Goods..... 138

2A-516.	Effect of Acceptance of Goods; Notice of Default; Burden of Establishing Default After Acceptance; Notice of Claim or Litigation to Person Answerable Over	139
2A-517.	Revocation of Acceptance of Goods	143
2A-518.	Cover; Substitute Goods	144
2A-519.	Lessee's Damages for Non-delivery, Repudiation, Default and Breach of Warranty in Regard to Accepted Goods	147
2A-520.	Lessee's Incidental and Consequential Damages	150
2A-521.	Lessee's Right to Specific Performance or Replevin	151
2A-522.	Lessee's Right to Goods on Lessor's Insolvency	152
C.	Default by Lessee	
2A-523.	Lessor's Remedies	153
2A-524.	Lessor's Right to Identify Goods to Lease Contract	159
2A-525.	Lessor's Right to Possession of Goods	160
2A-526.	Lessor's Stoppage of Delivery in Transit or Otherwise	162
2A-527.	Lessor's Rights to Dispose of Goods	164
2A-528.	Lessor's Damages for Non-acceptance or Repudiation	169
2A-529.	Lessor's Action for the Rent	172
2A-530.	Lessor's Incidental Damages	177
2A-531.	Standing to Sue Third Parties for Injury to Goods	178

ARTICLE 1 AND ARTICLE 9: CONFORMING AMENDMENTS

1-105. Territorial Application of the Act; Parties' Power to Choose Applicable Law..... 179

1-201(37). General Definitions: "Security Interest".... 180

9-113. Security Interests Arising Under Article on Sales or Under Article on Leases..... 187

PART 1. GENERAL PROVISIONS

§ 2A-101. SHORT TITLE.

This Article shall be known and may be cited as the Uniform Commercial Code - Leases.

OFFICIAL COMMENT

Rationale for Codification:

There are several reasons for codifying the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least three significant issues to be resolved by codification. First, what is a lease? It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases. Yet the distinction between a lease and a security interest disguised as a lease is not clear. Second, will the lessor be deemed to have made warranties to the lessee? If the transaction is a sale the express and implied warranties of Article 2 of the Uniform Commercial Code apply. However, the warranty law with respect to leases is uncertain. Third, what remedies are available to the lessor upon the lessee's default? If the transaction is a security interest disguised as a lease, the answer is stated in Part 5 of the Article on Secured Transactions (Article 9). There is no clear answer with respect to leases.

There are reasons to codify the law with respect to leases of goods in addition to those suggested by a review of the reported cases. The answer to this important question should not be limited to the issues raised in these cases. Is it not also proper to determine the remedies available to the lessee upon the lessor's default? It is, but that issue is not reached through a review of the reported cases. This is only one of the many issues presented in structuring, negotiating and documenting a lease of goods.

Statutory Analogue:

After it was decided to proceed with the codification project, the drafting committee of the National Conference of Commissioners on Uniform State Laws looked for a statutory analogue, gradually narrowing the focus to the Article on Sales (Article 2) and the Article on Secured Transactions (Article 9). A review of the literature with respect to the sale of goods reveals that Article 2 is predicated upon certain assumptions: Parties to the sales transaction frequently are without counsel; the agreement of the parties often is oral or evidenced by scant writings; obligations between the parties are bilateral; applicable law is influenced by the need to preserve freedom of contract. A review of the literature with respect to personal property security law reveals that Article 9 is predicated upon very different assumptions: Parties to a secured transaction regularly are represented by counsel; the agreement of the parties frequently is reduced to a writing, extensive in scope; the obligations between the parties are essentially unilateral; and applicable law seriously limits freedom of contract.

The lease is closer in spirit and form to the sale of goods than to the creation of a security interest. While parties to a lease are sometimes represented by counsel and their agreement is often reduced to a writing, the obligations of the parties are bilateral and the common law of leasing is dominated by the need to preserve freedom of contract. Thus the drafting committee concluded that Article 2 was the appropriate statutory analogue.

Issues:

The drafting committee then identified and resolved several issues critical to codification:

Scope: The scope of the Article was limited to leases (Section 2A-102). There was no need to include leases intended as security, i.e., security interests disguised as leases, as they are adequately treated in Article 9. Further, even if leases intended as security were included, the need to preserve the distinction would remain, as policy suggests treatment significantly different from that accorded leases.

Definition of Lease: Lease was defined to exclude leases intended as security (Section 2A-101(1)(j)). Given the litigation to date a revised definition of security interest was suggested for

inclusion in the Act. (Section 1-201(37)). This revision sharpens the distinction between leases and security interests disguised as leases.

Filing: The lessor was not required to file a financing statement against the lessee or take any other action to protect the lessor's interest in the goods (Section 2A-301). The refined definition of security interest will more clearly signal the need to file to potential lessors of goods. Those lessors who are concerned will file a protective financing statement (Section 9-408).

Warranties: All of the express and implied warranties of the Article on Sales (Article 2) were included (Sections 2A-210 through 2A-216), revised to reflect differences in lease transactions. The lease of goods is sufficiently similar to the sale of goods to justify this decision. Further, many courts have reached the same decision.

Certificate of Title Laws: Many leasing transactions involve goods subject to certificate of title statutes. To avoid conflict with those statutes, this Article is subject to them (Section 2A-104(1)(b)).

Consumer Leases: Many leasing transactions involve parties subject to consumer protection statutes. To avoid conflict with those statutes this Article is subject to them (Section 2A-104(1)(a) and (d)). Further, certain consumer protections have been incorporated in the Article.

Finance Leases: Certain leasing transactions substitute the seller of the goods for the lessor as the party responsible to the lessee with respect to warranties and the like. The definition of finance lease (Section 2A-103(1)(g)) was developed to describe these transactions. Various sections of the Article implement the substitution of the seller for the lessor, including Sections 2A-209 and 2A-407. No attempt was made to fashion a special rule where the finance lessor is an affiliate of the seller of goods; this is to be developed by the courts, case by case.

Sale and Leaseback: Sale and leaseback transactions are becoming increasingly common. A number of state statutes treat transactions where possession is retained by the seller as fraudulent per se or prima

facie fraudulent. That position is not balanced and thus is changed by the Article "if the buyer bought for value and in good faith" (Section 2A-308(3)).

Remedies: The Article has not only provided for lessor's remedies upon default by the lessee (Sections 2A-523 through 2A-531), but also for lessee's remedies upon default by the lessor (Sections 2A-508 through 2A-522). This is a significant departure from Article 9, which provides remedies only for the secured party upon default by the debtor. This difference is compelled by the bilateral nature of the obligations between the parties to a lease.

Damages: Many leasing transactions are predicated on the parties' ability to stipulate an appropriate measure of damages in the event of default. The rule with respect to sales of goods (Section 2-718) is not sufficiently flexible to accommodate this practice. Consistent with the common law emphasis upon freedom to contract, the Article has created a revised rule that allows greater flexibility with respect to leases of goods (Section 2A-504(1)).

History:

This Article is a revision of the Uniform Personal Property Leasing Act, which was approved by the National Conference of Commissioners on Uniform State Laws in August, 1985. However, it was believed that the subject matter of the Uniform Personal Property Leasing Act would be better treated as an article of this Act. Thus, although the Conference promulgated the Uniform Personal Property Leasing Act as a Uniform Law, activity was modest to allow time to restate the Uniform Personal Property Leasing Act as Article 2A.

In August, 1986 the Conference approved and recommended this Article (including conforming amendments to Article 1 and Article 9) for promulgation as an amendment to this Act. In December, 1986 the Council of the American Law Institute approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In March, 1987 the Permanent Editorial Board for the Uniform Commercial Code approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In May, 1987 the American Law Institute approved and recommended this Article (including conforming amendments

to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In August, 1987 the Conference confirmed its approval of the final text of this Article.

Relationship of Article 2A to Other Articles:

The Article on Sales provided a useful point of reference for codifying the law of leases. Many of the provisions of that Article were carried over, changed to reflect differences in style, leasing terminology or leasing practices. Thus, the official comments to those sections of Article 2 whose provisions were carried over are incorporated by reference in Article 2A, as well; further, any case law interpreting those provisions should be viewed as persuasive but not binding on a court when deciding a similar issue with respect to leases. Any change in the sequence that has been made when carrying over a provision from Article 2 should be viewed as a matter of style, not substance. This is not to suggest that in other instances Article 2A did not also incorporate substantially revised provisions of Article 2, Article 9 or otherwise where the revision was driven by a concern over the substance; but for the lack of a mandate, the drafting committee would have made the same or a similar change in the statutory analogue. Those sections in Article 2A include Sections 2A-104, 2A-105, 2A-106, 2A-108(2) and (4), 2A-109(2), 2A-208, 2A-214(2) and (3)(a), 2A-216, 2A-303, 2A-306, 2A-503, 2A-504(3)(b), 2A-506(2), and 2A-515. For lack of relevance or significance not all of the provisions of Article 2 were incorporated in Article 2A.

This codification was greatly influenced by the fundamental tenet of the common law as it has developed with respect to leases of goods: freedom of the parties to contract. Note that, like all other Articles of this Act, the principles of construction and interpretation contained in Article 1 are applicable throughout Article 2A (Section 2A-103(4)). These principles include the ability of the parties to vary the effect of the provisions of Article 2A, subject to certain limitations including those that relate to the obligations of good faith, diligence, reasonableness and care (Section 1-102(3)). Consistent with those principles no negative inference is to be drawn by the episodic use of the phrase "unless otherwise agreed" in certain provisions of Article 2A. Section 1-102(4). Indeed, the contrary is true, as the general rule in the Act, including this Article, is that the effect of the Act's provisions may be varied by agreement. Section 1-102(3). This conclusion follows even where the statutory analogue contains the phrase and the correlative provision in Article 2A does not.

§ 2A-102. SCOPE.

This Article applies to any transaction, regardless of form, that creates a lease.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-102(1). Throughout this Article, unless otherwise stated, references to "Section" are to other sections of this Act.

Changes: Substantially revised.

Purposes: This Article governs transactions as diverse as the lease of a hand tool to an individual for a few hours and the leveraged lease of a complex line of industrial equipment to a multi-national organization for a number of years.

To achieve that end it was necessary to provide that this Article applies to any transaction, regardless of form, that creates a lease. Since lease is defined as a transfer of an interest in goods (Section 2A-103(1)(j)) and goods is defined to include fixtures (Section 2A-103(1)(h)), application is limited to the extent the transaction relates to goods, including fixtures. Further, since the definition of lease does not include a sale (Section 2-106(1)) or retention or creation of a security interest (Section 1-201(37)), application is further limited; sales and security interests are governed by other Articles of this Act.

Finally, in recognition of the diversity of the transactions to be governed, the sophistication of many of the parties to these transactions, and the common law tradition as it applies to the bailment for hire or lease, freedom of contract has been preserved. DeKoven, Proceedings After Default by the Lessee Under a True Lease of Equipment, in 1C P. Coogan, W. Hogan, D. Vagts, Secured Transactions Under the Uniform Commercial Code, § 29B.02[2] (1986). Thus, despite the extensive regulatory scheme established by this Article, the parties to a lease will be able to create private rules to govern their transaction. Sections 2A-103(4) and 1-102(3). However, there are special rules in this Article governing consumer leases, as well as other state and federal statutes, that may further limit freedom of contract with respect to consumer leases.

A court may apply this Article by analogy to any transaction, regardless of form, that creates a lease of personal property other than goods, taking into account the expressed intentions of the parties to the transaction and any differences between a lease of goods and a lease of other property. Such application has precedent as the provisions of the Article on Sales (Article 2) have been applied by analogy to leases of goods. E.g., Hawkland, The Impact of the Uniform Commercial Code on Equipment Leasing, 1972 Ill. L.F. 446; Murray, Under the Spreading Analogy of Article 2 of the Uniform Commercial Code, 39 Fordham L. Rev. 447 (1971). Whether such application would be appropriate for other bailments of personal property, gratuitous or for hire, should be determined by the facts of each case. See Mieske v. Bartell Drug Co., 92 Wash. 2d 40, 46-48, 593 P.2d 1308, 1312 (1979).

Further, parties to a transaction creating a lease of personal property other than goods, or a bailment of personal property may provide by agreement that this Article applies. Upholding the parties' choice is consistent with the spirit of this Article.

Cross References:

Sections 1-102(3), 1-201(37), Article 2, esp. Section 2-106(1), and Sections 2A-103(1)(h), 2A-103(1)(j) and 2A-103(4).

Definitional Cross Reference:

"Lease". Section 2A-103(1)(j).

§ 2A-103. DEFINITIONS AND INDEX OF DEFINITIONS.

(1) In this Article unless the context otherwise requires:

(a) "Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him [or her] is in violation of the ownership rights or security interest or leasehold 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. "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.

(b) "Cancellation" occurs when either party puts an end to the lease contract for default by the other party.

(c) "Commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of lease and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article, as a machine, or a set of articles, as a suite of furniture or a line of machinery, or a quantity, as a gross or carload, or any other unit treated in use or in the relevant market as a single whole.

(d) "Conforming" goods or performance under a lease contract means goods or performance that are in accordance with the obligations under the lease contract.

(e) "Consumer lease" means a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee, except an organization, who takes

under the lease primarily for a personal, family, or household purpose, if the total payments to be made under the lease contract, excluding payments for options to renew or buy, do not exceed $25,000.

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

(g) "Finance lease" means a lease in which (i) the lessor does not select, manufacture or supply the goods, (ii) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease, and (iii) either the lessee receives a copy of the contract evidencing the lessor's purchase of the goods on or before signing the lease contract, or the lessee's approval of the contract evidencing the lessor's purchase of the goods is a condition to effectiveness of the lease contract.

(h) "Goods" means all things that are movable at the time of identification to the lease contract, or are fixtures (Section 2A-309), but the term does not include money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like, including oil and gas, before extraction. The term also includes the unborn young of animals.

(i) "Installment lease contract" means a lease contract that authorizes or requires the delivery of goods in separate lots to be separately accepted, even though the lease contract contains a clause "each delivery is a separate lease" or its equivalent.

(j) "Lease" means a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease. Unless the context clearly indicates otherwise, the term includes a sublease.

(k) "Lease agreement" means the bargain, with respect to the lease, of the lessor and the lessee 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 Article. Unless the context clearly indicates otherwise, the term includes a sublease agreement.

(l) "Lease contract" means the total legal obligation that results from the lease agreement as affected by this Article and any other applicable rules of law. Unless the context clearly indicates otherwise, the term includes a sublease contract.

(m) "Leasehold interest" means the interest of the lessor or the lessee under a lease contract.

(n) "Lessee" means a person who acquires the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessee.

(o) "Lessee in ordinary course of business" means a person who in good faith and without knowledge that the lease to him [or her] is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods leases in ordinary course from a person in the business of selling or leasing goods of that kind but does not include a pawnbroker. "Leasing" 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 lease contract but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(p) "Lessor" means a person who transfers the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessor.

(q) "Lessor's residual interest" means the lessor's interest in the goods after expiration, termination, or cancellation of the lease contract.

(r) "Lien" means a charge against or interest in goods to secure payment of a debt or performance of an

obligation, but the term does not include a security interest.

(s) "Lot" means a parcel or a single article that is the subject matter of a separate lease or delivery, whether or not it is sufficient to perform the lease contract.

(t) "Merchant lessee" means a lessee that is a merchant with respect to goods of the kind subject to the lease.

(u) "Present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate was not manifestly unreasonable at the time the transaction was entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

(v) "Purchase" includes taking by sale, lease, mortgage, security interest, pledge, gift, or any other voluntary transaction creating an interest in goods.

(w) "Sublease" means a lease of goods the right to possession and use of which was acquired by the lessor as a lessee under an existing lease.

(x) "Supplier" means a person from whom a lessor buys or leases goods to be leased under a finance lease.

(y) "Supply contract" means a contract under which a lessor buys or leases goods to be leased.

(z) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the lease contract otherwise than for default.

(2) Other definitions applying to this Article and the sections in which they appear are:

"Accessions". Section 2A-310(1).

"Construction mortgage". Section 2A-309(1)(d).

"Encumbrance". Section 2A-309(1)(e).

"Fixtures". Section 2A-309(1)(a).

"Fixture filing". Section 2A-309(1)(b).

"Purchase money lease". Section 2A-309(1)(c).

(3) The following definitions in other Articles apply to this Article:

"Accounts". Section 9-106.

"Between merchants". Section 2-104(3).

"Buyer". Section 2-103(1)(a).

"Chattel paper". Section 9-105(1)(b).

"Consumer goods". Section 9-109(1).

"Documents". Section 9-105(1)(f).

"Entrusting". Section 2-403(3).

"General intangibles". Section 9-106.

"Good faith". Section 2-103(1)(b).

"Instruments". Section 9-105(1)(i).

"Merchant". Section 2-104(1).

"Mortgage". Section 9-105(1)(j).

"Pursuant to commitment". Section 9-105(1)(k).

"Receipt". Section 2-103(1)(c).

"Sale". Section 2-106(1).

"Sale on Approval". Section 2-326.

"Sale or Return". Section 2-326.

"Seller". Section 2-103(1)(d).

(4) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

OFFICIAL COMMENT

(a) "Buyer in ordinary course of business". Section 1-201(9).

(b) "Cancellation". Section 2-106(4).

(c) "Commercial unit". Section 2-105(6).

(d) "Conforming". Section 2-106(2).

(e) "Consumer lease". New. This Article includes a subset of rules that applies only to consumer leases. Sections 2A-106, 2A-108(2), 2A-108(4), 2A-109(2), 2A-221, 2A-309, 2A-406, 2A-407, 2A-504(3)(b), and 2A-516(3)(b).

For a transaction to qualify as a consumer lease it must first qualify as a lease. Section 2A-103(1)(j). Note that this Article regulates the transactional elements of a lease, including a consumer lease; consumer protection statutes - present and future - are unaffected by this Article. Section 2A-104(1)(a) and (d).

This definition is modeled after the definition of consumer lease in the Consumer Leasing Act, 15 U.S.C. § 1667 (1982), and in the Unif. Consumer Credit Code § 1.301(14), 7A U.L.A. 43 (1974). However, this definition of consumer lease differs from its models in several respects: the lessor can be a person regularly engaged either in the business of leasing or of selling goods, the lease need not be for a term exceeding four months, a lease primarily for an agricultural purpose is not covered and the limitation of $25,000 is not subject to adjustment as the Consumer Price Index changes.

This definition focuses on the parties as well as the transaction. If a lease is within this definition, the lessor must be regularly engaged in the business of leasing or selling, and the lessee must be an individual not an organization; note that a lease to two or more individuals having a common interest through marriage or the like should not be considered excluded as a lease to an organization under Section 1-201(28). The lessee must take the interest primarily for a personal, family or household purpose. Further, total payments under the lease contract, excluding payments for options to renew or buy, cannot exceed $25,000.

(f) "Fault". Section 1-201(16).

(g) "Finance Lease". New. This Article includes a subset of rules that applies only to finance leases. Sections 2A-209, 2A-211(2), 2A-212(1), 2A-213, 2A-219(1), 2A-220(1)(a), 2A-221, 2A-405(c), 2A-407, 2A-516(2) and 2A-517(1)(a).

For a transaction to qualify as a finance lease it must first qualify as a lease. Section 2A-103(1)(j). Unless the lessor is comfortable that the transaction will qualify as a finance lease, the lease agreement should include provisions giving the lessor the benefits created by the subset of rules applicable to the transaction that qualifies as a finance lease8unar this Article.

A finance lease is the product of a three party transaction. The supplier manufactures or supplies the goods pursuant to the lessee's specification, perhaps even pursuant to a purchase order, sales agreement or lease agreement between the supplier and the lessee. After the prospective finance lease is negotiated, a purchase order, sales agreement, or lease agreement is entered into by the lessor (as buyer or prime lessee) or an existing order, agreement or lease is assigned by the lessee to the lessor, and the lessor and the lessee then enter into a lease or sublease of the goods. Due to the limited function usually performed by the

lessor, the lessee looks almost entirely to the supplier for representations, covenants and warranties. Yet, this definition does not restrict the lessor's function solely to the supply of funds; if the lessor undertakes or performs other functions, express warranties, covenants and the common law will protect the lessee.

This definition focuses on the transaction, not the status of the parties; to avoid confusion it is important to note that in other contexts, e.g., tax and accounting, the term finance lease has been used to connote different types of lease transactions, including leases that are disguised secured transactions. M. Rice, Equipment Financing, 62-71 (1981). A lessor who is a merchant with respect to goods of the kind subject to the lease may be a lessor under a finance lease. Many leases that are leases back to the seller of goods (Section 2A-308(3)) will be finance leases. This conclusion is easily demonstrated by a hypothetical. Assume that B has bought goods from C pursuant to a sales contract. After delivery to and acceptance of the goods by B, B negotiates to sell the goods to A and simultaneously to lease the goods back from A, on terms and conditions that, we assume, will qualify the transaction as a lease. Section 2A-103(1)(j). In documenting the sale and lease back, B assigns the original sales contract between B, as buyer, and C, as seller, to A. A review of these facts leads to the conclusion that the lease from A to B qualifies as a finance lease, as all three conditions of the definition are satisfied. Subparagraph (i) is satisfied as A, the lessor, had nothing to do with the selection, manufacture, or supply of the equipment. Subparagraph (ii) is satisfied as A, the lessor, bought the equipment at the same time that A leased the equipment to B, which certainly is in connection with the lease. Finally, subparagraph (iii) is satisfied as A entered into the sales contract with B at the same time that A leased the equipment back to B. B, the lessee, will have received a copy of the sales contract in a timely fashion.

Subsection (i) requires the lessor to remain outside the selection, manufacture and supply of the goods; that is the rationale for releasing the lessor from most of its traditional liability. The lessor is not prohibited from possession, maintenance or operation of the goods, as policy does not require such prohibition. To insure the lessee's reliance on the supplier, and not on the lessor, subsection (ii) requires that the goods (where the lessor is the buyer of the goods) or that the right to possession and use of the goods (where the lessor is the prime lessee and the sublessor of the goods) be acquired in connection with the lease (or sublease) to qualify as a finance lease. The scope of the

phrase "in connection with" is to be developed by the courts, case by case. Finally, as the lessee generally relies almost entirely upon the supplier for representations, covenants and warranties with respect to the goods, subsection (iii) requires that the lessee receive a copy of the supply contract on or before signing the lease contract or that the lessee's approval of the supply contract is a condition to the effectiveness of the lease contract. Thus, even where oral supply orders or computer placed supply orders are compelled by custom and usage the transaction may still qualify as a finance lease if the lessee approves the supply contract before the lease contract is effective and such approval was a condition to the effectiveness of the lease contract.

If a transaction does not qualify as a finance lease, the parties may achieve the same result by agreement; no negative implications are to be drawn if the transaction does not qualify. Further, absent the application of special rules (fraud, duress, and the like), a lease that qualifies as a finance lease and is assigned by the lessor or the lessee to a third party does not lose its status as a finance lease under this Article. Finally, this Article creates no special rule where the lessor is an affiliate of the supplier; whether the transaction qualifies as a finance lease will be determined by the facts of each case.

(h) "Goods". Section 9-105(1)(h). See Section 2A-103(3) for reference to the definition of "Accounts", "Chattel paper", "Documents", "General intangibles" and "Instruments". See Section 2A-217 for determination of the time and manner of identification.

(i) "Installment lease contract". Section 2-612(1).

(j) "Lease". New. There are several reasons to codify the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least several significant issues to be resolved by codification. First and foremost is the definition of a lease. It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the transaction will be governed by the Article on Secured Transactions (Article 9) and the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases under the common law and, except with respect to leases of fixtures (Section 2A-309), this Article

imposes no such requirement. Yet the distinction between a lease and a security interest disguised as a lease is not clear from the case law at the time of the promulgation of this Article. DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.S.F. L. Rev. 257 (1978).

At common law a lease of personal property is a bailment for hire. While there are several definitions of bailment for hire, all require a thing to be let and a price for the letting. Thus, in modern terms and as provided in this definition, a lease is created when the lessee agrees to furnish consideration for the right to the possession and use of goods over a specified period of time. Mooney, Personal Property Leasing: A Challenge, 36 Bus. Law. 1605, 1607 (1981). Further, a lease is neither a sale (Section 2-106(1)) nor a retention or creation of a security interest (Section 1-201(37)). Due to extensive litigation to distinguish true leases from security interests, an amendment to Section 1-201(37) has been promulgated with this Article to create a sharper distinction.

This section as well as Section 1-201(37) must be examined to determine whether the transaction in question creates a lease or a security interest. The following hypotheticals indicate the perimeters of the issue. Assume that A has purchased a number of copying machines, new, for $1,000 each; the machines have an estimated useful economic life of three years. A advertises that the machines are available to rent for a minimum of one month and that the monthly rental is $100.00. A intends to enter into leases where A provides all maintenance, without charge to the lessee. Further, the lessee will rent the machine, month to month, with no obligation to renew. At the end of the lease term the lessee will be obligated to return the machine to A's place of business. This transaction qualifies as a lease under the first half of the definition, for the transaction includes a transfer by A to a prospective lessee of possession and use of the machine for a stated term, month to month. The machines are goods (Section 2A-103(1)(h)). The lessee is obligated to pay consideration in return, $100.00 for each month of the term.

However, the second half of the definition provides that a sale or a security interest is not a lease. Since there is no passing of title, there is no sale. Sections 2A-103(3) and 2-106(1). Under pre-Act security law this transaction would have created a bailment for hire or a true lease and not a conditional sale. Da Rocha v. Macomber, 330 Mass. 611, 614-15, 116 N.E.2d 139, 142 (1953). Under Section

1-201(37), as amended with the promulgation of this Article, the same result would follow. While the lessee is obligated to pay rent for the one month term of the lease, one of the other four conditions of the second paragraph of Section 1-201(37) must be met and none is. The term of the lease is one month and the economic life of the machine is 36 months; thus, subparagraph (a) of Section 1-201(37) is not now satisfied. Considering the amount of the monthly rent, absent economic duress or coercion, the lessee is not bound either to renew the lease for the remaining economic life of the goods or to become the owner. If the lessee did lease the machine for 36 months, the lessee would have paid the lessor $3,600 for a machine that could have been purchased for $1,000; thus, subparagraph (b) of Section 1-201(37) is not satisfied. Finally, there are no options; thus, subparagraphs (c) and (d) of Section 1-201(37) are not satisfied. This transaction creates a lease, not a security interest. However, with each renewal of the lease the facts and circumstances at the time of each renewal must be examined to determine if that conclusion remains accurate, as it is possible that a transaction that first creates a lease, later creates a security interest.

Assume that the facts are changed and that A requires each lessee to lease the goods for 36 months, with no right to terminate. Under pre-Act security law this transaction would have created a conditional sale, and not a bailment for hire or true lease. Hervey v. Rhode Island Locomotive Works, 93 U.S. 664, 672-73 (1876). Under this subsection, and Section 1-201(37), as amended with the inclusion of this Article in the Act, the same result would follow. The lessee's obligation for the term is not subject to termination by the lessee and the term is equal to the economic life of the machine.

Between these extremes there are many transactions that can be created. Some of the transactions have not been properly categorized by the courts in applying the 1978 and earlier Official Texts of Section 1-201(37). This subsection, together with Section 1-201(37), as amended with the promulgation of this Article, draws a brighter line, which should create a clearer signal to the professional lessor and lessee.

(k) "Lease agreement". This definition is derived from the first sentence of Section 1-201(3). Because the definition of lease is broad enough to cover future transfers, lease agreement includes an agreement contemplating a current or subsequent transfer. Thus it was not necessary to make an express reference to an agreement

for the future lease of goods (Section 2-106(1)). This concept is also incorporated in the definition of lease contract. Note that the definition of lease does not include transactions in ordinary building materials that are incorporated into an improvement on land. Section 2A-309(2).

The provisions of this Article, if applicable, determine whether a lease agreement has legal consequences; otherwise the law of bailments and other applicable law determine the same. Sections 2A-103(4) and 1-103.

(l) "Lease contract". This definition is derived from the definition of contract in Section 1-201(11). Note that a lease contract may be for the future lease of goods, since this notion is included in the definition of lease.

(m) "Leasehold interest". New.

(n) "Lessee". New.

(o) "Lessee in ordinary course of business". Section 1-201(9).

(p) "Lessor". New.

(q) "Lessor's residual interest". New.

(r) "Lien". New. This term is used in Section 2A-307 (Priority of Liens Arising by Attachment or Levy on, Security Interests in, and Other Claims to Goods).

(s) "Lot". Section 2-105(5).

(t) "Merchant lessee". New. This term is used in Section 2A-511 (Merchant Lessee's Duties as to Rightfully Rejected Goods). A person may satisfy the requirement of dealing in goods of the kind subject to the lease as lessor, lessee, seller, or buyer.

(u) "Present value". New. Authorities agree that present value should be used to determine fairly the damages payable by the lessor or the lessee on default. E.g., Taylor v. Commercial Credit Equip. Corp., 170 Ga. App. 322, 316 S.E.2d 788 (Ct. App. 1984). Present value is defined to mean an amount that represents the discounted value as of a date certain of one or more sums payable in the future. This is a function of the economic principle that a dollar today is more valuable to the holder than a dollar payable in two years. While there is no question as to the principle, reasonable people would differ as to the rate of discount to

apply in determining the value of that future dollar today. To minimize litigation, this Article allows the parties to specify the discount or interest rate, if the rate was not manifestly unreasonable at the time the transaction was entered into. In all other cases, the interest rate will be a commercially reasonable rate that takes into account the facts and circumstances of each case, as of the time the transaction was entered into.

(v) "Purchase". Section 1-201(32). This definition omits the reference to lien contained in the definition of purchase in Article 1 (Section 1-201(32)). This should not be construed to exclude consensual liens from the definition of purchase in this Article; the exclusion was mandated by the scope of the definition of lien in Section 2A-103(1)(r). Further, the definition of purchaser in this Article adds a reference to lease; as purchase is defined in Section 1-201(32) to include any other voluntary transaction creating an interest in property, this addition is not substantive.

(w) "Sublease". New.

(x) "Supplier". New.

(y) "Supply contract". New.

(z) "Termination". Section 2-106(3).

§ 2A-104. LEASES SUBJECT TO OTHER STATUTES.

(1) A lease, although subject to this Article, is also subject to any applicable:

(a) statute of the United States;

(b) certificate of title statute of this State: (list any certificate of title statutes covering automobiles, trailers, mobile homes, boats, farm tractors, and the like);

(c) certificate of title statute of another jurisdiction (Section 2A-105); or

(d) consumer protection statute of this State.

(2) In case of conflict between the provisions of this Article, other than Sections 2A-105, 2A-304(3) and 2A-305(3), and any statute referred to in subsection (1), the provisions of that statute control.

(3) Failure to comply with any applicable statute has only the effect specified therein.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 9-203(4) and 9-302(3)(b) and (c).

Changes: Substantially revised.

Purposes: This Article creates a comprehensive scheme for the regulation of transactions that create leases. Section 2A-102. Thus, the Article supersedes all prior legislation dealing with leases, except to the extent set forth in this Section.

Subsection (1) states the general rule that a lease, although governed by the scheme of this Article, is also governed by certain other applicable statutes. This may occur in the case of a consumer lease. Section 2A-103(1)(e). An illustration of a statute of the United States that governs consumer leases is the Consumer Leasing Act, 15 U.S.C. §§ 1667-1667(e) (1982) and its implementing regulation, Regulation M, 12 C.F.R. § 213 (1986); the statute mandates disclosures of certain lease terms, delimits the liability of a lessee in leasing personal property, and regulates the advertising of lease terms. An illustration of a state statute that governs consumer leases is the Unif. Consumer Credit Code, which includes many provisions similar to those of the Consumer Leasing Act, e.g. Unif. Consumer Credit Code §§ 3.202, 3.209, 3.401, 7A U.L.A. 108-09, 115, 125 (1974), as well as provisions in addition to those of the Consumer Leasing Act, e.g., Unif. Consumer Credit Code §§ 5.109-.111, 7A U.L.A. 171-76 (1974) (the right to cure a default). Such statutes may define consumer lease so as to govern transactions within and without the definition of consumer lease under this Article.

Under subsection (2), subject to certain limited exclusions, in case of conflict the provisions of such a

statute prevail over the provisions of this Article. For example, a provision like Unif. Consumer Credit Code § 5.112, 7A U.L.A. 176 (1974), limiting self-help repossession, prevails over Section 2A-525(3).

Consumer protection in lease transactions is primarily left to other law. However, several provisions of this Article do contain special rules that may not be varied by agreement in the case of a consumer lease. E.g., Sections 2A-106, 2A-108, and 2A-109(2). Were that not so, the ability of the parties to govern their relationship by agreement together with the position of the lessor in a consumer lease too often could result in a one-sided lease agreement.

In construing this provision the reference to statute should be deemed to include applicable regulations.

Cross References:

Sections 2A-103(1)(e), 2A-106, 2A-108, 2A-109(2), and 2A-525(3).

Definitional Cross Reference:

"Lease". Section 2A-103(1)(j).

§ 2A-105. TERRITORIAL APPLICATION OF ARTICLE TO GOODS COVERED BY CERTIFICATE OF TITLE.

Subject to the provisions of Sections 2A-304(3) and 2A-305(3), with respect to goods covered by a certificate of title issued under a statute of this State or of another jurisdiction, compliance and the effect of compliance or noncompliance with a certificate of title statute are governed by the law (including the conflict of laws rules) of the jurisdiction issuing the certificate until the earlier of (a) surrender of the certificate, or (b) four months after the goods are removed from that jurisdiction and thereafter

until a new certificate of title is issued by another jurisdiction.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-103(2)(a) and (b).

Changes: Substantially revised. The provisions of the last sentence of Section 9-103(2)(b) have not been incorporated as it is superfluous in this context. The provisions of Section 9-103(2)(d) have not been incorporated because the problems dealt with are adequately addressed by this section and Sections 2A-304(3) and 305(3).

Purposes: The new certificate referred to in (b) must be permanent, not temporary. Generally, the lessor or creditor whose interest is indicated on the most recently issued certificate of title will prevail over interests indicated on certificates issued previously by other jurisdictions. This provision reflects a policy that it is reasonable to require holders of interests in goods covered by a certificate of title to police the goods or risk losing their interests when a new certificate of title is issued by another jurisdiction.

Cross References:

Sections 2A-304(3), 2A-305(3), 9-103(2)(b) and 9-103(2)(d).

Definitional Cross Reference:

"Goods". Section 2A-103(1)(h).

§ 2A-106. LIMITATION ON POWER OF PARTIES TO CONSUMER LEASE TO CHOOSE APPLICABLE LAW AND JUDICIAL FORUM.

(1) If the law chosen by the parties to a consumer lease is that of a jurisdiction other than a jurisdiction in which the lessee resides at the time the lease agreement becomes enforceable or within 30 days thereafter or in which the goods are to be used, the choice is not enforceable.

(2) If the judicial forum chosen by the parties to a consumer lease is a forum that would not otherwise have jurisdiction over the lessee, the choice is not enforceable.

OFFICIAL COMMENT

Uniform Statutory Source: Unif. Consumer Credit Code § 1.201(8), 7A U.L.A. 36 (1974).

Changes: Substantially revised.

Purposes: There is a real danger that a lessor may induce a consumer lessee to agree that the applicable law will be a jurisdiction that has little effective consumer protection, or to agree that the applicable forum will be a forum that is inconvenient for the lessee in the event of litigation. As a result, this section invalidates these choice of law or forum clauses, except where the law chosen is that of the state of the consumer's residence or where the goods will be kept, or the forum chosen is one that otherwise would have jurisdiction over the lessee.

Subsection (1) limits potentially abusive choice of law clauses in consumer leases. The 30-day rule in subsection (1) was suggested by Section 9-103(1)(c). This section has no effect on choice of law clauses in leases that are not consumer leases. Such clauses would be governed by other law.

Subsection (2) prevents enforcement of potentially abusive jurisdictional consent clauses in consumer leases. By using the term judicial forum, this section does not limit selection of a nonjudicial forum, such as arbitration. This section has no effect on choice of forum clauses in leases that are not consumer leases; such clauses are, as a matter of current law, "prima facie valid". The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 10 (1972). Such clauses would be governed by other law, including the Model Choice of Forum Act (1968).

Cross Reference:

Section 9-103(1)(c).

Definitional Cross Reference:

"Consumer lease". Section 2A-103(1)(e).
"Lease agreement". Section 2A-103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Goods". Section 2A-103(1)(h).
"Party". Section 1-201(29).

§ 2A-107. WAIVER OR RENUNCIATION OF CLAIM OR RIGHT AFTER DEFAULT.

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-107.

Changes: Revised to reflect leasing practices and terminology. This clause is used throughout the official comments to this Article to indicate the scope of change in the provisions of the Uniform Statutory Source included in the section; these changes range from one extreme, e.g., a significant difference in practice (a warranty as to merchantability is not implied in a finance lease (Section 2A-212)) to the other extreme, e.g., a modest difference in style or terminology (the transaction governed is a lease not a sale (Section 2A-203)).

Cross References:

Sections 2A-203 and 2A-212.

Definitional Cross References:

"Aggrieved party". Section 1-201(2).
"Delivery". Section 1-201(14).
"Rights". Section 1-201(36).
"Signed". Section 1-201(39).
"Written". Section 1-201(46).

§ 2A-108. UNCONSCIONABILITY.

(1) If the court as a matter of law finds a lease contract or any clause of a lease contract to have been unconscionable at the time it was made the court may refuse to enforce the lease contract, or it may enforce the remainder of the lease contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) With respect to a consumer lease, if the court as a matter of law finds that a lease contract or any clause of a lease contract has been induced by unconscionable conduct or that unconscionable conduct has occurred in the collection of a claim arising from a lease contract, the court may grant appropriate relief.

(3) Before making a finding of unconscionability under subsection (1) or (2), the court, on its own motion or that of a party, shall afford the parties a reasonable opportunity to present evidence as to the setting, purpose, and effect of the lease contract or clause thereof, or of the conduct.

(4) In an action in which the lessee claims unconscionability with respect to a consumer lease:

(a) If the court finds unconscionability under subsection (1) or (2), the court shall award reasonable attorney's fees to the lessee.

(b) If the court does not find unconscionability and the lessee claiming unconscionability has brought or maintained an action he [or she] knew to be groundless, the court shall award reasonable attorney's fees to the party against whom the claim is made.

(c) In determining attorney's fees, the amount of the recovery on behalf of the claimant under subsections (1) and (2) is not controlling.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-302 and Unif. Consumer Credit Code § 5.108, 7A U.L.A. 167-69 (1974).

Changes: Subsection (1) is taken almost verbatim from the provisions of Section 2-302(1). Subsection (2) is suggested by the provisions of Unif. Consumer Credit Code § 5.108(1), (2), 7A U.L.A. 167 (1974). Subsection (3), taken from the provisions of Section 2-302(2), has been expanded to cover unconscionable conduct. Unif. Consumer Credit Code § 5.108(3), 7A U.L.A. 167 (1974). The provision for the award of attorney's fees to consumers, subsection (4), covers unconscionability under subsection (1) as well as (2). Subsection (4) is modeled on the provisions of Unif. Consumer Credit Code § 5.108(6), 7A U.L.A. 169 (1974).

Purposes: Subsections (1) and (3) of this section apply the concept of unconscionability reflected in the provisions of Section 2-302 to leases. See Dillman & Assocs. v. Capitol Leasing Co., 110 Ill. App. 3d 335, 342, 442 N.E.2d 311, 316 (App. Ct. 1982). Subsection (3) omits the adjective "commercial" found in subsection 2-302(2) because subsection (3) is concerned with all leases and the relevant standard of conduct is determined by the context.

The balance of the section is modeled on the provisions of Unif. Consumer Credit Code § 5.108, 7A U.L.A. 167-69 (1974). Thus subsection (2) recognizes that a consumer lease or a clause in a consumer lease may not itself be unconscionable but that the agreement would never have been entered into if unconscionable means had not been employed to induce the consumer to agree. To make a

statement to induce the consumer to lease the goods, in the expectation of invoking an integration clause in the lease to exclude the statement's admissibility in a subsequent dispute, may be unconscionable. Subsection (2) also provides a consumer remedy for unconscionable conduct, such as using or threatening to use force or violence, in the collection of a claim arising from a lease contract. These provisions are not exclusive. The remedies of this section are in addition to remedies otherwise available for the same conduct under other law, for example, an action in tort for abusive debt collection or under another statute of this State for such conduct. The reference to appropriate relief in subsection (2) is intended to foster liberal administration of this remedy. Sections 2A-103(4) and 1-106(1).

Subsection (4) authorizes an award of reasonable attorney's fees if the court finds unconscionability with respect to a consumer lease under subsections (1) or (2). Provision is also made for recovery by the party against whom the claim was made if the court does not find unconscionability and does find that the consumer knew the action to be groundless. Further, subsection (4)(b) is independent of, and thus will not override, a term in the lease agreement that provides for the payment of attorney's fees.

Cross References:

Sections 1-106(1), 2-302 and 2A-103(4).

Definitional Cross Reference:

"Action". Section 1-201(1).
"Consumer lease". Section 2A-103(1)(e).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Party". Section 1-201(29).

§ 2A-109. OPTION TO ACCELERATE AT WILL.

(1) A term providing that one party or his [or her] successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or

"when he [or she] deems himself [or herself] insecure" or in words of similar import must be construed to mean that he [or she] has power to do so only if he [or she] in good faith believes that the prospect of payment or performance is impaired.

(2) With respect to a consumer lease, the burden of establishing good faith under subsection (1) is on the party who exercised the power; otherwise the burden of establishing lack of good faith is on the party against whom the power has been exercised.

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-208 and Unif. Consumer Credit Code § 5.109(2), 7A U.L.A. 171 (1974).

Purposes: Subsection (1) reflects modest changes in style to the provisions of the first sentence of Section 1-208.

Subsection (2), however, reflects a significant change in the provisions of the second sentence of Section 1-208 by creating a new rule with respect to a consumer lease. A lease provision allowing acceleration at the will of the lessor or when the lessor deems itself insecure is of critical importance to the lessee. In a consumer lease it is a provision that is not usually agreed to by the parties but is usually mandated by the lessor. Therefore, where its invocation depends not on specific criteria but on the discretion of the lessor, its use should be regulated to prevent abuse. Subsection (1) imposes a duty of good faith upon its exercise. Subsection (2) shifts the burden of establishing good faith to the lessor in the case of a consumer lease, but not otherwise.

Cross Reference:

Section 1-208.

Definitional Cross Reference:

"Burden of establishing". Section 1-201(8).
"Consumer lease". Section 2A-103(1)(e).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Party". Section 1-201(29).
"Term". Section 1-201(42).

PART 2. FORMATION AND CONSTRUCTION OF LEASE CONTRACT

§ 2A-201. STATUTE OF FRAUDS.

(1) A lease contract is not enforceable by way of action or defense unless:

(a) the total payments to be made under the lease contract, excluding payments for options to renew or buy, are less than $1,000; or

(b) there is a writing, signed by the party against whom enforcement is sought or by that party's authorized agent, sufficient to indicate that a lease contract has been made between the parties and to describe the goods leased and the lease term.

(2) Any description of leased goods or of the lease term is sufficient and satisfies subsection (1)(b), whether or not it is specific, if it reasonably identifies what is described.

(3) A writing is not insufficient because it omits or incorrectly states a term agreed upon, but the lease contract is not enforceable under subsection (1)(b) beyond the lease term and the quantity of goods shown in the writing.

(4) A lease contract that does not satisfy the requirements of subsection (1), but which is valid in other respects, is enforceable:

(a) if the goods are to be specially manufactured or obtained for the lessee and are not suitable for lease or sale to others in the ordinary course of the lessor's business, and the lessor, before notice of repudiation is received and under circumstances that reasonably indicate that the goods are for the lessee, has made either a substantial beginning of their manufacture or commitments for their procurement;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony or otherwise in court that a lease contract was made, but the lease contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods that have been received and accepted by the lessee.

(5) The lease term under a lease contract referred to in subsection (4) is:

(a) if there is a writing signed by the party against whom enforcement is sought or by that party's authorized agent specifying the lease term, the term so specified;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony, or otherwise in court a lease term, the term so admitted; or

(c) a reasonable lease term.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-201, 9-203(1) and 9-110.

Changes: This section is modeled on Section 2-201, with changes to reflect the differences between a lease contract and a contract for the sale of goods. In particular, subsection (1)(b) adds a requirement that the writing "describe the goods leased and the lease term", borrowing that concept, with revisions, from the provisions of Section 9-203(1)(a). Subsection (2), relying on the statutory analogue in Section 9-110, sets forth the minimum criterion for satisfying that requirement.

Purposes: The changes in this section conform the provisions of Section 2-201 to custom and usage in lease transactions. Section 2-201(2), stating a special rule between merchants, was not included in this section as the number of such transactions involving leases, as opposed to sales, was thought to be modest. Subsection (4) creates no exception for transactions where payment has been made and accepted. This represents a departure from the analogue, Section 2-201(3)(c). The rationale for the departure is grounded in the distinction between sales and leases. Unlike a buyer in a sales transaction, the lessee does not tender payment in full for goods delivered, but only payment of rent for one or more months. It was decided that, as a matter of policy, this act of payment is not a sufficient substitute for the required memorandum. Subsection (5) was needed to establish the criteria for supplying the lease term if it is omitted, as the lease contract may still be enforceable under subsection (4).

Cross References:

Sections 2-201, 9-110 and 9-203(1)(a).

Definitional Cross References:

"Action". Section 1-201(1).
"Agreed". Section 1-201(3).
"Buying". Section 2A-103(1)(a).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Sale". Section 2-106(1).
"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

§ 2A-202. FINAL WRITTEN EXPRESSION: PAROL OR EXTRINSIC EVIDENCE.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

(a) by course of dealing or usage of trade or by course of performance; and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-202.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Course of dealing". Section 1-205.
"Party". Section 1-201(29).
"Term". Section 1-201(42).
"Usage of trade". Section 1-205.
"Writing". Section 1-201(46).

§ 2A-203. SEALS INOPERATIVE.

The affixing of a seal to a writing evidencing a lease contract or an offer to enter into a lease contract does not render the writing a sealed instrument and the law with respect to sealed instruments does not apply to the lease contract or offer.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-203.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Lease contract". Section 2A-103(1)(l).
"Writing". Section 1-201(46).

§ 2A-204. FORMATION IN GENERAL.

(1) A lease contract may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of a lease contract.

(2) An agreement sufficient to constitute a lease contract may be found although the moment of its making is undetermined.

(3) Although one or more terms are left open, a lease contract does not fail for indefiniteness if the parties have intended to make a lease contract and there is a reasonably certain basis for giving an appropriate remedy.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-204.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Term". Section 1-201(42).

§ 2A-205. FIRM OFFERS.

An offer by a merchant to lease goods to or from another person in a signed writing that by its terms gives assurance it will be held open is not revocable, for lack of consideration, during the time stated or, if no time is stated, for a reasonable time, but in no event may the period of irrevocability exceed 3 months. Any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-205.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Merchant". Section 2-104(1).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

§ 2A-206. OFFER AND ACCEPTANCE IN FORMATION OF LEASE CONTRACT.

(1) Unless otherwise unambiguously indicated by the language or circumstances, an offer to make a lease contract must be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances.

(2) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-206(1)(a) and (2).

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Lease contract". Section 2A-103(1)(l).
"Notifies". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).

§ 2A-207. COURSE OF PERFORMANCE OR PRACTICAL CONSTRUCTION.

(1) If a lease contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection is relevant to determine the meaning of the lease agreement.

(2) The express terms of a lease agreement and any course of performance, as well as any course of dealing and usage of trade, must be construed whenever reasonable as consistent with each other; but if that construction is unreasonable, express terms control course of performance, course of performance controls both course of dealing and usage of trade, and course of dealing controls usage of trade.

(3) Subject to the provisions of Section 2A-208 on modification and waiver, course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-208 and 1-205(4).

Changes: Revised to reflect leasing practices and terminology, except that subsection (2) was further revised to make the subsection parallel the provisions of Section 1-205(4) by adding that course of dealing controls usage of trade.

Purposes: The section should be read in conjunction with Section 2A-208. In particular, although a specific term may control over course of performance as a matter of lease construction under subsection (2), subsection (3) allows the same course of dealing to show a waiver or modification, if Section 2A-208 is satisfied.

Cross References:

Sections 1-205(4), 2-208 and 2A-208.

Definitional Cross References:

"Course of dealing". Section 1-205.
"Knowledge". Section 1-201(25).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(1).
"Party". Section 1-201(29).
"Term". Section 1-201(42).
"Usage of trade". Section 1-205.

§ 2A-208. MODIFICATION, RESCISSION AND WAIVER.

(1) An agreement modifying a lease contract needs no consideration to be binding.

(2) A signed lease agreement that excludes modification or rescission except by a signed writing may not be otherwise modified or rescinded, but, except as between merchants, such a requirement on a form supplied by a merchant must be separately signed by the other party.

(3) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2), it may operate as a waiver.

(4) A party who has made a waiver affecting an executory portion of a lease contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-209.

Changes: Revised to reflect leasing practices and terminology, except that the provisions of subsection 2-209(3) were omitted.

Purposes: Section 2-209(3) provides that "the requirements of the statute of frauds section of this Article (Section 2-201) must be satisfied if the contract as modified is within its provisions." This provision was not incorporated as it is unfair to allow an oral modification to make the entire lease contract unenforceable, e.g. if the modification takes it a few dollars over the dollar limit. At the same time, the problem could not be solved by providing that the lease contract would still be enforceable in its pre-modification state (if it then satisfied the statute of frauds) since in some cases that might be worse than no enforcement at all. Resolution of the issue is left to the courts based on the facts of each case.

Cross References:

Sections 2-201 and 2-209.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Between merchants". Section 2-104(3).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Merchant". Section 2-104(1).
"Notification". Section 1-201(26).
"Party". Section 1-201(29).

"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

§ 2A-209. LESSEE UNDER FINANCE LEASE AS BENEFICIARY OF SUPPLY CONTRACT.

(1) The benefit of the supplier's promises to the lessor under the supply contract and of all warranties, whether express or implied, under the supply contract, extends to the lessee to the extent of the lessee's leasehold interest under a finance lease related to the supply contract, but subject to the terms of the supply contract and all of the supplier's defenses or claims arising therefrom.

(2) The extension of the benefit of the supplier's promises and warranties to the lessee (Section 2A-209(1)) does not: (a) modify the rights and obligations of the parties to the supply contract, whether arising therefrom or otherwise, or (b) impose any duty or liability under the supply contract on the lessee.

(3) Any modification or rescission of the supply contract by the supplier and the lessor is effective against the lessee unless, prior to the modification or rescission, the supplier has received notice that the lessee has entered into a finance lease related to the supply contract. If the supply contract is modified or rescinded after the lessee enters the finance lease, the lessee has a cause of action against the lessor, and against the supplier if the supplier

has notice of the lessee's entering the finance lease when the supply contract is modified or rescinded. The lessee's recovery from such action shall put the lessee in as good a position as if the modification or rescission had not occurred.

OFFICIAL COMMENT

Uniform Statutory Source: None.

Changes: This section is modeled on Section 9-318, the Restatement (Second) of Contracts §§ 302-315 (1981), and leasing practices. See Earman Oil Co. v. Burroughs Corp., 625 F.2d 1291, 1296-97 (5th Cir. 1980).

Purposes: The function performed by the lessor in a finance lease is extremely limited. Section 2A-103(1)(g). The lessee looks to the supplier of the goods for warranties and the like. That expectation is reflected in subsection (1), which is self-executing. As a matter of policy, the operation of this provision may not be excluded, modified or limited; however, an exclusion, modification, or limitation of any term of the supply contract, including any with respect to rights and remedies, effective against the lessor as buyer under the supply contract, is also effective against the lessee as the beneficiary designated under this provision. The supplier is not precluded from excluding or modifying an express or implied warranty under a supply contract. Sections 2-312(2) and 2-316. Further, the supplier is not precluded from limiting the rights and remedies of the lessor, as buyer, and from liquidating damages. Sections 2-718 and 2-719. If the supply contract excludes or modifies warranties, limits remedies for breach, or liquidates damages with respect to the lessor, such provisions are enforceable against the lessee as beneficiary. Thus, only selective discrimination against the beneficiaries designated under this section is precluded, i.e., exclusion of the supplier's liability to the lessee with respect to warranties made to the lessor.

Enforcement of this benefit is by action. Sections 2A-103(4) and 1-106(2).

The benefit extended by these provisions is not without a price, as this Article also provides in the case of a finance lease that is not a consumer lease that the lessee's promises to the lessor under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods. Section 2A-407.

Subsection (2) limits the effect of subsection (1) on the supplier and the lessor by preserving, notwithstanding the transfer of the benefits of the supply contract to the lessee, all of the supplier's and the lessor's rights and obligations with respect to each other and others; it further absolves the lessee of any duties with respect to the supply contract that might have been inferred from the extension of the benefits thereof. Subsections (2) and (3) also deal with difficult issues related to modification or rescission of the supply contract. Subsection (2) states a rule that determines the impact of the statutory extension of benefit contained in subsection (1) upon the relationship of the parties to the supply contract and, in a limited respect, upon the lessee. This statutory extension of benefit, like that contained in Sections 2A-216 and 2-318, is not a modification of the supply contract by the parties. Thus, subsection (3) states the rules that apply to a modification or rescission of the supply contract by the parties. Subsection (3) recognizes the lessee's potential causes of action against the lessor and the supplier arising from modification or rescission of the supply contract. The existence and extent of a cause of action by the supplier against the lessor is left to resolution by the courts based on the facts of each case.

Cross References:

Sections 2A-103(g), 2A-407 and 9-318.

Definitional Cross References:

"Action". Section 1-201(1).
"Finance lease". Section 2A-103(1)(g).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).
"Supply contract". Section 2A-103(1)(y).
"Term". Section 1-201(42).

§ 2A-210. EXPRESS WARRANTIES.

(1) Express warranties by the lessor are created as follows:

(a) Any affirmation of fact or promise made by the lessor to the lessee which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods will conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods will conform to the description.

(c) Any sample or model that is made part of the basis of the bargain creates an express warranty that the whole of the goods will conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the lessor use formal words, such as "warrant" or "guarantee," or that the lessor have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the lessor's opinion or commendation of the goods does not create a warranty.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-313.

Changes: Revised to reflect leasing practices and terminology.

Purposes: All of the express and implied warranties of the Article on Sales (Article 2) are included in this Article, revised to reflect the differences between a sale of goods and a lease of goods. Sections 2A-210 through 2A-216. The lease of goods is sufficiently similar to the sale of goods to justify this decision. Hawkland, The Impact of the Uniform Commercial Code on Equipment Leasing, 1972 Ill. L.F. 446, 459-60. Many state and federal courts have reached the same conclusion.

Value of the goods, as used in subsection (2), includes rental value.

Cross References:

Article 2, esp. Section 2-313, and Sections 2A-210 through 2A-216.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Value". Section 1-201(44).

§ 2A-211. WARRANTIES AGAINST INTERFERENCE AND AGAINST INFRINGEMENT; LESSEE'S OBLIGATION AGAINST INFRINGEMENT.

(1) There is in a lease contract a warranty that for the lease term no person holds a claim to or interest in the goods that arose from an act or omission of the lessor, other than a claim by way of infringement or the like, which will interfere with the lessee's enjoyment of its leasehold interest.

(2) Except in a finance lease there is in a lease contract by a lessor who is a merchant regularly dealing in

goods of the kind a warranty that the goods are delivered free of the rightful claim of any person by way of infringement or the like.

(3) A lessee who furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim by way of infringement or the like that arises out of compliance with the specifications.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-312.

Changes: This section is modeled on the provisions of Section 2-312, with modifications to reflect the limited interest transferred by a lease contract and the total interest transferred by a sale. Section 2-312(2), which is omitted here, is incorporated in Section 2A-214. The warranty of quiet possession was abolished with respect to sales of goods. Section 2-312 official comment 1. Section 2A-211(1) reinstates the warranty of quiet possession with respect to leases. Inherent in the nature of the limited interest transferred by the lease - the right to possession and use of the goods - is the need of the lessee for protection greater than that afforded to the buyer. Since the scope of the protection is limited to claims or interests that arose from acts or omissions of the lessor, the lessor will be in position to evaluate the potential cost, certainly a far better position than that enjoyed by the lessee. Further, to the extent the market will allow, the lessor can attempt to pass on the anticipated additional cost to the lessee in the guise of higher rent.

Purposes: General language was chosen for subsection (1) that expresses the essence of the lessee's expectation: with an exception for infringement and the like, no person holding a claim or interest that arose from an act or omission of the lessor will be able to interfere with the lessee's use and enjoyment of the goods for the lease term. Subsection (2), like other similar provisions in later sections, excludes the finance lessor from extending this warranty; with few exceptions (Sections 2A-210 and 2A-211(1)), the lessee under a finance lease is to look to the supplier for warranties and the like. Subsections (2)

and (3) are derived from Section 2-312(3). These subsections, as well as the analogue, should be construed so that applicable principles of law and equity supplement their provisions. Sections 2A-103(4) and 1-103.

Cross References:

Sections 2-312, 2-312(1), 2-312(2), 2-312 official comment 1, 2A-210, 2A-211(1) and 2A-214.

Definitional Cross References:

"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Person". Section 1-201(30).
"Supplier". Section 2A-103(1)(x).

§ 2A-212. IMPLIED WARRANTY OF MERCHANTABILITY.

(1) Except in a finance lease, a warranty that the goods will be merchantable is implied in a lease contract if the lessor is a merchant with respect to goods of that kind.

(2) Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the description in the lease agreement;

(b) in the case of fungible goods, are of fair average quality within the description;

(c) are fit for the ordinary purposes for which goods of that type are used;

(d) run, within the variation permitted by the lease agreement, of even kind, quality, and quantity within each unit and among all units involved;

(e) are adequately contained, packaged, and labeled as the lease agreement may require; and

(f) conform to any promises or affirmations of fact made on the container or label.

(3) Other implied warranties may arise from course of dealing or usage of trade.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-314.

Changes: Revised to reflect leasing practices and terminology. E.g., Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 225, 541 P.2d 1184, 1193 (1975) (implied warranty of merchantability (Article 2) extends to lease transactions).

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Course of dealing". Section 1-205.
"Finance lease". Section 2A-103(1)(g).
"Fungible". Section 1-201(17).
"Goods". Section 2A-103(1)(h).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Usage of trade". Section 1-205.

§ 2A-213. IMPLIED WARRANTY OF FITNESS FOR PARTICULAR PURPOSE.

Except in a finance lease, if the lessor at the time the lease contract is made has reason to know of any particular purpose for which the goods are required and that the lessee is relying on the lessor's skill or judgment to select or furnish suitable goods, there is in the lease contract an implied warranty that the goods will be fit for that purpose.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-315.

Changes: Revised to reflect leasing practices and terminology. E.g., All-States Leasing Co. v. Bass, 96 Idaho 873, 879, 538 P.2d 1177, 1183 (1975) (implied warranty of fitness for a particular purpose (Article 2) extends to lease transactions).

Definitional Cross References:

"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Knows". Section 1-201(25).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

§ 2A-214. EXCLUSION OR MODIFICATION OF WARRANTIES.

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit a warranty must be construed wherever reasonable as consistent with each other; but, subject to the provisions of Section 2A-202 on parol or extrinsic evidence, negation or

limitation is inoperative to the extent that the construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention "merchantability", be by a writing, and be conspicuous. Subject to subsection (3), to exclude or modify any implied warranty of fitness the exclusion must be by a writing and be conspicuous. Language to exclude all implied warranties of fitness is sufficient if it is in writing, is conspicuous and states, for example, "There is no warranty that the goods will be fit for a particular purpose".

(3) Notwithstanding subsection (2), but subject to subsection (4),

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," or "with all faults," or by other language that in common understanding calls the lessee's attention to the exclusion of warranties and makes plain that there is no implied warranty, if in writing and conspicuous;

(b) if the lessee before entering into the lease contract has examined the goods or the sample or model as fully as desired or has refused to examine the goods, there is no implied warranty with regard to defects that an examination ought in the circumstances to have revealed; and

(c) an implied warranty may also be excluded or modified by course of dealing, course of performance, or usage of trade.

(4) To exclude or modify a warranty against interference or against infringement (Section 2A-211) or any part of it, the language must be specific, be by a writing, and be conspicuous, unless the circumstances, including course of performance, course of dealing, or usage of trade, give the lessee reason to know that the goods are being leased subject to a claim or interest of any person.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-316 and 2-312(2).

Changes: Subsection (2) requires that a disclaimer of the warranty of merchantability be conspicuous and in writing as is the case for a disclaimer of the warranty of fitness; this is contrary to the rule stated in Section 2-316(2) with respect to the disclaimer of the warranty of merchantability. This section also provides that to exclude or modify the implied warranty of merchantability, fitness or against interference or infringement the language must be in writing and conspicuous. There are, however, exceptions to the rule. E.g., course of dealing, course of performance, or usage of trade may exclude or modify an implied warranty. Section 2A-214(3)(c). The analogue of Section 2-312(2) has been moved to subsection (4) of this section for a more unified treatment of disclaimers; there is no policy with respect to leases of goods that would justify continuing certain distinctions found in the Article on Sales (Article 2) regarding the treatment of the disclaimer of various warranties. Compare Sections 2-312(2) and 2-316(2). Finally, the example of a disclaimer of the implied warranty of fitness stated in subsection (2) differs from the analogue stated in Section 2-316(2); this example should promote a better understanding of the effect of the disclaimer.

Purposes: These changes were made to reflect leasing practices. E.g., FMC Finance Corp. v. Murphree, 632 F.2d 413, 418 (5th Cir. 1980) (disclaimer of implied warranty under lease transactions must be conspicuous and in writing). The omission of the provisions of Section 2-316(4) was not substantive. Sections 2A-503 and 2A-504.

Cross References:

Article 2, esp. Sections 2-312(2) and 2-316, and Sections 2A-503 and 2A-504.

Definitional Cross References:

"Conspicuous". Section 1-201(10).
"Course of dealing". Section 1-205.
"Fault". Section 2A-103(1)(f).
"Good". Section 2A-103(1)(h).
"Know". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Person". Section 1-201(30).
"Usage of trade". Section 1-205.
"Writing". Section 1-201(46).

§ 2A-215. CUMULATION AND CONFLICT OF WARRANTIES EXPRESS OR IMPLIED.

Warranties, whether express or implied, must be construed as consistent with each other and as cumulative, but if that construction is unreasonable, the intention of the parties determines which warranty is dominant. In ascertaining that intention the following rules apply:

(a) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(b) A sample from an existing bulk displaces inconsistent general language of description.

(c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-317.

Definitional Cross Reference:

"Party". Section 1-201(29).

§ 2A-216. THIRD-PARTY BENEFICIARIES OF EXPRESS AND IMPLIED WARRANTIES.

ALTERNATIVE A

A warranty to or for the benefit of a lessee under this Article, whether express or implied, extends to any natural person who is in the family or household of the lessee or who is a guest in the lessee's home if it is reasonable to expect that such person may use, consume, or be affected by the goods and who is injured in person by breach of the warranty. This section does not displace principles of law and equity that extend a warranty to or for the benefit of a lessee to other persons. The operation of this section may not be excluded, modified, or limited, but an exclusion, modification, or limitation of the warranty, including any with respect to rights and remedies, effective

against the lessee is also effective against any beneficiary designated under this section.

ALTERNATIVE B

A warranty to or for the benefit of a lessee under this Article, whether express or implied, extends to any natural person who may reasonably be expected to use, consume, or be affected by the goods and who is injured in person by breach of the warranty. This section does not displace principles of law and equity that extend a warranty to or for the benefit of a lessee to other persons. The operation of this section may not be excluded, modified, or limited, but an exclusion, modification, or limitation of the warranty, including any with respect to rights and remedies, effective against the lessee is also effective against the beneficiary designated under this section.

ALTERNATIVE C

A warranty to or for the benefit of a lessee under this Article, whether express or implied, extends to any person who may reasonably be expected to use, consume, or be affected by the goods and who is injured by breach of the warranty. The operation of this section may not be excluded, modified, or limited with respect to injury to the person of an individual to whom the warranty extends, but an exclusion, modification, or limitation of the warranty, including any with respect to rights and remedies, effective against the

lessee is also effective against the beneficiary designated under this section.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-318.

Changes: The provisions of Section 2-318 have been included in this section, modified in two respects: first, to reflect leasing practice, including the special practices of the lessor under a finance lease; second, to reflect and thus codify elements of the official comment to Section 2-318 with respect to the effect of disclaimers and limitations of remedies against third parties.

Purposes: Alternative A is based on the 1962 version of Section 2-318 and is least favorable to the injured person as the doctrine of privity imposed by other law is abrogated to only a limited extent. Alternatives B and C are based on later additions to Section 2-318 and are more favorable to the injured person. In determining which alternative to select, the state legislature should consider making its choice parallel to the choice it made with respect to Section 2-318, as interpreted by the courts.

The last sentence of each of Alternatives A, B and C does not preclude the lessor from excluding or modifying an express or implied warranty under a lease. Section 2A-214. Further, that sentence does not preclude the lessor from limiting the rights and remedies of the lessee and from liquidating damages. Sections 2A-503 and 2A-504. If the lease excludes or modifies warranties, limits remedies for breach, or liquidates damages with respect to the lessee, such provisions are enforceable against the beneficiaries designated under this section. However, this last sentence forbids selective discrimination against the beneficiaries designated under this section, i.e., exclusion of the lessor's liability to the beneficiaries with respect to warranties made by the lessor to the lessee.

Other law, including the Article on Sales (Article 2), may apply in determining the extent to which a warranty to or for the benefit of the lessor extends to the lessee and third parties. This is in part a function of whether the lessor has bought or leased the goods.

This Article does not purport to change the development of the relationship of the common law, with

respect to products liability, including strict liability in tort (as restated in Restatement (Second) of Torts, § 402A (1965)), to the provisions of this Act. Compare Cline v. Prowler Indus. of Maryland, 418 A.2d 968 (Del. 1980) and Hawkins Constr. Co. v. Matthews Co., 190 Neb. 546, 209 N.W.2d 643 (1973) with Dippel v. Sciano, 37 Wis. 2d 443, 155 N.W.2d 55 (1967).

Cross References:

Article 2, esp. Section 2-318, and Sections 2A-214, 2A-503 and 2A-504.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

§ 2A-217. IDENTIFICATION.

Identification of goods as goods to which a lease contract refers may be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement, identification occurs:

(a) when the lease contract is made if the lease contract is for a lease of goods that are existing and identified;

(b) when the goods are shipped, marked, or otherwise designated by the lessor as goods to which the lease contract refers, if the lease contract is for a lease of goods that are not existing and identified; or

(c) when the young are conceived, if the lease contract is for a lease of unborn young of animals.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501.

Changes: This section, together with Section 2A-218, is derived from the provisions of Section 2-501, with changes to reflect lease terminology; however, this section omits as irrelevant to leasing practice the treatment of special property.

Purposes: With respect to subsection (b) there is a certain amount of ambiguity in the reference to when goods are designated, e.g., when the lessor is both selling and leasing goods to the same lessee/buyer and has marked goods for delivery but has not distinguished between those related to the lease contract and those related to the sales contract. As in Section 2-501(1)(b), this issue has been left to be resolved by the courts, case by case.

Cross References:

Sections 2-501 and 2A-218.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).

§ 2A-218. INSURANCE AND PROCEEDS.

(1) A lessee obtains an insurable interest when existing goods are identified to the lease contract even though the goods identified are nonconforming and the lessee has an option to reject them.

(2) If a lessee has an insurable interest only by reason of the lessor's identification of the goods, the lessor, until default or insolvency or notification to the lessee that identification is final, may substitute other goods for those identified.

(3) Notwithstanding a lessee's insurable interest under subsections (1) and (2), the lessor retains an insurable interest until an option to buy has been exercised by the lessee and risk of loss has passed to the lessee.

(4) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

(5) The parties by agreement may determine that one or more parties have an obligation to obtain and pay for insurance covering the goods and by agreement may determine the beneficiary of the proceeds of the insurance.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501.

Changes: This section, together with Section 2A-217, is derived from the provisions of Section 2-501, with changes and additions to reflect leasing practices and terminology.

Purposes: Subsection (2) states a rule allowing substitution of goods by the lessor under certain circumstances, until default or insolvency of the lessor, or until notification to the lessee that identification is final. Subsection (3) states a rule regarding the lessor's insurable interest that, by virtue of the difference between a sale and a lease, necessarily is different from the rule stated in Section 2-501(2) regarding the seller's insurable interest. For this purpose the option to buy shall be deemed to have been exercised by the lessee when the resulting sale

is closed, not when the lessee gives notice to the lessor. Further, subsection (5) is new and reflects the common practice of shifting the responsibility and cost of insuring the goods between the parties to the lease transaction.

Cross References:

Sections 2-501, 2-501(2) and 2A-217.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Buying". Section 2A-103(1)(a).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Party". Section 1-201(29).

§ 2A-219. RISK OF LOSS.

(1) Except in the case of a finance lease, risk of loss is retained by the lessor and does not pass to the lessee. In the case of a finance lease, risk of loss passes to the lessee.

(2) Subject to the provisions of this Article on the effect of default on risk of loss (Section 2A-220), if risk of loss is to pass to the lessee and the time of passage is not stated, the following rules apply:

(a) If the lease contract requires or authorizes the goods to be shipped by carrier

(i) and it does not require delivery at a particular destination, the risk of loss passes to the lessee when the goods are duly delivered to the carrier; but

(ii) if it does require delivery at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the lessee when the goods are there duly so tendered as to enable the lessee to take delivery.

(b) If the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the lessee on acknowledgment by the bailee of the lessee's right to possession of the goods.

(c) In any case not within subsection (a) or (b), the risk of loss passes to the lessee on the lessee's receipt of the goods if the lessor, or, in the case of a finance lease, the supplier, is a merchant; otherwise the risk passes to the lessee on tender of delivery.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-509(1) through (3).

Changes: Subsection (1) is new. The introduction to subsection (2) is new, but subparagraph (a) incorporates the provisions of Section 2-509(1); subparagraph (b) incorporates the provisions of Section 2-509(2) only in part, reflecting current practice in lease transactions.

Purposes: Subsection (1) states rules related to retention or passage of risk of loss consistent with current practice in lease transactions. The provisions of subsection (4) of Section 2-509 are not incorporated as they are not necessary. This section does not deal with responsibility for loss caused by the wrongful act of either the lessor or the lessee.

Cross References:

Sections 2-509(1), 2-509(2) and 2-509(4).

Definitional Cross References:

"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

§ 2A-220. EFFECT OF DEFAULT ON RISK OF LOSS.

(1) Where risk of loss is to pass to the lessee and the time of passage is not stated:

(a) If a tender or delivery of goods so fails to conform to the lease contract as to give a right of rejection, the risk of their loss remains with the lessor, or, in the case of a finance lease, the supplier, until cure or acceptance.

(b) If the lessee rightfully revokes acceptance, he [or she], to the extent of any deficiency in his [or her]

effective insurance coverage, may treat the risk of loss as having remained with the lessor from the beginning.

(2) Whether or not risk of loss is to pass to the lessee, if the lessee as to conforming goods already identified to a lease contract repudiates or is otherwise in default under the lease contract, the lessor, or, in the case of a finance lease, the supplier, to the extent of any deficiency in his [or her] effective insurance coverage may treat the risk of loss as resting on the lessee for a commercially reasonable time.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-510.

Changes: Revised to reflect leasing practices and terminology. The rule in Section (1)(b) does not allow the lessee under a finance lease to treat the risk of loss as having remained with the supplier from the beginning. This is appropriate given the limited circumstances under which the lessee under a finance lease is allowed to revoke acceptance. Section 2A-517 and Section 2A-516 official comment.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

§ 2A-221. CASUALTY TO IDENTIFIED GOODS.

If a lease contract requires goods identified when the lease contract is made, and the goods suffer casualty without fault of the lessee, the lessor or the supplier before delivery, or the goods suffer casualty before risk of loss passes to the lessee pursuant to the lease agreement or Section 2A-219, then:

(a) if the loss is total, the lease contract is avoided; and

(b) if the loss is partial or the goods have so deteriorated as to no longer conform to the lease contract, the lessee may nevertheless demand inspection and at his [or her] option either treat the lease contract as avoided or, except in a finance lease that is not a consumer lease, accept the goods with due allowance from the rent payable for the balance of the lease term for the deterioration or the deficiency in quantity but without further right against the lessor.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-613.

Changes: Revised to reflect leasing practices and terminology.

Purpose: Due to the vagaries of determining the amount of due allowance (Section 2-613(b)), no attempt was made in subsection (b) to treat a problem unique to lease contracts and installment sales contracts: determining how to recapture the allowance, e.g., application to the first or last rent payments or allocation, pro rata, to all rent payments.

Cross References:

Section 2-613.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Fault". Section 2A-103(1)(f).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

PART 3. EFFECT OF LEASE CONTRACT

§ 2A-301. ENFORCEABILITY OF LEASE CONTRACT.

Except as otherwise provided in this Article, a lease contract is effective and enforceable according to its terms between the parties, against purchasers of the goods and against creditors of the parties.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-201.

Changes: The first sentence of Section 9-201 was incorporated, modified to reflect leasing terminology. The second sentence of Section 9-201 was eliminated as not relevant to leasing practices.

Purposes: This section establishes a general rule regarding the validity and enforceability of a lease contract. The lease contract is effective and enforceable between the parties and against third parties. Exceptions to this general rule arise where there is a specific rule to the contrary in this Article. Enforceability is, thus, dependent upon the lease contract meeting the requirements of the Statute of Frauds provisions of Section 2A-201. Enforceability is also a function of the lease contract conforming to the principles of construction and interpretation contained in the Article on General Provisions (Article 1). Section 2A-103(4).

The effectiveness or enforceability of the lease contract is not dependent upon the lease contract or any financing statement or the like being filed or recorded; however, the priority of the interest of a lessor of fixtures with respect to the interests of certain third parties in such fixtures is subject to the provisions of the Article on Secured Transactions (Article 9). Section 2A-309. Prior to the adoption of this Article filing or recording was not required with respect to leases, only leases intended as security. The definition of security interest, as amended concurrently with the adoption of this Article, more clearly delineates leases and leases intended as security and thus signals the need to file. Section 1-201(37). Those lessors who are concerned about whether the transaction creates a lease or a security interest will continue to file a protective financing statement. Section 9-408. Coogan, Leasing and the Uniform Commercial Code, in Equipment Leasing-Leveraged Leasing 681, 744-46 (2d ed. 1980).

Hypothetical: 1. In construing this section it is important to recognize its relationship to other sections in this Article. This is best demonstrated by reference to a hypothetical. Assume that on February 1 A, a manufacturer of combines and other farm equipment, leased a fleet of six combines to B, a corporation engaged in the business of farming, for a 12 month term. Under the lease agreement between A and B, A agreed to defer B's payment of the first two months' rent to April 1. On March 1 B recognized that it would need only four combines and thus subleased two combines to C for an 11 month term.

2. This hypothetical raises a number of issues that are answered by the sections contained in this part. Since lease is defined to include sublease (Section 2A-103(1)(j) and (w)), this section provides that the prime lease between A and B and the sublease between B and C are enforceable in accordance with their terms, except as otherwise provided in

this Artic e; that exception, in this case, is one of considerable scope.

3. The separation of ownership, which is in A, and possession, which is in B with respect to four combines and which is in C with respect to two combines, is not relevant. Section 2A-302. A's interest in the six combines cannot be challenged simply because A parted with possession to B, who in turn parted with possession of some of the combines to C. Yet it is import at to note that by the terms of Section 2A-302 this conclusion is subject to change if otherwise provided in this Article.

4. B's entering the sublease with C raises an issue that is treated by this part. In a dispute over the leased combines A may challenge B's right to sublease. The general rule is permissive as to transfers of interests under a lease contract, including subleases. Section 2A-303(1). However, the rule creates two significant exceptions. If the prime lease contract between A and B prohibits B from subleasing the combines, Section 2A-303(1)(a) applies, as the transfer is voluntary and prohibited; thus, B's interest under the prime lease may not be transferred under the sublease to C. Absent a prohibition in the prime lease contract A might be able to argue that the sublease to C materially increases A's risk; thus B's interest under the prime lease may not be transferred under the sublease to C, if after demand by A, C fails to provide the assurances required by Section 2A-303(2). Section 2A-303(1)(b).

5. Resolution of this issue is also a function of the section dealing with the sublease of goods by a prime lessee (Section 2A-305). Subsection (1) of Section 2A-305, which is subject to the rule of Section 2A-303 stated above, provides that C takes subject to the interest of A under the prime lease between A and B. However, there are two exceptions. First, if B is a merchant (Sections 2A-103(3) and 2-104(1)) dealing in goods of that kind and C is a sublessee in the ordinary course of business (Sections 2A-103(1)(o) and 2A-103(1)(n)), C takes free of the prime lease between A and B. Second, if B has rejected the six combines under the prime lease with A, and B disposes of the goods by sublease to C, C takes free of the prime lease if C can establish good faith. Section 2A-511(4).

6. If the facts of this hypothetical are expanded and we assume that the prime lease obligated B to maintain the combines, an additional issue may be presented. Prior to entering the sublease, B, in satisfaction of its maintenance covenant, brought the two combines that it desired to

sublease to a local independent dealer of A's. The dealer did the requested work for B. C inspected the combines on the dealer's lot after the work was completed. C signed the sublease with B two days later. C, however, was prevented from taking delivery of the two combines as B refused to pay the dealer's invoice for the repairs. The dealer furnished the repair service to B in the ordinary course of the dealer's business. If under applicable law the dealer has a lien on repaired goods in the dealer's possession, the dealer's lien will take priority over A's, B's and C's interests. Section 2A-306.

7. Now assume that C is in financial straits and one of C's creditors obtains a judgment against C. If the creditor levies on C's subleasehold interest in the two combines, who will prevail? Unless the levying creditor also holds a lien covered by Section 2A-306, discussed above, the judgment creditor will take its interest subject to B's rights under the sublease and A's rights under the prime lease. Section 2A-307(1). The hypothetical becomes more complicated if we assume that B is in financial straits and B's creditor holds the judgment. Here the judgment creditor takes subject to the sublease unless the lien attached to the two combines before the sublease contract became enforceable. Section 2A-307(2)(a). However, B's judgment creditor cannot prime A's interest in the goods because, with respect to A, the judgment creditor is a creditor of B in its capacity as lessee under the prime lease between A and B. Thus, here the judgment creditor's interest is subject to the lease between A and B. Section 2A-307(1).

8. Finally, assume that on April 1 B is unable to pay A the deferred rent then due under the prime lease, but that C is current in its payments under the sublease from B. What effect will B's default under the prime lease between A and B have on C's rights under the sublease between B and C? Section 2A-301 provides that a lease contract is effective against the creditors of either party. Since a lease contract includes a sublease contract (Section 2A-103(1)(l)), the sublease contract between B and C arguably could be enforceable against A, a prime lessor who has extended unsecured credit to B, the prime lessee/sublessor, if the sublease contract meets the requirements of Section 2A-201. However, the rule stated in Section 2A-301 is subject to other provisions in this Article. Under Section 2A-305, C, as sublessee, would take subject to the prime lease contract in most cases. Thus, B's default under the prime lease will in most cases lead to A's recovery of the goods from C. Section 2A-523. C's recourse will be to assert a claim for damages against B. Section 2A-508.

Relationship Between Sections: 1. As the analysis of the hypothetical demonstrates, Part 3 of the Article focuses on issues that relate to the enforceability of the lease contract (Sections 2A-301, 2A-302 and 2A-303) and to the priority of various claims to the goods subject to the lease contract (Sections 2A-304, 2A-305, 2A-306, 2A-307, 2A-308, 2A-309 and 2A-310).

2. This section states a general rule of enforceability, which is subject to specific rules to the contrary stated elsewhere in the Article. Section 2A-302 negates any notion that the separation of title and possession is fraudulent as a rule of law. Finally, Section 2A-303 states a permissive rule with respect to the transfer of the lessor's interest (as well as the residual interest in the goods) or the lessee's interest under the lease contract. Conditions are imposed as a function of various issues including whether the transfer is voluntary or involuntary. In addition, a system of rules is created to deal with the rights and duties among assignor, assignee and the other party to the lease contract.

3. Sections 2A-304 and 2A-305 are twins that deal with good faith transferees of goods subject to the lease contract. Section 2A-304 creates a set of rules with respect to transfers by the lessor of goods subject to a lease contract; the transferee considered is a subsequent lessee of the goods. The priority dispute covered here is between the subsequent lessee and the original lessee of the goods (or persons claiming through the original lessee). Section 2A-305 creates a set of rules with respect to transfers by the lessee of goods subject to a lease contract; the transferees considered are buyers of the goods or sublessees of the goods. The priority dispute covered here is between the transferee and the lessor of the goods (or persons claiming through the lessor).

4. Section 2A-306 creates a rule with respect to priority disputes between holders of liens for services or materials furnished with respect to goods subject to a lease contract and the lessor or the lessee under that contract. Section 2A-307 creates a rule with respect to priority disputes between the lessee and creditors of the lessor and priority disputes between the lessor and creditors of the lessee.

5. Section 2A-308 creates a series of rules relating to allegedly fraudulent transfers and preferences. The most significant rule is that set forth in subsection (3) which validates sale-leaseback transactions if the

buyer-lessor can establish that he or she bought for value and in good faith.

6. Finally, Sections 2A-309 and 2A-310 create a series of rules with respect to priority disputes between various third parties and a lessor of fixtures or accessions, respectively, with respect thereto.

Cross References:

Article 1, esp. Section 1-201(37), and Sections 2-104(1), 2A-103(1)(j), 2A-103(1)(l), 2A-103(1)(n), 2A-103(1)(o) and 2A-103(1)(w), 2A-103(3), 2A-103(4), 2A-201, 2A-301 through 2A-303, 2A-303(1), 2A-303(1)(a), 2A-303 (1)(b), 2A-304 through 2A-307, 2A-307(1), 2A-307(2)(a), 2A-308 through 2A-310, 2A-508, 2A-511(4), 2A-523, Article 9, esp. Sections 9-201 and 9-408.

Definitional Cross References:

"Creditor". Section 1-201(12).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Purchaser". Section 1-201(33).
"Term". Section 1-201(42).

§ 2A-302. TITLE TO AND POSSESSION OF GOODS.

Except as otherwise provided in this Article, each provision of this Article applies whether the lessor or a third party has title to the goods, and whether the lessor, the lessee, or a third party has possession of the goods, notwithstanding any statute or rule of law that possession or the absence of possession is fraudulent.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-202.

Changes: Section 9-202 was modified to reflect leasing terminology and to clarify the law of leases with respect to fraudulent conveyances or transfers.

Purposes: The separation of ownership and possession of goods between the lessor and the lessee (or a third party) has created problems under certain fraudulent conveyance statutes. See, e.g., In re Ludlum Enters., 510 F.2d 996 (5th Cir. 1975); Suburbia Fed. Sav. & Loan Ass'n v. Bel-Air Conditioning Co., 385 So. 2d 1151 (Fla. Dist. Ct. App. 1980). This section provides, among other things, that separation of ownership and possession per se does not affect the enforceability of the lease contract. Sections 2A-301 and 2A-308.

Cross References:

Sections 2A-301, 2A-308 and 9-202.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

§ 2A-303. ALIENABILITY OF PARTY'S INTEREST UNDER LEASE CONTRACT OR OF LESSOR'S RESIDUAL INTEREST IN GOODS; DELEGATION OF PERFORMANCE; ASSIGNMENT OF RIGHTS.

(1) Any interest of a party under a lease contract and the lessor's residual interest in the goods may be transferred unless

(a) the transfer is voluntary and the lease contract prohibits the transfer; or

(b) the transfer materially changes the duty of or materially increases the burden or risk imposed on the other party to the lease contract, and within a reasonable time after notice of the transfer the other party demands that the transferee comply with subsection (2) and the transferee fails to comply.

(2) Within a reasonable time after demand pursuant to subsection (1)(b), the transferee shall:

(a) cure or provide adequate assurance that he [or she] will promptly cure any default other than one arising from the transfer;

(b) compensate or provide adequate assurance that he [or she] will promptly compensate the other party to the lease contract and any other person holding an interest in the lease contract, except the party whose interest is being transferred, for any loss to that party resulting from the transfer;

(c) provide adequate assurance of future due performance under the lease contract; and

(d) assume the lease contract.

(3) Demand pursuant to subsection (1)(b) is without prejudice to the other party's rights against the transferee and the party whose interest is transferred.

(4) An assignment of "the lease" or of "all my rights under the lease" or an assignment in similar general

terms is a transfer of rights, and unless the language or the circumstances, as in an assignment for security, indicate the contrary, the assignment is a delegation of duties by the assignor to the assignee and acceptance by the assignee constitutes a promise by him [or her] to perform those duties. This promise is enforceable by either the assignor or the other party to the lease contract.

(5) Unless otherwise agreed by the lessor and the lessee, no delegation of performance relieves the assignor as against the other party of any duty to perform or any liability for default.

(6) A right to damages for default with respect to the whole lease contract or a right arising out of the assignor's due performance of his [or her] entire obligation can be assigned despite agreement otherwise.

(7) To prohibit the transfer of an interest of a party under a lease contract, the language of prohibition must be specific, by a writing, and conspicuous.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-210.

Changes: The provisions of Section 2-210 were incorporated in this Article, with substantial modifications to reflect leasing terminology and practice, as well as certain developments of the law with respect to creditors' rights.

Purposes: Unlike Section 2-210, which deals with voluntary transfers of rights and duties under a sales contract, this section deals with involuntary as well as

voluntary transfers of rights and duties under a lease contract. Voluntary transfers are permitted unless prohibited by the lease contract or, as is also the case for involuntary transfers, there is a material change in the duty of, or a material increase in the burden or risk to, the other party to the lease contract and the transferee fails to comply with the conditions in subsection (2) within a reasonable time after a demand, which need not be in writing, has been made for such compliance.

Subsection (2) establishes four criteria that must be satisfied by the transferee after a demand has been made. These criteria are modeled on the requirements contained in the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. § 365 (1982 & Supp. II 1984), governing the assumption and assignment of an unexpired lease or executory contract by a trustee in bankruptcy. Section 2-210(5) resolves this issue for sales by allowing the other party to demand assurances from the transferee (Section 2-609). Section 365 of the Bankruptcy Code, a modern version of the provisions of Section 2-609, provided a better model for resolving this issue for leases.

Sections 9-206 and 9-318 are also relevant in this context. Section 9-206 sanctions an agreement by a lessee not to assert certain types of claims or defenses against the lessor's assignee. Section 9-318 deals with, among other things, the other party's rights against the assignee where Section 9-206(1) does not apply. Since the definition of contract under Section 1-201(11) includes a lease agreement, the definition of account debtor under Section 9-105(1)(a) includes a lessee of goods and Section 9-206 applies to lease agreements; thus, there is no need to restate those sections in this Article. However, the reference to "defenses or claims arising out of a sale" in Section 9-318(1) should be interpreted broadly to include defenses or claims arising out of a lease. This should follow as Section 9-318(1) codifies the common law rule with respect to contracts, including contracts of sale and contracts of lease. Further, Section 9-318(4) should be interpreted to allow the rule of this section to control with respect to transfers of leases.

Subsection (4) is taken almost verbatim from the provisions of Section 2-210(4). The subsection states a rule of construction that distinguishes a commercial assignment, which substitutes the assignee for the assignor as to rights and duties, and an assignment for security or financing assignment, which substitutes the assignee for the assignor only as to rights. Note that the assignment for security or financing assignment is a subset of all security interests.

Security interest is defined to include "any interest of a buyer of ... chattel paper". Section 1-201(37). Chattel paper is defined to include a lease. Section 9-105(1)(b). Thus, a buyer of leases is the holder of a security interest in the leases. That conclusion should not influence this issue, as the policy is quite different. Whether a buyer of leases is the holder of a commercial assignment, or an assignment for security or financing assignment should be determined by the language of the assignment or the circumstances of the assignment.

While it is recognized that a lease contract may impose restrictions on the transfer of an interest of a party under a lease, such restrictions are not generally favored in law. Subsection (7) balances these competing interests and ensures that both parties knowingly impose prohibitions on transfer, by providing that the language of prohibition be specific, by a writing, and conspicuous.

Cross References:

Sections 1-201(11), 1-201(37), 2-210, 2-609, 9-105(1)(a), 9-206, and 9-318.

Definitional Cross References:

"Agreed" and "Agreement". Section 1-201(3).
"Conspicuous". Section 1-201(10).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lessor's residual interest". Section 2A-103(1)(q).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

§ 2A-304. SUBSEQUENT LEASE OF GOODS BY LESSOR.

(1) Subject to the provisions of Section 2A-303, a subsequent lessee from a lessor of goods under an existing lease contract obtains, to the extent of the leasehold interest transferred, the leasehold interest in the goods that the lessor had or had power to transfer, and except as provided in subsection (2) and Section 2A-527(4), takes subject to the existing lease contract. A lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value, but only to the extent set forth in the preceding sentence. When goods have been delivered under a transaction of purchase the lessor has that power even though:

(a) the lessor's transferor was deceived as to the identity of the lessor;

(b) the delivery was in exchange for a check which is later dishonored;

(c) it was agreed that the transaction was to be a "cash sale"; or

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A subsequent lessee in the ordinary course of business from a lessor who is a merchant dealing in goods of that kind to whom the goods were entrusted by the existing lessee before the interest of the subsequent lessee became

enforceable against the lessor obtains, to the extent of the leasehold interest transferred, all of the lessor's and the existing lessee's rights to the goods, and takes free of the existing lease contract.

(3) A subsequent lessee from the lessor of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this State or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403.

Changes: While Section 2-403 was used as a model for this section, the provisions of Section 2-403 were significantly revised to reflect leasing practices and to integrate this Article with certificate of title statutes.

Purposes: This section must be read in conjunction with, as it is subject to, the provisions of Section 2A-303, which govern voluntary and involuntary transfers of rights and duties under a lease contract, including the lessor's residual interest in the goods.

This section must also be read in conjunction with Section 2-403. This section and Section 2A-305 are derived from Section 2-403, which states a unified policy on good faith purchases of goods. Given the scope of the definition of purchaser (Section 1-201(33)), a person who bought goods to lease as well as a person who bought goods subject to an existing lease from a lessor will take pursuant to Section 2-403. Further, a person who leases such goods from the person who bought them should also be protected under Section 2-403, first because the lessee's rights are derivative and second because the definition of purchaser should be interpreted to include one who takes by lease; no negative implication should be drawn from the inclusion of lease in the definition of purchase in this Article. Section 2A-103(1)(v).

There are hypotheticals that relate to an entrustee's unauthorized lease of entrusted goods to a third party that are outside the provisions of Sections 2-403, 2A-304 and 2A-305. Consider a sale of goods by M, a merchant, to B, a buyer. After paying for the goods B allows M to retain possession of the goods as B is short of storage. Before B calls for the goods M leases the goods to L, a lessee. This transaction is not governed by Section 2-403(2) as L is not a buyer in the ordinary course of business. Section 1-201(9). Further, this transaction is not governed by Section 2A-304(2) as B is not an existing lessee. Finally, this transaction is not governed by Section 2A-305(2) as B is not M's lessor. Section 2A-307(2) resolves the potential dispute between B, M and L. By virtue of B's entrustment of the goods to M and M's lease of the goods to L, B has a cause of action against M under the common law. Sections 2A-103(4) and 1-103. See, e.g., Restatement (Second) of Torts §§ 222A-243. Thus, B is a creditor of M. Sections 2A-103(4) and 1-201(12). Section 2A-307(2) provides that B, as M's creditor, takes subject to M's lease to L. Thus, if L does not default under the lease, L's enjoyment and possession of the goods should be undisturbed. However, B is not without recourse. B's action should result in a judgment against M providing, among other things, a turnover of all proceeds arising from M's lease to L, as well as a transfer of all of M's right, title and interest as lessor under M's lease to L, including M's residual interest in the goods. Section 2A-103(1)(q).

Subsection (1) states a rule with respect to the leasehold interest obtained by a subsequent lessee from a lessor of goods under an existing lease contract. The interest will include such leasehold interest as the lessor has in the goods as well as the leasehold interest that the lessor had the power to transfer. Thus, the subsequent lessee obtains unimpaired all rights acquired under the law of agency, apparent agency, ownership or other estoppel, whether based upon statutory provisions or upon case law principles. Sections 2A-103(4) and 1-103. In general, the subsequent lessee takes subject to the existing lease contract, including the existing lessee's rights thereunder. Furthermore, the subsequent lease contract is, of course, limited by its own terms, and the subsequent lessee takes only to the extent of the leasehold interest transferred thereunder.

Subsection (1) further provides that a lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value. In addition, subsections (1)(a) through (d) provide specifically

for the protection of the good faith subsequent lessee for value in a number of specific situations which have been troublesome under prior law.

The position of an existing lessee who entrusts leased goods to its lessor is not distinguishable from the position of other entrusters. Thus, subsection (2) provides that the subsequent lessee in the ordinary course of business takes free of the existing lease contract between the lessor entrustee and the lessee entruster, if the lessor is a merchant dealing in goods of that kind. Further, the subsequent lessee obtains all of the lessor entrustee's and the lessee entruster's rights to the goods, but only to the extent of the leasehold interest transferred by the lessor entrustee. Thus, the lessor entrustee retains the residual interest in the goods. Section 2A-103(1)(q). However, entrustment by the existing lessee must have occurred before the interest of the subsequent lessee became enforceable against the lessor. Entrusting is defined in Section 2-403(3) and that definition applies here. Section 2A-103(3).

Subsection (3) states a rule with respect to a transfer of goods from a lessor to a subsequent lessee where the goods are subject to an existing lease and covered by a certificate of title. The subsequent lessee's rights are no greater than those provided by this section and the applicable certificate of title statute, including any applicable case law construing such statute. Where the relationship between the certificate of title statute and Section 2-403, the statutory analogue to this section, has been construed by a court, that construction is incorporated here. Sections 2A-103(4) and 1-102(1) and (2). The better rule is that the certificate of title statutes are in harmony with Section 2-403 and thus would be in harmony with this section. E.g., Atwood Chevrolet-Olds v. Aberdeen Mun. School Dist., 431 So.2d 926, 928 (Miss. 1983); Godfrey v. Gilsdorf, 476 P.2d 3, 6, 86 Nev. 714, 718 (1970); Martin v. Nager, 192 N.J. Super. 189, 197-98, 469 A.2d 519, 523 (Super. Ct. Ch. Div. 1983). Where the certificate of title statute is silent on this issue of transfer, this section will control.

Cross References:

Sections 1-102, 1-103, 1-201(33), 2-403, 2A-103(1)(v), 2A-103(3), 2A-103(4), 2A-303 and 2A-305.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Delivery". Section 1-201(14).
"Entrusting". Section 2-403(3).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Purchase". Section 2A-103(1)(v).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

§ 2A-305. SALE OR SUBLEASE OF GOODS BY LESSEE.

(1) Subject to the provisions of Section 2A-303, a buyer or sublessee from the lessee of goods under an existing lease contract obtains, to the extent of the interest transferred, the leasehold interest in the goods that the lessee had or had power to transfer, and except as provided in subsection (2) and Section 2A-511(4), takes subject to the existing lease contract. A lessee with a voidable leasehold interest has power to transfer a good leasehold interest to a good faith buyer for value or a good faith sublessee for value, but only to the extent set forth in the preceding sentence. When goods have been delivered under a transaction of lease the lessee has that power even though:

(a) the lessor was deceived as to the identity of the lessee;

(b) the delivery was in exchange for a check which is later dishonored; or

(c) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A buyer in the ordinary course of business or a sublessee in the ordinary course of business from a lessee who is a merchant dealing in goods of that kind to whom the goods were entrusted by the lessor obtains, to the extent of the interest transferred, all of the lessor's and lessee's rights to the goods, and takes free of the existing lease contract.

(3) A buyer or sublessee from the lessee of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this State or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403.

Changes: While Section 2-403 was used as a model for this section, the provisions of Section 2-403 were significantly revised to reflect leasing practice and to integrate this Article with certificate of title statutes.

Purposes: This section, a companion to Section 2A-304, states the rule with respect to the leasehold interest obtained by a buyer or sublessee from a lessee of goods under an existing lease contract. Cf. Section 2A-304 official comment. Note that this provision is consistent with existing case law, which prohibits the bailee's transfer of title to a good faith purchaser for value under Section 2-403(1). Rohweder v. Aberdeen Product. Credit Ass'n, 765 F.2d 109 (8th Cir. 1985).

Subsection (2) is also consistent with existing case law. American Standard Credit, Inc. v. National Cement Co., 643 F.2d 248, 269-70 (5th Cir. 1981); but cf. Exxon Co., U.S.A. v. TLW Computer Indus., 37 U.C.C. Rep. Serv. (Callaghan) 1052, 1057-58 (D. Mass. 1983). Unlike Section 2A-304(2), this subsection does not contain any requirement with respect to the time that the goods were entrusted to the merchant. In Section 2A-304(2) the competition is between two customers of the merchant lessor; the time of entrusting was added as a criterion to create additional protection to the customer who was first in time: the existing lessee. In subsection (2) the equities between the competing interests were viewed as balanced.

There appears to be some overlap between Section 2-403(2) and Section 2A-305(2) with respect to a buyer in the ordinary course of business. However, an examination of this Article's definition of buyer in the ordinary course of business (Section 2A-103(1)(a)) makes clear that this reference was necessary to treat entrusting in the context of a lease.

Subsection (3) states a rule of construction with respect to a transfer of goods from a lessee to a buyer or sublessee, where the goods are subject to an existing lease and covered by a certificate of title. Cf. Section 2A-304 official comment.

Cross References:

Sections 2-403, 2A-103(1)(a), 2A-304 and 2A-305(2).

Definitional Cross References:

"Buyer". Section 2-103(1)(a).
"Buyer in the ordinary course of business". Section 2A-103(1)(a).

"Delivery". Section 1-201(14).
"Entrusting". Section 2-403(3).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Leasehold interest." Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Rights". Section 1-201(36).
"Sale". Section 2-106(1).
"Sublease". Section 2A-103(1)(w).
"Value". Section 1-201(44).

§ 2A-306. PRIORITY OF CERTAIN LIENS ARISING BY OPERATION OF LAW.

If a person in the ordinary course of his [or her] business furnishes services or materials with respect to goods subject to a lease contract, a lien upon those goods in the possession of that person given by statute or rule of law for those materials or services takes priority over any interest of the lessor or lessee under the lease contract or this Article unless the lien is created by statute and the statute provides otherwise or unless the lien is created by rule of law and the rule of law provides otherwise.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-310.

Changes: The approach reflected in the provisions of Section 9-310 was included, but revised to conform to leasing terminology and to expand the exception to the special priority granted to protected liens to cover liens created by rule of law as well as those created by statute.

Purposes: This section should be interpreted to allow a qualified lessor or a qualified lessee to be the competing lienholder if the statute or rule of law so provides. The reference to statute includes applicable regulations and cases; these sources must be reviewed in resolving a priority dispute under this section.

Cross Reference:

Section 9-310.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lease Contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lien". Section 2A-103(1)(r).
"Person". Section 1-201(30).

§ 2A-307. PRIORITY OF LIENS ARISING BY ATTACHMENT OR LEVY ON, SECURITY INTERESTS IN, AND OTHER CLAIMS TO GOODS.

(1) Except as otherwise provided in Section 2A-306, a creditor of a lessee takes subject to the lease contract.

(2) Except as otherwise provided in subsections (3) and (4) of this section and in Sections 2A-306 and 2A-308, a creditor of a lessor takes subject to the lease contract:

(a) unless the creditor holds a lien that attached to the goods before the lease contract became enforceable, or

(b) unless the creditor holds a security interest in the goods that under the Article on Secured Transactions (Article 9) would have priority over any

other security interest in the goods perfected by a filing covering the goods and made at the time the lease contract became enforceable, whether or not any other security interest existed.

(3) A lessee in the ordinary course of business takes the leasehold interest free of a security interest in the goods created by the lessor even though the security interest is perfected and the lessee knows of its existence.

(4) A lessee other than a lessee in the ordinary course of business takes the leasehold interest free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the lease or more than 45 days after the lease contract becomes enforceable, whichever first occurs, unless the future advances are made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the 45-day period.

OFFICIAL COMMENT

Uniform Statutory Source: None for subsections (1) and (2). Subsections (3) and (4) are derived from the provisions of Section 9-307(1) and (3), respectively.

Changes: The provisions of Section 9-307(1) and (3) were incorporated, and modified to reflect leasing terminology and the basic concepts reflected in this Article.

Purposes: Subsection (1) states a general rule of priority that a creditor of the lessee takes subject to the lease contract. The term lessee (Section 2A-103(1)(n)) includes sublessee. Therefore, this subsection not only

covers disputes between the prime lessor and a creditor of the prime lessee but also disputes between the prime lessor, or the sublessor, and a creditor of the sublessee. Section 2A-301 official comment. Further, by using the term creditor (Section 1-201(12)), this subsection will cover disputes with a general creditor, a secured creditor, a lien creditor and any representative of creditors. Section 2A-103(4).

Subsection (2) states a general rule of priority that a creditor of a lessor takes subject to the lease contract. Note the discussion above with regard to the scope of these rules. Section 2A-301 official comment. Thus, the section will not only cover disputes between the prime lessee and a creditor of the prime lessor but also disputes between the prime lessee, or the sublessee, and a creditor of the sublessor.

To take priority over the lease contract, and the interests derived therefrom, the creditor must come within one of two exceptions stated within the rule. First, subsection (2)(a) provides that where the creditor holds a lien (Section 2A-103(1)(r)) that attached before the lease contract became enforceable (Section 2A-301), the creditor does not take subject to the lease. Second, subsection (2)(b) provides that when the creditor holds a security interest (Section 1-201(37)) that would have priority over a hypothetical secured creditor holding a security interest perfected by a filing made at the time the lease contract became enforceable (Section 2A-301), the creditor does not take subject to the lease. With respect to this provision the hypothetical secured creditor is not the holder of a purchase money security interest entitled to special priority: first, the facts and circumstances relating to the security interest described in Section 2A-307(2)(b) would not create a purchase money security interest as defined in Section 9-107, and second, assuming arguendo that it did create a purchase money security interest, the facts and circumstances relating to the security interest described in Section 2A-307(2)(b) would not create a special priority under the provisions of Section 9-312(3) or (4). Thus, the priority rules of Section 9-312(5) govern the security interest held by the hypothetical secured creditor. The use of a hypothetical creditor as a statutory means to resolve disputes between competing interests is not without precedent. The Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. § 544(a) (1982 & Supp. II 1984)."

The rule stated in subsection (2)(b) is best understood by reviewing a hypothetical. Assume that a

merchant engaged in the business of selling and leasing musical instruments obtained possession of a truck load of musical instruments on deferred payment terms from a supplier of musical instruments. To secure payment of such credit the merchant granted the supplier a security interest in the instruments; the security interest was perfected by filing on January 15. The merchant, as lessor, entered into a lease to an individual of one of the musical instruments supplied by the supplier; the lease became enforceable on March 1. Under the rule stated in subsection (2)(b) a priority dispute between the supplier, as the lessor's secured creditor, and the lessee would be determined by assuming that on March 1 (the day the lease became enforceable) the merchant had granted a security interest in such musical instruments to a hypothetical secured creditor and the hypothetical secured creditor perfected such security interest by filing on March 1. Under the priority rules of the Article on Secured Transactions (Article 9) the hypothetical secured creditor would lose in a priority dispute with the supplier. Section 9-312(5)(a). Thus, under the rule stated in subsection (2)(b), the supplier's security interest in the musical instrument would have priority over the lease contract. However, subsection (2)(b) states that its rule is subject to the rules of subsections (3) and (4). Under this hypothetical the lessee should qualify as a "lessee in the ordinary course of business". Section 2A-103(1)(o). Subsection (3) also makes clear that the lessee in the ordinary course of business will win even if he or she knows of the existence of the supplier's security interest.

Subsections (3) and (4), which are modeled on the provisions of Section 9-307(1) and (3), respectively, state two exceptions to the priority rule stated in subsection (2) with respect to a creditor who holds a security interest. The lessee in the ordinary course of business will be treated in the same fashion as the buyer in the ordinary course of business, given a priority dispute with a secured creditor over goods subject to a lease contract.

Cross References:

Sections 1-201(12), 1-201(37), 2A-103(1)(n), 2A-103(1)(o), 2A-103(1)(r), 2A-103(4), 2A-301 official comment, Article 9, esp. Sections 9-307(1), 9-307(3) and 9-312(5)(a).

Definitional Cross References:

"Creditor". Section 1-201(12).
"Goods". Section 2A-103(1)(h).
"Knowledge" and "Knows". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Lien". Section 2A-103(1)(r).
"Party". Section 1-201(29).
"Pursuant to commitment". Section 2A-103(3)
"Security interest". Section 1-201(37).

§ 2A-306. SPECIAL RIGHTS OF CREDITORS.

(1) A creditor of a lessor in possession of goods subject to a lease contract may treat the lease contract as void if as against the creditor retention of possession by the lessor is fraudulent under any statute or rule of law, but retention of possession in good faith and current course of trade by the lessor for a commercially reasonable time after the lease contract becomes enforceable is not fraudulent.

(2) Nothing in this Article impairs the rights of creditors of a lessor if the lease contract (a) becomes enforceable, not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security, or the like, and (b) is made under circumstances which under any statute or rule of law apart

from this Article would constitute the transaction a fraudulent transfer or voidable preference.

(3) A creditor of a seller may treat a sale or an identification of goods to a contract for sale as void if as against the creditor retention of possession by the seller is fraudulent under any statute or rule of law, but retention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-402(2) and (3)(b).

Changes: Rephrased and new material added to conform to leasing terminology and practice.

Purposes: Subsection (1) states a general rule of avoidance where the lessor has retained possession of goods if such retention is fraudulent under any statute or rule of law. However, the subsection creates an exception under certain circumstances for retention of possession of goods for a commercially reasonable time after the lease contract becomes enforceable.

Subsection (2) also preserves the possibility of an attack on the lease by creditors of the lessor if the lease was made in satisfaction of or as security for a pre-existing claim, and would constitute a fraudulent transfer or voidable preference under other law.

Finally, subsection (3) states a new rule with respect to sale-leaseback transactions, i.e., transactions where the seller sells goods to a buyer but possession of the goods is retained by the seller pursuant to a lease contract

registered, of a financing statement concerning goods that are or are to become fixtures and conforming to the requirements of subsection (5) of Section 9-402;

(c) a lease is a "purchase money lease" unless the lessee has possession or use of the goods or the right to possession or use of the goods before the lease agreement is enforceable;

(d) a mortgage is a "construction mortgage" to the extent it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates; and

(e) "encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests.

(2) Under this Article a lease may be of goods that are fixtures or may continue in goods that become fixtures, but no lease exists under this Article of ordinary building materials incorporated into an improvement on land.

(3) This Article does not prevent creation of a lease of fixtures pursuant to real estate law.

(4) The perfected interest of a lessor of fixtures has priority over a conflicting interest of an encumbrancer or owner of the real estate if:

(a) the lease is a purchase money lease, the conflicting interest of the encumbrancer or owner arises before the goods become fixtures, the interest of the lessor is perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and the lessee has an interest of record in the real estate or is in possession of the real estate; or

(b) the interest of the lessor is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the lessor's interest has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the lessee has an interest of record in the real estate or is in possession of the real estate.

(5) The interest of a lessor of fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate if:

(a) the fixtures are readily removable factory or office machines, readily removable equipment that is not primarily used or leased for use in the operation of the real estate, or readily removable replacements of domestic appliances that are goods subject to a consumer lease, and before the goods become fixtures the lease contract is enforceable; or

(b) the conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the lease contract is enforceable; or

(c) the encumbrancer or owner has consented in writing to the lease or has disclaimed an interest in the goods as fixtures; or

(d) the lessee has a right to remove the goods as against the encumbrancer or owner. If the lessee's right to remove terminates, the priority of the interest of the lessor continues for a reasonable time.

(6) Notwithstanding paragraph (a) of subsection (4) but otherwise subject to subsections (4) and (5), the interest of a lessor of fixtures is subordinate to the conflicting interest of an encumbrancer of the real estate under a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent given to refinance a construction mortgage, the conflicting interest of an encumbrancer of the real estate under a mortgage has this priority to the same extent as the encumbrancer of the real estate under the construction mortgage.

(7) In cases not within the preceding subsections, priority between the interest of a lessor of fixtures and the conflicting interest of an encumbrancer or owner of the real estate who is not the lessee is determined by the priority rules governing conflicting interests in real estate.

(8) If the interest of a lessor has priority over all conflicting interests of all owners and encumbrancers of the real estate, the lessor or the lessee may (a) on default, expiration, termination, or cancellation of the lease agreement by the other party but subject to the provisions of the lease agreement and this Article, or (b) if necessary to enforce his [or her] other rights and remedies under this Article, remove the goods from the real estate, free and clear of all conflicting interests of all owners and encumbrancers of the real estate, but he [or she] must reimburse any encumbrancer or owner of the real estate who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

(9) Even though the lease agreement does not create a security interest, the interest of a lessor of fixtures is perfected by filing a financing statement as a fixture filing for leased goods that are or are to become fixtures in accordance with the relevant provisions of the Article on Secured Transactions (Article 9).

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-313.

Changes: Revised to reflect leasing terminology and to add new material.

Purposes: While Section 9-313 provided a model for this section, certain provisions were substantially revised.

Section 2A-309(1)(c), which is new, defines purchase money lease to exclude leases where the lessee had possession or use of the goods or the right thereof before the lease agreement became enforceable. This term is used in subsection (4)(a) as one of the conditions that must be satisfied to obtain priority over the conflicting interest of an encumbrancer or owner of the real estate.

Section 2A-309(4), which states one of several priority rules found in this section, deletes reference to office machines and the like (Section 9-313(4)(c)) as well as certain liens (Section 9-313(4)(d)). However, these items are included in subsection (5), another priority rule that is more permissive than the rule found in subsection (4) as it applies whether or not the interest of the lessor is perfected. In addition, subsection (5)(a) expands the scope of the provisions of Section 9-313(4)(c) to include readily removable equipment not primarily used or leased for use in the operation of real estate; the qualifier is intended to exclude from the expanded rule equipment integral to the operation of real estate, e.g., heating and air conditioning equipment.

The rule stated in subsection (7) is more liberal than the rule stated in Section 9-313(7) in that issues of priority not otherwise resolved in this subsection are left for resolution by the priority rules governing conflicting interests in real estate, as opposed to the Section 9-313(7) automatic subordination of the security interest in fixtures.

The rule stated in subsection (8) is more liberal than the rule stated in Section 9-313(8) in that the right of removal is extended to both the lessor and the lessee and the occasion for removal includes expiration, termination or cancellation of the lease agreement, and enforcement of rights and remedies under this Article, as well as default. The new language also provides that upon removal the goods are free and clear of conflicting interests of owners and encumbrancers of the real estate.

Finally, subsection (9) provides a mechanism for the lessor of fixtures to perfect its interest by filing a financing statement under the provisions of the Article on Secured Transactions (Article 9), even though the lease agreement does not create a security interest. Section 1-201(37). The relevant provisions of Article 9 must be interpreted permissively to give effect to this mechanism as it implicitly expands the scope, perfection and priority provisions of Article 9 to govern transactions that create a lease of fixtures, even though the lease agreement does not create a security interest. This mechanism is similar to that provided in Section 2-326(3)(c) for the seller of goods on consignment, even though the consignment is not "intended as security". Section 1-201(37). Given the lack of litigation with respect to the mechanism created for consignment sales, this new mechanism should prove effective. Note, however, that this is a more pervasive change in Article 9 than that wrought by expanding the filing system to accommodate permissive filing for leases. U.C.C. § 9-408 app. II (West 1983)(Reasons for 1972 Adoption of New Section).

Cross References:

Sections 1-201(37), 2A-309(1)(c), 2A-309(4), Article 9, esp. Sections 9-313, 9-313(4)(c), 9-313(4)(d), 9-313(7), 9-313(8) and 9-408.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Cancellation". Section 2A-103(1)(b).
"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A-103(1)(e).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lien". Section 2A-103(1)(r).
"Mortgage". Section 9-105(1)(j).
"Party". Section 1-201(29).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

"Security interest". Section 1-201(37).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Writing". Section 1-201(46).

§ 2A-310. LESSOR'S AND LESSEE'S RIGHTS WHEN GOODS BECOME ACCESSIONS.

(1) Goods are "accessions" when they are installed in or affixed to other goods.

(2) The interest of a lessor or a lessee under a lease contract entered into before the goods became accessions is superior to all interests in the whole except as stated in subsection (4).

(3) The interest of a lessor or a lessee under a lease contract entered into at the time or after the goods became accessions is superior to all subsequently acquired interests in the whole except as stated in subsection (4) but is subordinate to interests in the whole existing at the time the lease contract was made unless the holders of such interests in the whole have in writing consented to the lease or disclaimed an interest in the goods as part of the whole.

(4) The interest of a lessor or a lessee under a lease contract described in subsection (2) or (3) is subordinate to the interest of

(a) a buyer in the ordinary course of business or a lessee in the ordinary course of business of any interest in the whole acquired after the goods became accessions; or

(b) a creditor with a security interest in the whole perfected before the lease contract was made to the extent that the creditor makes subsequent advances without knowledge of the lease contract.

(5) When under subsections (2) or (3) and (4) a lessor or a lessee of accessions holds an interest that is superior to all interests in the whole, the lessor or the lessee may (a) on default, expiration, termination, or cancellation of the lease contract by the other party but subject to the provisions of the lease contract and this Article, or (b) if necessary to enforce his [or her] other rights and remedies under this Article, remove the goods from the whole, free and clear of all interests in the whole, but he [or she] must reimburse any holder of an interest in the whole who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-314.

Changes: Revised to reflect leasing terminology and to add new material.

Purposes: Subsections (1) and (2) restate the provisions of subsection (1) of Section 9-314 to clarify the definition of accession and to add leasing terminology to the priority rule that applies when the lease is entered into before the goods become accessions. Subsection (3) restates the provisions of subsection (2) of Section 9-314 to add leasing terminology to the priority rule that applies when the lease is entered into on or after the goods become accessions. Unlike the rule with respect to security interests, the lease is merely subordinate, not invalid.

Subsection (4) creates two exceptions to the priority rules stated in subsections (2) and (3). Subsection (4) deletes the special priority rule found in the provisions of Section 9-314(3)(b) as the interests of the lessor and lessee are entitled to greater protection.

Finally, subsection (5) is modeled on the provisions of Section 9-314(4) with respect to removal of accessions, restated to reflect the parallel changes in Section 2A-309(8).

Neither this section nor Section 9-314 governs where the accession to the goods is not subject to the interest of a lessor or a lessee under a lease contract and is not subject to the interest of a secured party under a security agreement. This issue is to be resolved by the courts, case by case.

Cross References:

Sections 2A-309(8), 9-314(1), 9-314(2), 9-314(3)(b), 9-314(4).

Definitional Cross References:

"Agreed". Section 1-201(3).
"Buyer in the ordinary course of business". Section 2A-103(1)(a).
"Cancellation". Section 2A-103(1)(b).
"Creditor". Section 1-201(12).
"Goods". Section 2A-103(1)(h).
"Holder". Section 1-201(20).
"Knowledge". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).

"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Writing". Section 1-201(46).

PART 4. PERFORMANCE OF LEASE CONTRACT: REPUDIATED, SUBSTITUTED AND EXCUSED

§ 2A-401. INSECURITY: ADEQUATE ASSURANCE OF PERFORMANCE.

(1) A lease contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.

(2) If reasonable grounds for insecurity arise with respect to the performance of either party, the insecure party may demand in writing adequate assurance of due performance. Until the insecure party receives that assurance, if commercially reasonable the insecure party may suspend any performance for which he [or she] has not already received the agreed return.

(3) A repudiation of the lease contract occurs if assurance of due performance adequate under the circumstances of the particular case is not provided to the insecure party within a reasonable time, not to exceed 30 days after receipt of a demand by the other party.

(4) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to commercial standards.

(5) Acceptance of any nonconforming delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-609.

Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (3) (Section 2-609(4)), the adjective "justified" modifies demand. The adjective was deleted here as unnecessary, implying no substantive change.

Definitional Cross References:

"Aggrieved party". Section 1-201(2).
"Agreed". Section 1-201(3).
"Between merchants". Section 2-104(3).
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Writing". Section 1-201(46).

§ 2A-402. ANTICIPATORY REPUDIATION.

If either party repudiates a lease contract with respect to a performance not yet due under the lease contract, the loss of which performance will substantially

impair the value of the lease contract to the other, the aggrieved party may:

(a) for a commercially reasonable time, await retraction of repudiation and performance by the repudiating party;

(b) make demand pursuant to Section 2A-401 and await assurance of future performance adequate under the circumstances of the particular case; or

(c) resort to any right or remedy upon default under the lease contract or this Article, even though the aggrieved party has notified the repudiating party that the aggrieved party would await the repudiating party's performance and assurance and has urged retraction. In addition, whether or not the aggrieved party is pursuing one of the foregoing remedies, the aggrieved party may suspend performance or, if the aggrieved party is the lessor, proceed in accordance with the provisions of this Article on the lessor's right to identify goods to the lease contract notwithstanding default or to salvage unfinished goods (Section 2A-524).

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-610.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Aggrieved party". Section 1-201(2).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

§ 2A-403. RETRACTION OF ANTICIPATORY REPUDIATION.

(1) Until the repudiating party's next performance is due, the repudiating party can retract the repudiation unless, since the repudiation, the aggrieved party has cancelled the lease contract or materially changed the aggrieved party's position or otherwise indicated that the aggrieved party considers the repudiation final.

(2) Retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform under the lease contract and includes any assurance demanded under Section 2A-401.

(3) Retraction reinstates a repudiating party's rights under a lease contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-611.

Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (2) (Section 2-611(2)) the adjective "justifiably" modifies demanded. The adjective was deleted here (as it was in Section 2A-401) as unnecessary, implying no substantive change.

Definitional Cross References:

"Aggrieved party". Section 1-201(2).
"Cancellation". Section 2A-103(1)(b).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).

§ 2A-404. SUBSTITUTED PERFORMANCE.

(1) If without fault of the lessee, the lessor and the supplier, the agreed berthing, loading, or unloading facilities fail or the agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable, but a commercially reasonable substitute is available, the substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation:

(a) the lessor may withhold or stop delivery or cause the supplier to withhold or stop delivery unless the lessee provides a means or manner of payment that is commercially a substantial equivalent; and

(b) if delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the lessee's obligation unless the regulation is discriminatory, oppressive, or predatory.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-614.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Delivery". Section 1-201(14).
"Fault". Section 2A-103(1)(f).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Supplier". Section 2A-103(1)(x).

§ 2A-405. EXCUSED PERFORMANCE.

Subject to Section 2A-404 on substituted performance, the following rules apply:

(a) Delay in delivery or nondelivery in whole or in part by a lessor or a supplier who complies with paragraphs (b) and (c) is not a default under the lease contract if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the lease contract was made or by compliance in good faith with any applicable foreign or domestic

governmental regulation or order, whether or not the regulation or order later proves to be invalid.

(b) If the causes mentioned in paragraph (a) affect only part of the lessor's or the supplier's capacity to perform, he [or she] shall allocate production and deliveries among his [or her] customers but at his [or her] option may include regular customers not then under contract for sale or lease as well as his [or her] own requirements for further manufacture. He [or she] may so allocate in any manner that is fair and reasonable.

(c) The lessor seasonably shall notify the lessee and in the case of a finance lease the supplier seasonably shall notify the lessor and the lessee, if known, that there will be delay or nondelivery and, if allocation is required under paragraph (b), of the estimated quota thus made available for the lessee.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-615.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Contract". Section 1-201(11).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Knows". Section 1-201(25).

"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Sale". Section 2-106(1).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).

§ 2A-406. PROCEDURE ON EXCUSED PERFORMANCE.

(1) If the lessee receives notification of a material or indefinite delay or an allocation justified under Section 2A-405, the lessee may by written notification to the lessor as to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (Section 2A-510):

(a) terminate the lease contract (Section 2A-505(2)); or

(b) except in a finance lease that is not a consumer lease, modify the lease contract by accepting the available quota in substitution, with due allowance from the rent payable for the balance of the lease term for the deficiency but without further right against the lessor.

(2) If, after receipt of a notification from the lessor under Section 2A-405, the lessee fails so to modify the lease agreement within a reasonable time not exceeding 30

days, the lease contract lapses with respect to any deliveries affected.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-616(1) and (2).

Changes: Revised to reflect leasing practices and terminology. Note that subsection 1(a) allows the lessee under a lease, including a finance lease, the right to terminate the lease for excused performance (Sections 2A-404 and 2A-405). However, subsection 1(b), which allows the lessee the right to modify the lease for excused performance, excludes a finance lease that is not a consumer lease. This exclusion is compelled by the same policy that led to codification of provisions with respect to irrevocable promises. Section 2A-407.

Definitional Cross References:

"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Written". Section 1-201(46).

§ 2A-407. IRREVOCABLE PROMISES: FINANCE LEASES.

(1) In the case of a finance lease that is not a consumer lease the lessee's promises under the lease contract

become irrevocable and independent upon the lessee's acceptance of the goods.

(2) A promise that has become irrevocable and independent under subsection (1):

(a) is effective and enforceable between the parties, and by or against third parties including assignees of the parties, and

(b) is not subject to cancellation, termination, modification, repudiation, excuse, or substitution without the consent of the party to whom the promise runs.

OFFICIAL COMMENT

Uniform Statutory Source: None.

Purposes: This section extends the benefits of the classic "hell or high water" clause to a finance lease that is not a consumer lease. This section is self-executing; no special provision need be added to the contract. This section makes covenants in a finance lease irrevocable and independent due to the function of the finance lessor in a three party relationship: the lessee is looking to the supplier to perform the essential covenants and warranties. Section 2A-209. Thus, upon the lessee s acceptance of the goods the lessee's promises to the lessor under the lease contract become irrevocable and independent. The provisions of this section remain subject to the obligation of good faith (Sections 2A-103(4) and 1-203), and the lessee's revocation of acceptance (Section 2A-517).

The section requires the lessee to perform even if the lessor's performance after the lessee's acceptance is not in accordance with the lease contract; the lessee may, however, have and pursue a cause of action against the lessor, e.g., breach of certain limited warranties (Sections 2A-210 and 211(1)). This is appropriate because the benefit of the supplier's promises and warranties to the lessor under the supply contract is extended to the lessee under the finance lease. Section 2A-209. Despite this balance, this

section excludes a finance lease that is a consumer lease. That a consumer be obligated to pay notwithstanding defective goods or the like is a principle that is not tenable under case law (Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967)), state statute (Unif. Consumer Credit Code §§ 3.403-.405, 7A U.L.A. 126-31 (1974), or federal statute (15 U.S.C. § 1666i (1982)).

The relationship of the three parties to a transaction that qualifies as a finance lease is best demonstrated by a hypothetical. A, the potential lessor, has been contacted by B, the potential lessee, to discuss the lease of an expensive line of equipment that B has recently placed an order for with C, the manufacturer of such goods. The negotiation is completed and A, as lessor, and B, as lessee, sign a lease of the line of equipment for a 60-month term. B, as buyer, assigns the purchase order with C to A. If this transaction creates a lease (Section 2A-103(1)(j)), this transaction should qualify as a finance lease. Section 2A-103(1)(g).

The line of equipment is delivered by C to B's place of business. After installation by C and testing by B, B accepts the goods by signing a certificate of delivery and acceptance, a copy of which is sent by B to A and C. One year later the line of equipment malfunctions and B falls behind in its manufacturing schedule.

Under this Article, because the lease is a finance lease, no warranty of fitness or merchantability is extended by A to B. Sections 2A-212(1) and 2A-213. Absent an express provision in the lease agreement, application of Section 2A-210 or Section 2A-211(1), or application of the principles of law and equity, including the law with respect to fraud, duress, or the like (Sections 2A-103(4) and 1-103), B has no claim against A. B's obligation to pay rent to A continues as the obligation became irrevocable and independent when B accepted the line of equipment (Section 2A-407(1)). B has no right of set-off with respect to any part of the rent still due under the lease. Section 2A-508(6). However, B may have another remedy. Despite the lack of privity between B and C (the purchase order with C having been assigned by B to A), B may have a claim against C. Section 2A-209(1).

This section is silent as to whether a "hell or high water" clause, i.e., a clause that is to the effect of this section, is enforceable if included in a finance lease that is a consumer lease or a lease that is not a finance lease. That issue will continue to be determined by the facts of

each case. Sections 2A-104, 2A-103(4), 9-206 and 9-318. However, with respect to finance leases that are not consumer leases courts have enforced "hell or high water" clauses. In re O.P.M. Leasing Servs., 21 Bankr. 993, 1006 (Bankr. S.D.N.Y. 1982).

Subsection (2) further provides that a promise that has become irrevocable and independent under subsection (1) is enforceable not only between the parties but also against third parties. Thus, the finance lease can be transferred or assigned without disturbing enforceability. Further, subsection (2) also provides that the promise cannot, among other things, be cancelled or terminated without the consent of the lessor.

Cross References:

Sections 1-103, 1-203, 2A-103(1)(g), 2A-103(1)(j), 2A-103(4), 2A-104, 2A-209, 2A-209(1), 2A-210, 2A-211(1), 2A-212(1), 2A-213, 2A-517(1)(b), 9-206 and 9-318.

Definitional Cross References:

"Cancellation". Section 2A-103(1)(b).
"Consumer lease". Section 2A-103(1)(e).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n)
"Party". Section 1-201(29).
"Termination". Section 2A-103(1)(z).

PART 5. DEFAULT

A. IN GENERAL

§ 2A-501. DEFAULT: PROCEDURE.

(1) Whether the lessor or the lessee is in default under a lease contract is determined by the lease agreement and this Article.

(2) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement has rights and remedies as provided in this Article and, except as limited by this Article, as provided in the lease agreement.

(3) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement may reduce the party's claim to judgment, or otherwise enforce the lease contract by self-help or any available judicial procedure or nonjudicial procedure, including administrative proceeding, arbitration, or the like, in accordance with this Article.

(4) Except as otherwise provided in this Article or the lease agreement, the rights and remedies referred to in subsections (2) and (3) are cumulative.

(5) If the lease agreement covers both real property and goods, the party seeking enforcement may proceed under this Part as to the goods, or under other applicable law as to both the real property and the goods in accordance with his [or her] rights and remedies in respect of the real property, in which case this Part does not apply.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-501.

Changes: Substantially revised.

Purposes: Subsection (1) is new and represents a departure from the Article on Secured Transactions (Article 9) as the subsection makes clear that whether a party to the lease agreement is in default is determined by

the agreement as well as this Article. Sections 2A-508 and 2A-523. It further departs from Article 9 in recognizing the potential default of either party, a function of the bilateral nature of the obligations between the parties to the lease contract.

Subsection (2) is a version of the first sentence of Section 9-501(1), revised to reflect leasing terminology.

Subsection (3), an expansive version of the second sentence of Section 9-501(1), lists the procedures that may be followed by the party seeking enforcement; in effect, the scope of the procedures listed in subsection (3) is consistent with the scope of the procedures available to the foreclosing secured party.

Subsection (4) establishes that the parties' rights and remedies are cumulative. DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.S.F. L. Rev. 257, 276-80 (1978).

Section 9-501(3), which, among other things, states that certain rules, to the extent they give rights to the debtor and impose duties on the secured party, may not be waived or varied, was not incorporated in this Article. Given the significance of freedom of contract in the development of the common law as it applies to bailments for hire and the lessee's lack of an equity of redemption, there was no reason to impose that restraint.

Cross References:

Sections 2A-508, 2A-523, Article 9, esp. Sections 9-501(1) and 9-501(3).

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

§ 2A-502. NOTICE AFTER DEFAULT.

Except as otherwise provided in this Article or the lease agreement, the lessor or lessee in default under the lease contract is not entitled to notice of default or notice of enforcement from the other party to the lease agreement.

OFFICIAL COMMENT

Uniform Statutory Source: None.

Purposes: This section makes clear that absent agreement to the contrary or provision in this Article to the contrary, e.g., Section 2A-516(3)(a), the party in default is not entitled to notice of default or enforcement. While a review of Part 5 of Article 9 leads to the same conclusion with respect to giving notice of default to the debtor, it is never stated. Although Article 9 requires notice of disposition and strict foreclosure, the different scheme of lessors' and lessees' rights and remedies developed under the common law, and codified by this Article, generally does not require notice of enforcement; furthermore, such notice is not mandated by due process requirements. However, certain sections of this Article do require notice. E.g., Section 2A-517(2).

Cross References:

Sections 2A-516(3)(a), 2A-517(2), and Article 9, esp. Part 5.

Definitional Cross References:

"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).

§ 2A-503. MODIFICATION OR IMPAIRMENT OF RIGHTS AND REMEDIES.

(1) Except as otherwise provided in this Article, the lease agreement may include rights and remedies for default in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article.

(2) Resort to a remedy provided under this Article or in the lease agreement is optional unless the remedy is expressly agreed to be exclusive. If circumstances cause an exclusive or limited remedy to fail of its essential purpose, or provision for an exclusive remedy is unconscionable, remedy may be had as provided in this Article.

(3) Consequential damages may be liquidated under Section 2A-504, or may otherwise be limited, altered, or excluded unless the limitation, alteration, or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

(4) Rights and remedies on default by the lessor or the lessee with respect to any obligation or promise collateral or ancillary to the lease contract are not impaired by this Article.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-719 and 2-701.

Changes: Rewritten to reflect lease terminology and to clarify the relationship between this section and Section 2A-504.

Purposes: A significant purpose of this Part is to provide rights and remedies for those parties to a lease who fail to provide them by agreement or whose rights and remedies fail of their essential purpose or are unenforceable. However, it is important to note that this implies no restriction on freedom to contract. Sections 2A-103(4) and 1-102(3). Thus, subsection (1), a revised version of the provisions of Section 2-719(1), allows the parties to the lease agreement freedom to provide for rights and remedies in addition to or in substitution for those provided in this Article and to alter or limit the measure of damages recoverable under this Article. Except to the extent otherwise provided in this Article (e.g., Sections 2A-105, 106 and 108(1) and (2)), this Part shall be construed neither to restrict the parties' ability to provide for rights and remedies or to limit or alter the measure of damages by agreement, nor to imply disapproval of rights and remedy schemes other than those set forth in this Part.

Subsection (2) makes explicit with respect to this Article what is implicit in Section 2-719 with respect to the Article on Sales (Article 2): if an exclusive remedy is held to be unconscionable, remedies under this Article are available. Section 2-719 official comment 1.

Subsection (3), a revision of Section 2-719(3), makes clear that consequential damages may also be liquidated. Section 2A-504(1).

Subsection (4) is a revision of the provisions of Section 2-701. This subsection leaves the treatment of default with respect to obligations or promises collateral or ancillary to the lease contract to other law. Sections 2A-103(4) and 1-103. An example of such an obligation would be that of the lessor to the secured creditor which has provided the funds to leverage the lessor's lease transaction; an example of such a promise would be that of the lessee, as seller, to the lessor, as buyer, in a sale-leaseback transaction.

Cross References:

Sections 1-102(3), 1-103, Article 2, esp. Sections 2-701, 2-719, 2-719(1), 2-719(3), 2-719 official comment 1, and Sections 2A-103(4), 2A-105, 2A-106, 2A-108(1), 2A-108(2), 2A-504 and 2A-504(1).

Definitional Cross References:

"Agreed". Section 1-201(3).
"Consumer goods". Section 9-109(1).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

§ 2A-504. LIQUIDATION OF DAMAGES.

(1) Damages payable by either party for default, or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default or other act or omission.

(2) If the lease agreement provides for liquidation of damages, and such provision does not comply with subsection (1), or such provision is an exclusive or limited remedy that circumstances cause to fail of its essential purpose, remedy may be had as provided in this Article.

(3) If the lessor justifiably withholds or stops delivery of goods because of the lessee's default or insolvency (Section 2A-525 or 2A-526), the lessee is entitled to restitution of any amount by which the sum of his [or her] payments exceeds:

(a) the amount to which the lessor is entitled by virtue of terms liquidating the lessor's damages in accordance with subsection (1); or

(b) in the absence of those terms, 20 percent of the then present value of the total rent the lessee was obligated to pay for the balance of the lease term, or, in the case of a consumer lease, the lesser of such amount or $500.

(4) A lessee's right to restitution under subsection (3) is subject to offset to the extent the lessor establishes:

(a) a right to recover damages under the provisions of this Article other than subsection (1); and

(b) the amount or value of any benefits received by the lessee directly or indirectly by reason of the lease contract.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-718(1), (2), (3) and 2-719(2).

Changes: Substantially rewritten.

Purposes: Many leasing transactions are predicated on the parties' ability to agree to an appropriate amount of damages or formula for damages in the event of default or other act or omission. The rule with respect to sales of goods (Section 2-718) may not be sufficiently flexible to accommodate this practice. Thus, consistent with the common law emphasis upon freedom to contract with respect to bailments for hire, this section has created a revised rule that allows greater flexibility with respect to leases of goods.

Subsection (1), a significantly modified version of the provisions of Section 2-718(1), provides for liquidation of damages in the lease agreement at an amount or by a formula. Section 2-718(1) does not by its express terms include liquidation by a formula; this change was compelled by modern leasing practice. Subsection (1), in a further expansion of Section 2-718(1), provides for liquidation of damages for default as well as any other act or omission.

A liquidated damages formula that is common in leasing practice provides that the sum of lease payments past due, accelerated future lease payments, and the lessor's estimated residual interest, less the net proceeds of disposition (whether by sale or re-lease) of the leased goods is the lessor's damages. Tax indemnities, costs, interest and attorney's fees are also added to determine the lessor's damages. Another common liquidated damages formula utilizes a periodic depreciation allocation as a credit to the aforesaid amount in mitigation of a lessor's damages. A third formula provides for a fixed number of periodic payments as a means of liquidating damages. Stipulated loss or stipulated damage schedules are also common. Whether these formulae are enforceable will be determined in the context of each case by applying a standard of reasonableness in light of the harm anticipated when the formula was agreed to. Whether the inclusion of these formulae will affect the classification of the transaction as a lease or a security interest is to be determined by the facts of each case. Section 1-201(37). E.g., In re Noack, 44 Bankr. 172, 174-75 (Bankr. E.D. Wis. 1984).

This section does not incorporate two other tests that under sales law determine enforceability of liquidated damages, i.e., difficulties of proof of loss and inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. The ability to liquidate damages is critical to modern leasing practice; given the parties' freedom to contract at common law, the policy behind

retaining these two additional requirements here was thought to be outweighed. Further, given the expansion of subsection (1) to enable the parties to liquidate the amount payable with respect to an indemnity for loss or diminution of anticipated tax benefits resulted in another change: the last sentence of Section 2-718(1), providing that a term fixing unreasonably large liquidated damages is void as a penalty, was also not incorporated. The impact of local, state and federal tax laws on a leasing transaction can result in an amount payable with respect to the tax indemnity many times greater than the original purchase price of the goods. By deleting the reference to unreasonably large liquidated damages the parties are free to negotiate a formula, restrained by the rule of reasonableness in this section. These changes should invite the parties to liquidate damages. Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 Yale L.J. 199, 278 (1963).

Subsection (2), a revised version of Section 2-719(2), provides that if the liquidated damages provision is not enforceable or fails of its essential purpose, remedy may be had as provided in this Article.

Subsection (3)(b) of this section differs from subsection (2)(b) of Section 2-718; in the absence of a valid liquidated damages amount or formula the lessor is permitted to retain 20 percent of the present value of the total rent payable under the lease. The alternative limitation of $500 contained in Section 2-718 is deleted as unrealistically low with respect to a lease other than a consumer lease.

Cross References:

Sections 1-201(37), 2-718, 2-718(1), 2-718(2)(b) and 2-719(2).

Definitional Cross References:

"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).

"Lessor". Section 2A-103(1)(p).
"Lessor's residual interest". Section 2A-103(1)(q).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).
"Value". Section 1-201(44).

§ 2A-505. CANCELLATION AND TERMINATION AND EFFECT OF CANCELLATION, TERMINATION, RESCISSION, OR FRAUD ON RIGHTS AND REMEDIES.

(1) On cancellation of the lease contract, all obligations that are still executory on both sides are discharged, but any right based on prior default or performance survives, and the cancelling party also retains any remedy for default of the whole lease contract or any unperformed balance.

(2) On termination of the lease contract, all obligations that are still executory on both sides are discharged but any right based on prior default or performance survives.

(3) Unless the contrary intention clearly appears, expressions of "cancellation," "rescission," or the like of the lease contract may not be construed as a renunciation or discharge of any claim in damages for an antecedent default.

(4) Rights and remedies for material misrepresentation or fraud include all rights and remedies available under this Article for default.

(5) Neither rescission nor a claim for rescission of the lease contract nor rejection or return of the goods may bar or be deemed inconsistent with a claim for damages or other right or remedy.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-106(3) and (4), 2-720 and 2-721.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Cancellation". Section 2A-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Termination". Section 2A-103(1)(z).

§ 2A-506. STATUTE OF LIMITATIONS.

(1) An action for default under a lease contract, including breach of warranty or indemnity, must be commenced within 4 years after the cause of action accrued. By the original lease contract the parties may reduce the period of limitation to not less than one year.

(2) A cause of action for default accrues when the act or omission on which the default or breach of warranty is based is or should have been discovered by the aggrieved party, or when the default occurs, whichever is later. A

cause of action for indemnity accrues when the act or omission on which the claim for indemnity is based is or should have been discovered by the indemnified party, whichever is later.

(3) If an action commenced within the time limited by subsection (1) is so terminated as to leave available a remedy by another action for the same default or breach of warranty or indemnity, the other action may be commenced after the expiration of the time limited and within 6 months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action that have accrued before this Article becomes effective.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-725.

Changes: Substantially rewritten.

Purposes: Subsection (1) does not incorporate the limitation found in Section 2-725(1) prohibiting the parties from extending the period of limitation. Breach of warranty and indemnity claims often arise in a lease transaction; with the passage of time such claims often diminish or are eliminated. To encourage the parties to commence litigation under these circumstances makes little sense.

Subsection (2) states two rules for determining when a cause of action accrues. With respect to default, the rule

of Section 2-725(2) is not incorporated in favor of a more liberal rule of the later of the date when the default occurs or when the act or omission on which it is based is or should have been discovered. With respect to indemnity, a similarly liberal rule is adopted.

Cross References:

Sections 2-725(1) and 2-725(2).

Definitional Cross References:

"Action". Section 1-201(1).
"Aggrieved party". Section 1-201(2).
"Lease contract". Section 2A-103(1)(1).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Termination". Section 2A-103(1)(z).

§ 2A-507. PROOF OF MARKET RENT: TIME AND PLACE.

(1) Damages based on market rent (Section 2A-519 or 2A-528) are determined according to the rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the time of the default.

(2) If evidence of rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the times or places described in this Article is not readily available, the rent prevailing within any reasonable time before or after the time described or at any other place or for a different lease term which in commercial judgment or

under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the difference, including the cost of transporting the goods to or from the other place.

(3) Evidence of a relevant rent prevailing at a time or place or for a lease term other than the one described in this Article offered by one party is not admissible unless and until he [or she] has given the other party notice the court finds sufficient to prevent unfair surprise.

(4) If the prevailing rent or value of any goods regularly leased in any established market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of that market are admissible in evidence. The circumstances of the preparation of the report may be shown to affect its weight but not its admissibility.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-723 and 2-724.

Changes: Revised to reflect leasing practices and terminology. Section 2A-519(2) provides an example of one of the several times this Article refers to a determination of market rent prevailing at a given time or place. Section 2A-507(2).

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Usage of trade". Section 1-205.
"Value". Section 1-201(44).

B. DEFAULT BY LESSOR

§ 2A-508. LESSEE'S REMEDIES.

(1) If a lessor fails to deliver the goods in conformity to the lease contract (Section 2A-509) or repudiates the lease contract (Section 2A-402), or a lessee rightfully rejects the goods (Section 2A-509) or justifiably revokes acceptance of the goods (Section 2A-517), then with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (Section 2A-510), the lessor is in default under the lease contract and the lessee may:

(a) cancel the lease contract (Section 2A-505(1));

(b) recover so much of the rent and security as has been paid, but in the case of an installment lease contract the recovery is that which is just under the circumstances;

(c) cover and recover damages as to all goods affected whether or not they have been identified to the lease contract (Sections 2A-518 and 2A-520), or recover damages for nondelivery (Sections 2A-519 and 2A-520).

(2) If a lessor fails to deliver the goods in conformity to the lease contract or repudiates the lease contract, the lessee may also:

(a) if the goods have been identified, recover them (Section 2A-522); or

(b) in a proper case, obtain specific performance or replevy the goods (Section 2A-521).

(3) If a lessor is otherwise in default under a lease contract, the lessee may exercise the rights and remedies provided in the lease contract and this Article.

(4) If a lessor has breached a warranty, whether express or implied, the lessee may recover damages (Section 2A-519(4)).

(5) On rightful rejection or justifiable revocation of acceptance, a lessee has a security interest in goods in the lessee's possession or control for any rent and security that has been paid and any expenses reasonably incurred in their inspection, receipt, transportation, and care and custody and may hold those goods and dispose of them in good faith and in a commercially reasonable manner, subject to the provisions of Section 2A-527(5).

(6) Subject to the provisions of Section 2A-407, a lessee, on notifying the lessor of the lessee's intention to do so, may deduct all or any part of the damages resulting from any default under the lease contract from any part of the rent still due under the same lease contract.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-711 and 2-717.

Changes: Substantially rewritten.

Purposes: This section is an index to Sections 2A-509 through 522 and their effect on the lessee's rights and remedies after the lessor's default. The lessor and the lessee can otherwise agree; thus, the parties can, among other things, raise or lower the threshold of events that give rise to a lessor's default or create a new scheme of rights and remedies triggered by the occurrence of the default. Sections 2A-103(4) and 1-102(3).

Subsection (1), a substantially rewritten version of the provisions of Section 2-711(1), lists three cumulative remedies of the lessee where the lessor has failed to deliver conforming goods or has repudiated the contract, or the lessee has rightfully rejected or justifiably revoked. Sections 2A-501(2) and (4). This Article rejects any doctrine of election of remedy. To determine if one remedy bars another in a particular case is a function of whether the lessee has been put in as good a position as if the lessor had fully performed the lease agreement. Sections 2A-103(4) and 1-106(1). Note that a special rule has been created regarding the lessee's recovery of rent and security that have been paid in the case of an installment lease -- recovery is limited to that which is just under the circumstances. With the various different types of installment leases, no bright line can be created that would operate fairly in all cases; in addition, this provision should further encourage the parties to establish their own rules by agreement.

Subsection (2), a version of the provisions of Section 2-711(2) revised to reflect leasing terminology, lists two alternative remedies for the recovery of the goods

by the lessee; however, each of these remedies is cumulative with respect to those listed in subsection (1).

Subsection (3) is new and allows the lessee access to the remedy scheme of this Article as well as the lease contract if the lessor is in default for reasons other than those stated in subsection (1). Note that the reference to this Article includes supplemental principles of law and equity. Sections 2A-103(4) and 1-103.

Subsection (4) is new and merely adds to the completeness of the index by including a reference to the lessee's recovery of damages upon the lessor's breach of warranty; such breach may not rise to the level of a default by the lessor (e.g. breach of an express warranty that the goods subject to the lease conform to description where the non-conformity is such that when measured by objective criteria it reflects a minimal deviation from description) unless the breach is material or unless so provided by the lease agreement.

Subsection (5), a revised version of the provisions of Section 2-711(3), recognizes, on rightful rejection or justifiable revocation, the lessee's security interest in goods in its possession and control. Section 9-113, which recognized security interests arising under the Article on Sales (Article 2), was amended with the adoption of this Article to reflect the security interests arising under this Article. Pursuant to Section 2A-511(4), a purchaser who purchases goods from the lessee in good faith takes free of any rights of the lessor, or in the case of a finance lease the supplier. Such goods, however, must have been rightfully rejected and disposed of pursuant to Section 2A-511 or 2A-512. However, Section 2A-517(3) provides that the lessee will have the same rights and duties with respect to goods where acceptance has been revoked as with respect to goods rejected. Thus, Section 2A-511(4) will apply to the lessee's disposition of such goods.

Pursuant to Section 2A-527(5), the lessee must account to the lessor for the excess proceeds of such disposition, after satisfaction of the claim secured by the lessee's security interest.

Subsection (6), a slightly revised version of the provisions of Section 2-717, sanctions a right of set-off by the lessee, subject to the rule of Section 2A-407 with respect to irrevocable promises in a finance lease that is

not a consumer lease, and further subject to an enforceable "hell or high water" clause in the lease agreement. Section 2A-407 official comment. No attempt is made to state how the set-off should occur; this is to be determined by the facts of each case.

There is no special treatment of the finance lease in this section. Absent supplemental principles of law and equity to the contrary, in the case of most finance leases, following the lessee's acceptance of the goods the lessee will have no rights or remedies against the lessor, because the lessor's obligations to the lessee are minimal. Sections 2A-210 and 2A-211(1). Since the lessee will look to the supplier for performance, this is appropriate. Section 2A-209.

Cross References:

Sections 1-102(2), 1-103, 1-106(1), Article 2, esp. Sections 2-711, 2-717 and Sections 2A-103(4), 2A-209, 2A-210, 2A-211(1), 2A-407, 2A-501(2), 2A-501(4), 2A-509 through 2A-522, 2A-511(3), 2A-517(3), 2A-527(5) and Section 9-113.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Receipt". Section 2-103(1)(c).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Value". Section 1-201(44).

§ 2A-509. LESSEE'S RIGHTS ON IMPROPER DELIVERY; RIGHTFUL REJECTION.

(1) Subject to the provisions of Section 2A-510 on default in installment lease contracts, if the goods or the

tender or delivery fail in any respect to conform to the lease contract, the lessee may reject or accept the goods or accept any commercial unit or units and reject the rest of the goods.

(2) Rejection of goods is ineffective unless it is within a reasonable time after tender or delivery of the goods and the lessee seasonably notifies the lessor.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-601 and 2-602(1).

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Commercial unit". Section 2A-103(1)(c).
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Seasonably". Section 1-204(3).

§ 2A-510. INSTALLMENT LEASE CONTRACTS: REJECTION AND DEFAULT.

(1) Under an installment lease contract a lessee may reject any delivery that is nonconforming if the nonconformity substantially impairs the value of that

delivery and cannot be cured or the nonconformity is a defect in the required documents; but if the nonconformity does not fall within subsection (2) and the lessor or the supplier gives adequate assurance of its cure, the lessee must accept that delivery.

(2) Whenever nonconformity or default with respect to one or more deliveries substantially impairs the value of the installment lease contract as a whole there is a default with respect to the whole. But, the aggrieved party reinstates the installment lease contract as a whole if the aggrieved party accepts a nonconforming delivery without seasonably notifying of cancellation or brings an action with respect only to past deliveries or demands performance as to future deliveries.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-612.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Action". Section 1-201(1)
"Aggrieved party". Section 1-201(2).
"Cancellation". Section 2A-103(1)(b).
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Installment lease contract". Section 2A-103(1)(i).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Seasonably". Section 1-204(3).

"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

§ 2A-511. MERCHANT LESSEE'S DUTIES AS TO RIGHTFULLY REJECTED GOODS.

(1) Subject to any security interest of a lessee (Section 2A-508(5)), if a lessor or a supplier has no agent or place of business at the market of rejection, a merchant lessee, after rejection of goods in his [or her] possession or control, shall follow any reasonable instructions received from the lessor or the supplier with respect to the goods. In the absence of those instructions, a merchant lessee shall make reasonable efforts to sell, lease, or otherwise dispose of the goods for the lessor's account if they threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) If a merchant lessee (subsection (1)) or any other lessee (Section 2A-512) disposes of goods, he [or she] is entitled to reimbursement either from the lessor or the supplier or out of the proceeds for reasonable expenses of caring for and disposing of the goods and, if the expenses include no disposition commission, to such commission as is usual in the trade, or if there is none, to a reasonable sum not exceeding 10 percent of the gross proceeds.

(3) In complying with this section or Section 2A-512, the lessee is held only to good faith. Good faith

conduct hereunder is neither acceptance or conversion nor the basis of an action for damages.

(4) A purchaser who purchases in good faith from a lessee pursuant to this section or Section 2A-512 takes the goods free of any rights of the lessor and the supplier even though the lessee fails to comply with one or more of the requirements of this Article.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-603 and 2-706(5).

Changes: Revised to reflect leasing practices and terminology. This section, by its terms, applies to merchants as well as others. Thus, in construing the section it is important to note that under this Act the term good faith is defined differently for merchants (Section 2-103(1)(b)) than for others (Section 1-201(19)). Section 2A-103(3) and (4).

Definitional Cross References:

"Action". Section 1-201(1).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Merchant lessee". Section 2A-103(1)(t).
"Purchaser". Section 1-201(33).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

§ 2A-512. LESSEE'S DUTIES AS TO RIGHTFULLY REJECTED GOODS.

(1) Except as otherwise provided with respect to goods that threaten to decline in value speedily (Section 2A-511) and subject to any security interest of a lessee (Section 2A-508(5)):

(a) the lessee, after rejection of goods in the lessee's possession, shall hold them with reasonable care at the lessor's or the supplier's disposition for a reasonable time after the lessee's seasonable notification of rejection;

(b) if the lessor or the supplier gives no instructions within a reasonable time after notification of rejection, the lessee may store the rejected goods for the lessor's or the supplier's account or ship them to the lessor or the supplier or dispose of them for the lessor's or the supplier's account with reimbursement in the manner provided in Section 2A-511; but

(c) the lessee has no further obligations with regard to goods rightfully rejected.

(2) Action by the lessee pursuant to subsection (1) is not acceptance or conversion.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-602(2)(b) and (c) and 2-604.

Changes: Substantially rewritten.

Purposes: The introduction to subsection (1) references goods that threaten to decline in value speedily and not perishables, the reference in Section 2-604, the statutory analogue. This is a change in style, not substance, as the first phrase includes the second. Subparagraphs (a) and (c) are revised versions of the provisions of Section 2-602(2)(b) and (c). Subparagraph (a) states the rule with respect to the lessee's treatment of goods in its possession following rejection; subparagraph (b) states the rule regarding such goods if the lessor or supplier then fails to give instructions to the lessee. If the lessee performs in a fashion consistent with subparagraphs (a) and (b), subparagraph (c) exonerates the lessee.

Cross References:

Sections 2-602(2)(b), 2-602(2)(c) and 2-604.

Definitional Cross References:

"Action". Section 1-201(1).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Seasonably". Section 1-204(3).
"Security interest". Section 1-201(37).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

§ 2A-513. CURE BY LESSOR OF IMPROPER TENDER OR DELIVERY; REPLACEMENT.

(1) If any tender or delivery by the lessor or the supplier is rejected because nonconforming and the time for performance has not yet expired, the lessor or the supplier may seasonably notify the lessee of the lessor's or the supplier's intention to cure and may then make a conforming delivery within the time provided in the lease contract.

(2) If the lessee rejects a nonconforming tender that the lessor or the supplier had reasonable grounds to believe would be acceptable with or without money allowance, the lessor or the supplier may have a further reasonable time to substitute a conforming tender if he [or she] seasonably notifies the lessee.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-508.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Money". Section 1-201(24).
"Notifies". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).

§ 2A-514. WAIVER OF LESSEE'S OBJECTIONS.

(1) In rejecting goods, a lessee's failure to state a particular defect that is ascertainable by reasonable inspection precludes the lessee from relying on the defect to justify rejection or to establish default:

(a) if, stated seasonably, the lessor or the supplier could have cured it (Section 2A-513); or

(b) between merchants if the lessor or the supplier after rejection has made a request in writing for a full and final written statement of all defects on which the lessee proposes to rely.

(2) A lessee's failure to reserve rights when paying rent or other consideration against documents precludes recovery of the payment for defects apparent on the face of the documents.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-605.

Changes: Revised to reflect leasing practices and terminology.

Purposes: The principles applicable to the commercial practice of payment against documents (subsection 2) are explained in official comment 4 to Section 2-605, the statutory analogue to this section.

Cross Reference:

Section 2-605 official comment 4.

Definitional Cross References:

"Between merchants". Section 2-104(3).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).
"Writing". Section 1-201(46).

§ 2A-515. ACCEPTANCE OF GOODS.

(1) Acceptance of goods occurs after the lessee has had a reasonable opportunity to inspect the goods and

(a) the lessee signifies or acts with respect to the goods in a manner that signifies to the lessor or the supplier that the goods are conforming or that the lessee will take or retain them in spite of their nonconformity; or

(b) the lessee fails to make an effective rejection of the goods (Section 2A-509(2)).

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-606.

Changes: The provisions of Section 2-606(1)(a) were substantially rewritten to provide that the lessee's conduct may signify acceptance. Further, the provisions of Section 2-606(1)(c) were not incorporated as irrelevant given the lessee's possession and use of the leased goods.

Cross References:

Sections 2-606(1)(a) and 2-606(1)(c).

Definitional Cross References:

"Commercial unit". Section 2A-103(1)(c).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Supplier". Section 2A-103(1)(x).

§ 2A-516. EFFECT OF ACCEPTANCE OF GOODS; NOTICE OF DEFAULT; BURDEN OF ESTABLISHING DEFAULT AFTER ACCEPTANCE; NOTICE OF CLAIM OR LITIGATION TO PERSON ANSWERABLE OVER.

(1) A lessee must pay rent for any goods accepted in accordance with the lease contract, with due allowance for goods rightfully rejected or not delivered.

(2) A lessee's acceptance of goods precludes rejection of the goods accepted. In the case of a finance lease, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it. In any other case, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Acceptance does not of itself impair any other remedy provided by this Article or the lease agreement for nonconformity.

(3) If a tender has been accepted:

(a) within a reasonable time after the lessee discovers or should have discovered any default, the lessee shall notify the lessor and the supplier, or be barred from any remedy;

(b) except in the case of a consumer lease, within a reasonable time after the lessee receives notice of litigation for infringement or the like (Section 2A-211) the lessee shall notify the lessor or be barred from any

remedy over for liability established by the litigation; and

(c) the burden is on the lessee to establish any default.

(4) If a lessee is sued for breach of a warranty or other obligation for which a lessor or a supplier is answerable over:

(a) The lessee may give the lessor or the supplier written notice of the litigation. If the notice states that the lessor or the supplier may come in and defend and that if the lessor or the supplier does not do so he [or she] will be bound in any action against him [or her] by the lessee by any determination of fact common to the two litigations, then unless the lessor or the supplier after seasonable receipt of the notice does come in and defend he [or she] is so bound.

(b) The lessor or the supplier may demand in writing that the lessee turn over control of the litigation including settlement if the claim is one for infringement or the like (Section 2A-211) or else be barred from any remedy over. If the demand states that the lessor or the supplier agrees to bear all expense and to satisfy any adverse judgment, then unless the lessee after seasonable receipt of the demand does turn over control the lessee is so barred.

(5) The provisions of subsections (3) and (4) apply to any obligation of a lessee to hold the lessor or the supplier harmless against infringement or the like (Section 2A-211).

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-607.

Changes: Substantially revised.

Purposes: Subsection (2) creates a special rule for finance leases, precluding revocation if acceptance is made with knowledge of nonconformity with respect to the lease agreement, as opposed to the supply agreement; this is not inequitable as the lessee has a direct claim against the supplier. Section 2A-209(1). Revocation of acceptance of a finance lease is permitted if the lessee's acceptance was without discovery of the nonconformity (with respect to the lease agreement, not the supply agreement) and was reasonably induced by the lessor's assurances. Section 2A-517(1)(b). Absent exclusion or modification, the lessor under a finance lease makes certain warranties to the lessee. Sections 2A-210 and 2A-211(1). Revocation of acceptance is not prohibited even after the lessee's promise has become irrevocable and independent. Section 2A-407 official comment. Where the finance lease creates a security interest, the rule may be to the contrary. General Elec. Credit Corp. of Tennessee v. Ger-Beck Mach. Co., 806 F.2d 1207 (3rd Cir. 1986).

Subsection (3)(a) requires the lessee to give notice of default, within a reasonable time after the lessee discovered or should have discovered the default. In all cases, notice of default must be given to the lessor. In the case of a finance lease, notice of defualt must be given to the lessor and the supplier. The definition of supplier is a person from whom a lessor buys or leases goods to be leased under a finance lease. Section 2A-103(1)(x). Thus, not all sellers or lessors of goods to be leased are included within the set of persons to be given notice of default, as suppliers.

Subsection (3)(b) requires the lessee to give the lessor notice of litigation for infringement or the like.

There is an exception created in the case of a consumer lease. While such an exception was considered for a finance lease, it was not created because it was not necessary - the lessor in a finance lease does not give a warranty against infringement. Section 2A-211(2). Even though not required under subsection (3)(b), the lessee who takes under a finance lease should consider giving notice of litigation for infringement or the like to the supplier, because the lessee obtains the benefit of the suppliers' promises subject to the suppliers' defenses or claims. Sections 2A-209(1) and 2-607(3)(b).

Cross References:

Sections 2-607(3)(b), 2A-209(1), 2A-210, 2A-211(1), 2A-211(2), 2A-407 official comment and 2A-517(1)(b).

Definitional Cross References:

"Action". Section 1-201(1).
"Agreement." Section 1-201(3).
"Burden of establishing". Section 1-201(8).
"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Knowledge". Section 1-201(25).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Notifies". Section 1-201(26).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Remedy". Section 1-201(34).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).
"Written". Section 1-201(46).

§ 2A-517. REVOCATION OF ACCEPTANCE OF GOODS.

(1) A lessee may revoke acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to the lessee if he [or she] has accepted it:

(a) except in the case of a finance lease, on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(b) without discovery of the nonconformity if the lessee's acceptance was reasonably induced either by the lessor's assurances or, except in the case of a finance lease, by the difficulty of discovery before acceptance.

(2) Revocation of acceptance must occur within a reasonable time after the lessee discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by the nonconformity. Revocation is not effective until the lessee notifies the lessor.

(3) A lessee who so revokes has the same rights and duties with regard to the goods involved as if the lessee had rejected them.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-608.

Changes: Revised to reflect leasing practices and terminology. Note that in the case of a finance lease the lessee retains a limited right to revoke acceptance. Sections 2A-517(1)(b) and 2A-516 official comment.

Cross References:

Sections 2A-516 official comment and 2A-517(1)(b).

Definitional Cross References:

"Commercial unit". Section 2A-103(1)(c).
"Conforming". Section 2A-103(1)(d).
"Discover". Section 1-201(25).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lot". Section 2A-103(1)(s).
"Notifies." Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Seasonably". Section 1-204(3).
"Value". Section 1-201(44).

§ 2A-518. COVER; SUBSTITUTE GOODS.

(1) After default by a lessor under the lease contract (Section 2A-508(1)), the lessee may cover by making any purchase or lease of or contract to purchase or lease goods in substitution for those due from the lessor.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A-504) or determined by agreement of the parties (Section 1-102(3)), if a lessee's cover is by lease agreement substantially similar to the original lease agreement and the lease agreement is made in good faith and in a commercially reasonable manner, the lessee may recover from the lessor as damages (a) the present value, as of the date of default, of the difference between the total rent for the lease term of the new lease

agreement and the total rent for the remaining lease term of the original lease agreement and (b) any incidental or consequential damages less expenses saved in consequence of the lessor's default.

(3) If a lessee's cover is by lease agreement that for any reason does not qualify for treatment under subsection (2), or is by purchase or otherwise, the lessee may recover from the lessor as if the lessee had elected not to cover and Section 2A-519 governs.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-712.

Changes: Substantially revised.

Purposes: Subsection (1) allows the lessee to take action to fix its damages after default by the lessor. Such action may consist of the purchase or lease of goods. The decision to cover is a function of commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9-507.

Subsection (2) states a rule for determining the amount of lessee's damages provided that there is no agreement to the contrary. The lessee's damages will be established using the new lease agreement as a measure if the following three criteria are met: (i) the lessee's cover is by lease agreement, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such cover was effected in good faith, and in a commercially reasonable manner. Thus, the lessee will be entitled to recover from the lessor the present value, as of the date of default, of the difference between the rent reserved under the new lease and the original lease, together with incidental or consequential damages less expenses saved in consequence of the lessor's default. Note that the reference in Section 2A-518(2)(a) is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only

after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, § 5-1, at 216-217 (1971). Section 2A-501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A-103(4) and 1-103. If the lessee's cover does not satisfy the criteria of subsection (2), Section 2A-519 governs.

Two of the three criteria to be met by the lessee are familiar, but the concept of the new lease agreement being substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. Thus, the decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

While the section does not draw a bright line, it is possible to describe some of the factors that should be considered in finding that a new lease agreement is substantially similar to the original. First, the goods subject to the new lease agreement should be examined. For example, in a lease of computer equipment the new lease might be for more modern equipment. However, it may be that at the time of the lessor's breach it was not possible to obtain the same type of goods in the market place. Because the lessee's remedy under Section 2A-519 is intended to place the lessee in essentially the same position as if he had covered, if goods similar to those to have been delivered under the original lease are not available, then the computer equipment in this hypothetical should qualify as a commercially reasonable substitute. See Section 2-712(1).

Second, the various elements of the new lease agreement should also be examined. Those elements include the term of the new lease (because the damages are calculated under subsection (2) as the difference between the total rent payable for the entire term of the new lease agreement and the remaining term of the original lease); the presence or absence of options to purchase or release; the lessor's representations, warranties and covenants to the lessee, as well as those to be provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the amount of rent to be paid.

Having examined the goods and the agreement, the test to be applied is whether, in light of these comparisons, the new lease agreement is substantially similar to the original lease agreement. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently with respect to the goods and each element of the agreement, as it is important that a sense of commercial judgment pervade the finding. To establish the new lease as a proper measure of damage under subsection (2), these factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original.

Cross References:

Sections 2-712(1), 2A-519 and 9-507.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Contract". Section 1-201(11).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Purchase". Section 2A-103(1)(v).

§ 2A-519. LESSEE'S DAMAGES FOR NON-DELIVERY, REPUDIATION, DEFAULT AND BREACH OF WARRANTY IN REGARD TO ACCEPTED GOODS.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A-504) or determined by agreement of the parties (Section 1-102(3)), if a lessee elects not to cover or a lessee elects to cover and the cover is by lease agreement that for any reason does not

qualify for treatment under Section 2A-518(2), or is by purchase or otherwise, the measure of damages for non-delivery or repudiation by the lessor or for rejection or revocation of acceptance by the lessee is the present value as of the date of the default of the difference between the then market rent and the original rent, computed for the remaining lease term of the original lease agreement together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(2) Market rent is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

(3) If the lessee has accepted goods and given notification (Section 2A-516(3)), the measure of damages for non-conforming tender or delivery by a lessor is the loss resulting in the ordinary course of events from the lessor's default as determined in any manner that is reasonable together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(4) The measure of damages for breach of warranty is the present value at the time and place of acceptance of the difference between the value of the use of the goods accepted and the value if they had been as warranted for the lease term, unless special circumstances show proximate damages of a different amount, together with incidental and

consequential damages, less expenses saved in consequence of the lessor's default or breach of warranty.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-713 and 2-714.

Changes: Substantially revised.

Purposes: Subsection (1), a revised version of the provisions of Section 2-713(1), states the basic rule governing the measure of lessee's damages for non-delivery or repudiation by the lessor or for rightful rejection or revocation of acceptance by the lessee. This measure will apply, absent agreement to the contrary, if the lessee does not cover or if the cover does not qualify under Section 2A-518. There is no sanction for cover that does not qualify.

The measure of damage is the present value, as of the date of default, of the difference between market rent and original rent for the remaining term of the lease, less expenses saved in consequence of the default. Note that the reference in Section 2A-519(1) is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, § 5-1, at 216-217 (1971). Section 2A-501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A-103(4) and 1-103.

Subsection (2), a revised version of the provisions of Section 2-713(2), states the rule with respect to determining market rent.

Subsection (3), a revised version of the provisions of Section 2-714(1) and (3), states the measure of damages where goods have been accepted and acceptance is not revoked. The measure in essence is the loss, in the ordinary course of events, flowing from the default.

Subsection (4), a revised version of the provisions of Section 2-714(2), states the measure of damages for breach of warranty. The measure in essence is the present value of

the difference between the value of the goods accepted and of the goods if they had been as warranted.

Cross References:

Sections 2-713(1), 2-713(2), 2-714 and Section 2A-518.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Present value". Section 2A-103(1)(u).
"Value". Section 1-201(44).

§ 2A-520. LESSEE'S INCIDENTAL AND CONSEQUENTIAL DAMAGES.

(1) Incidental damages resulting from a lessor's default include expenses reasonably incurred in inspection, receipt, transportation, and care and custody of goods rightfully rejected or goods the acceptance of which is justifiably revoked, any commercially reasonable charges, expenses or commissions in connection with effecting cover, and any other reasonable expense incident to the default.

(2) Consequential damages resulting from a lessor's default include:

(a) any loss resulting from general or particular requirements and needs of which the lessor at the time of

contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-715.

Changes: Revised to reflect leasing terminology and practices.

Purposes: Subsection (1), a revised version of the provisions of Section 2-715(1), lists some examples of incidental damages resulting from a lessor's default; the list is not exhaustive. Subsection (1) makes clear that it applies not only to rightful rejection, but also to justifiable revocation.

Subsection (2), a revised version of the provisions of Section 2-715(2), lists some examples of consequential damages resulting from a lessor's default; the list is not exhaustive.

Cross References:

Section 2-715.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Knows". Section 1-201(25).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Person". Section 1-201(30).
"Receipt". Section 2-103(1)(c).

§ 2A-521. LESSEE'S RIGHT TO SPECIFIC PERFORMANCE OR REPLEVIN.

(1) Specific performance may be decreed if the goods are unique or in other proper circumstances.

(2) A decree for specific performance may include any terms and conditions as to payment of the rent, damages, or other relief that the court deems just.

(3) A lessee has a right of replevin, detinue, sequestration, claim and delivery, or the like for goods identified to the lease contract if after reasonable effort the lessee is unable to effect cover for those goods or the circumstances reasonably indicate that the effort will be unavailing.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-716.

Changes: Revised to reflect leasing practices and terminology, and to expand the reference to the right of replevin in subsection (3) to include other similar rights of the lessee.

Definitional Cross References:

"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).

§ 2A-522. LESSEE'S RIGHT TO GOODS ON LESSOR'S INSOLVENCY.

(1) Subject to subsection (2) and even though the goods have not been shipped, a lessee who has paid a part or all of the rent and security for goods identified to a lease contract (Section 2A-217) on making and keeping good a tender

of any unpaid portion of the rent and security due under the lease contract may recover the goods identified from the lessor if the lessor becomes insolvent within 10 days after receipt of the first installment of rent and security.

(2) A lessee acquires the right to recover goods identified to a lease contract only if they conform to the lease contract.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-502.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).

C. DEFAULT BY LESSEE

§ 2A-523. LESSOR'S REMEDIES.

(1) If a lessee wrongfully rejects or revokes acceptance of goods or fails to make a payment when due or repudiates with respect to a part or the whole, then, with respect to any goods involved, and with respect to all of the

goods if under an installment lease contract the value of the whole lease contract is substantially impaired (Section 2A-510), the lessee is in default under the lease contract and the lessor may:

(a) cancel the lease contract (Section 2A-505(1));

(b) proceed respecting goods not identified to the lease contract (Section 2A-524);

(c) withhold delivery of the goods and take possession of goods previously delivered (Section 2A-525);

(d) stop delivery of the goods by any bailee (Section 2A-526);

(e) dispose of the goods and recover damages (Section 2A-527), or retain the goods and recover damages (Section 2A-528), or in a proper case recover rent (Section 2A-529).

(2) If a lessee is otherwise in default under a lease contract, the lessor may exercise the rights and remedies provided in the lease contract and this Article.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-703.

Changes: Substantially revised.

Purposes: This section is an index to Sections 2A-524 through 2A-531 and their effect on the lessor's rights and remedies upon the lessee's default. The lessor and the lessee can agree otherwise; thus, the parties can, among other things, raise or lower the threshold that gives rise to lessee's default or create a new scheme of rights and

remedies triggered by the occurrence of the default. Sections 2A-103(4) and 1-102(3).

Subsection (1), a substantially rewritten version of Section 2-703, lists various cumulative remedies of the lessor where the lessee wrongfully rejects or revokes acceptance, fails to make a payment when due, or repudiates. Section 2A-501(4). This Article rejects the doctrine of election of remedy. Whether, in a particular case, one remedy bars another, is a function of whether lessor has been put in as good a position as if the lessee had fully performed the lease contract. Sections 2A-103(4) and 1-106(1).

Hypothetical: 1. To better understand the application of subparagraphs (a) through (e), it is useful to review a hypothetical. Assume that A is a merchant in the business of selling and leasing new bicycles of various types. B is about to engage in the business of subleasing bicycles to summer residents of and visitors to an island resort. A, as lessor, has agreed to lease 60 bicycles to B. While there is one master lease, deliveries and terms are staggered. 20 bicycles are to be delivered by A to B's island location on June 1; the term of the lease of these bicycles is 4 months. 20 bicycles are to be delivered by A to B's island location on July 1; the term of the lease of these bicycles is three months. Finally, 20 bicycles are to be delivered by A to B's island location on August 1; the term of the lease of these bicycles is two months. B is obligated to pay rent to A on the 15th day of each month during the term for the lease. Rent is $50 per month, per bicycle. B has no option to purchase or release and must return the bicycles to A at the end of the term, in good condition, reasonable wear and tear excepted. Since the retail price of each bicycle is $400 and bicycles used in the retail rental business have a useful economic life of 36 months, this transaction creates a lease. Sections 2A-103(1)(j) and 1-201(37).

2. A's current inventory of bicycles is not large. Thus, upon signing the lease with B in February, A agreed to purchase 60 new bicycles from A's principal manufacturer, with special instructions to drop ship the bicycles to B's island location in accordance with the delivery schedule set forth in the lease.

3. The first shipment of 20 bicycles was received by B on May 21. B inspected the bicycles, accepted the same as conforming to the lease and signed a receipt of delivery

and acceptance. However, due to poor weather that summer, business was terrible and B was unable to pay the rent due on June 15. Pursuant to the lease A sent B notice of default and proceeded to enforce his rights and remedies against B.

4. A's counsel first advised A that under Section 2A-510(2) and the terms of the lease B's failure to pay was a default with resp to the whole. Thus, to minimize A's continued exposur was advised to take possession of the bicycles. If A had possession of the goods A could refuse to deliver. Section 2A-525(1). However, the facts here are different. With respect to the bicycles in B's possession, A has the right to take possession of the bicycles, without breach of the peace. Section 2A-525(2). If B refuses to allow A access to the bicycles, A can proceed by action, including replevin or injunctive relief.

5. With respect to the 40 bicycles that have not been delivered, this Article provides various alternatives. First, assume that 20 of the remaining 40 bicycles have been manufactured and delivered by the manufacturer to a carrier for shipment to B. Given the size of the shipment, the carrier was using a small truck for the delivery and the truck had not yet reached the island fa y when the manufacturer (at the request of A) instructed the carrier to divert the shipment to A's place of business. A's right to stop delivery is recognized under these circumstances. Section 2A-526(1). Second, assume that the 20 remaining bicycles were in the process of manufacture when B defaulted. A retains the right (as between A as lessor and B as lessee) to exercise reasonable commercial judgment whether to complete manufacture or to dispose of the unfinished goods for scrap. Since A is not the manufacturer and A has a binding contract to buy the bicycles, A elected to allow the manufacturer to complete the manufacture of the bicycles, but instructed the manufacturer to deliver the completed bicycles to A's place of business. Section 2A-524(2).

6. Thus, so far A has elected to exercise the remedies referred to in subparagraphs (b) through (d) in subsection (1). None of these remedies bars any of the others because A's election and enforcement merely resulted in A's possession of the bicycles. Had B performed A would have recovered possession of the bicycles. Thus A is in the process of obtaining the benefit of his bargain.

7. A's counsel next would determine what action, if any, should be taken with respect to the goods. As stated in subparagraph (e) and as discussed fully in Section 2A-527(1)

the lessor may, but has no obligation to, dispose of the goods by lease, sale or otherwise. In this case, since A is in the business of leasing and selling bicycles, A will probably inventory the 60 bicycles for its retail trade.

8. A's counsel then will determine which of the various, alternate means of ascertaining A's claim for damages against B will be computed. Subparagraph (2) catalogues each relevant section. First, under Section 2A-527(2) the amount of A's claim will be computed by comparing the original lease between A and B with any subsequent lease of the bicycles but only if the subsequent lease is substantially similar to the lease contract. While the section does not define this term, the official comment does establish some parameters. If, however, A elects to lease the bicycles to his retail trade, it is unlikely that the resulting lease will be substantially similar to the original, as leases to retail customers are considerably different from leases to wholesale customers like B. If, however, the leases were substantially similar, the damage claim is for accrued and unpaid rent, the present value of the difference between the rent reserved under both leases for the balance of their terms, together with incidental damages less expenses saved in consequence of the lessee's default.

9. If the new lease is not substantially similar or if A elects to sell the bicycles or to hold the bicycles, damages are computed under Section 2A-528 or 2A-529.

10. If A elects to pursue his claim under Section 2A-528(1) the damage rule is the same as that stated in Section 2A-527(2) except that the standard of comparison is not the rent reserved under a substantially similar lease entered into by the lessor but a market rent, as defined in Section 2A-507. Further, if the facts of this hypothetical were more elaborate A may be able to establish that the measure of damage under subsection (1) is inadequate to put him in the same position that B's performance would have, in which case A can claim his lost profits.

11. Yet another alternative for computing A's damage claim against B is prescribed by Section 2A-529. However, to use this formula A must, among other things, hold the bicycles identified in the lease contract for B. Since this would include all 60 bicycles and A is a merchant, it is unlikely to occur. Further, subsection (1)(a), which in essence allows A to receive the present value of the rent reserved under the lease, would in this case apply only to

the 20 bicycles accepted by B in May. With respect to the remaining 40 bicycles, subsection 1(b) will apply only if A is unable to dispose of them, or circumstances indicate the effort will be unavailing, in which case the damage formula identical to the one set forth in (1)(a) will apply. At any time up to collection of a judgment by A against B, A may dispose of the bicycles. In such case A's claim for damages against B is governed by Section 2A-527 or 2A-528. Section 2A-529(3). The resulting recalculation of claim should reduce the amount recoverable by A against B. However, the nature of the post-judgment proceedings to resolve this issue, and the sanctions for abuse, if any, will be determined by other law.

12. Finally, if the lease agreement had provided, A's claim against B would not be determined under any of these statutory formulae, but pursuant to a liquidated damages clause. Section 2A-504(1).

13. These various methods of computing A's damage claim against B are alternatives. However, the pursuit of any one of these alternatives is not a bar to, nor has it been barred by, A's earlier action to obtain possession of the 60 bicycles. These formulae, which vary as a function of an overt or implied mitigation of damage theory, focus on allowing A a recovery of the benefit of his bargain with B. Had B performed, A would have received the rent as well as the return of the 60 bicycles at the end of the term.

14. Finally, A's counsel should also advise A of his right to cancel the lease contract under subparagraph (a). Section 2A-505(1). Cancellation will discharge all existing obligations but preserve A's rights and remedies.

15. Subsection (2) is new and allows the lessor access to the remedy scheme of this Article as well as that contained in the lease contract if the lessee is in default for reasons other than those stated in subsection (1). Note that the reference to this Article includes supplementary principles of law and equity, e.g., fraud, misrepresentation and duress. Sections 2A-103(4) and 1-103.

16. There is no special treatment of the finance lease in this section. Absent supplementary principles of law to the contrary, in most cases the supplier will have no rights or remedies against the defaulting lessee. Section 2A-209(2)(b). Given that the supplier will look to the lessor for payment, this is appropriate. However, there is a specific exception to this rule with respect to the right to

identify goods to the lease contract. Section 2A-524(2). The parties are free to create a different result in a particular case. Sections 2A-103(4) and 1-102(3).

Cross References:

Sections 1-102(3), 1-103, 1-106(1), 1-201(37), 2-703, 2A-103(1)(j), 2A-103(4), 2A-209(2)(b), 2A-501(4), 2A-504(1), 2A-505(1), 2A-507, 2A-510(2), 2A-524 through 2A-531, 2A-524(2), 2A-525(1), 2A-525(2), 2A-526(1), 2A-527(1), 2A-527(2), 2A-528(1) and 2A-529(3).

Definitional Cross References:

"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

§ 2A-524. LESSOR'S RIGHT TO IDENTIFY GOODS TO LEASE CONTRACT.

(1) A lessor aggrieved under Section 2A-523(1) may:

(a) identify to the lease contract conforming goods not already identified if at the time the lessor learned the default they were in the lessor's or the supplier's possession or control; and

(b) dispose of goods (Section 2A-527(1)) that demonstrably have been intended for the particular lease contract even though those goods are unfinished.

(2) If the goods are unfinished, in the exercise of reasonable commercial judgment for the purposes of avoiding

loss and of effective realization, an aggrieved lessor or the supplier may either complete manufacture and wholly identify the goods to the lease contract or cease manufacture and lease, sell, or otherwise dispose of the goods for scrap or salvage value or proceed in any other reasonable manner.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-704.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Aggrieved party". Section 1-201(2).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Learn". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

§ 2A-525. LESSOR'S RIGHT TO POSSESSION OF GOODS.

(1) If a lessor discovers the lessee to be insolvent, the lessor may refuse to deliver the goods.

(2) The lessor has on default by the lessee under the lease contract the right to take possession of the goods. If the lease contract so provides, the lessor may require the lessee to assemble the goods and make them available to the lessor at a place to be designated by the

lessor which is reasonably convenient to both parties. Without removal, the lessor may render unusable any goods employed in trade or business, and may dispose of goods on the lessee's premises (Section 2A-527).

(3) The lessor may proceed under subsection (2) without judicial process if that can be done without breach of the peace or the lessor may proceed by action.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-702(1) and 9-503.

Changes: Substantially revised.

Purposes: Subsection (1), a revised version of the provisions of Section 2-702(1), allows the lessor to refuse to deliver goods if the lessee is insolvent. Note that the provisions of Section 2-702(2), granting the unpaid seller certain rights of reclamation, were not incorporated in this section. Subsection (2) made this unnecessary.

Subsection (2), a revised version of the provisions of Section 9-503, allows the lessor, on default by the lessee, the right to take possession of or reclaim the goods; since the lessee's insolvency is an event of default in a standard lease agreement, subsection (2) is the functional equivalent of Section 2-702(2). Further, subsection (2) sanctions the classic crate and delivery clause obligating the lessee to assemble the goods and to make them available to the lessor. Finally, the lessor may leave the goods in place, render them unusable (if they are goods employed in trade or business), and dispose of them on the lessee's premises.

Subsection (3), a revised version of the provisions of Section 9-503, allows the lessor to proceed under subsection (2) without judicial process, absent breach of the peace, or by action. Sections 2A-501(3), 2A-103(4) and 1-201(1). In the appropriate case action includes injunctive relief. Clark Equip. Co. v. Armstrong Equip. Co., 431 F.2d 54 (5th Cir. 1970), cert. denied, 402 U.S. 909 (1971). This

Section, as well as a number of other Sections in this Part, are included in the Article to codify the lessor's common law right to protect the lessor's reversionary interest in the goods. Section 2A-103(1)(q). These Sections are intended to supplement and not displace principles of law and equity with respect to the protection of such interest. Sections 2A-103(4) and 1-103. Such principles apply in many instances, e.g., loss or damage to goods if risk of loss passes to the lessee, failure of the lessee to return goods to the lessor in the condition stipulated in the lease, and refusal of the lessee to return goods to the lessor after termination or cancellation of the lease.

Cross References:

Sections 1-106(2), 2-702(1), 2-702(2), 2A-103(4), 2A-501(3) and 9-503.

Definitional Cross References:

"Action". Section 1-201(1).
"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).

§ 2A-526. LESSOR'S STOPPAGE OF DELIVERY IN TRANSIT OR OTHERWISE.

(1) A lessor may stop delivery of goods in the possession of a carrier or other bailee if the lessor discovers the lessee to be insolvent and may stop delivery of carload, truckload, planeload, or larger shipments of express or freight if the lessee repudiates or fails to make a payment due before delivery, whether for rent, security or

otherwise under the lease contract, or for any other reason the lessor has a right to withhold or take possession of the goods.

(2) In pursuing its remedies under subsection (1), the lessor may stop delivery until

(a) receipt of the goods by the lessee;

(b) acknowledgment to the lessee by any bailee of the goods, except a carrier, that the bailee holds the goods for the lessee; or

(c) such an acknowledgment to the lessee by a carrier via reshipment or as warehouseman.

(3) (a) To stop delivery, a lessor shall so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) After notification, the bailee shall hold and deliver the goods according to the directions of the lessor, but the lessor is liable to the bailee for any ensuing charges or damages.

(c) A carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-705..

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Bill of lading". Section 1-201(6).
"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(1).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies" and "Notification". Section 1-201(26).
"Person". Section 1-201(30).
"Receipt". Section 2-103(1)(c).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

§ 2A-527. LESSOR'S RIGHTS TO DISPOSE OF GOODS.

(1) After a default by a lessee under the lease contract (Section 2A-523(1)) or after the lessor refuses to deliver or takes possession of goods (Section 2A-525 or 2A-526), the lessor may dispose of the goods concerned or the undelivered balance thereof by lease, sale or otherwise.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A-504) or determined by agreement of the parties (Section 1-102(3)), if the disposition is by lease agreement substantially similar to the original lease agreement and the lease agreement is made in good faith and in a commercially reasonable manner, the lessor may recover from the lessee as damages (a) accrued and unpaid rent as of the date of default, (b) the present value as of the date of default of the difference between the total rent for the remaining lease term of the original lease

agreement and the total rent for the lease term of the new lease agreement, and (c) any incidental damages allowed under Section 2A-530, less expenses saved in consequence of the lessee's default.

(3) If the lessor's disposition is by lease agreement that for any reason does not qualify for treatment under subsection (2), or is by sale or otherwise, the lessor may recover from the lessee as if the lessor had elected not to dispose of the goods and Section 2A-528 governs.

(4) A subsequent buyer or lessee who buys or leases from the lessor in good faith for value as a result of a disposition under this section takes the goods free of the original lease contract and any rights of the original lessee even though the lessor fails to comply with one or more of the requirements of this Article.

(5) The lessor is not accountable to the lessee for any profit made on any disposition. A lessee who has rightfully rejected or justifiably revoked acceptance shall account to the lessor for any excess over the amount of the lessee's security interest (Section 2A-508(5)).

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-706(1), (5) and (6).

Changes: Substantially revised.

Purposes: Subsection (1), a revised version of the first sentence of subsection 2-706(1), allows the lessor the

right to dispose of goods after default by the lessee (even if the goods remain in the lessee's possession - Section 2A-525(2)) or after the lessor refuses to deliver or takes possession of the goods. The lessor's decision to exercise this right is a function of a commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9-507. As the owner of the goods, in the case of a lessor, or as the prime lessee of the goods, in the case of a sublessor, compulsory disposition of the goods is inconsistent with the nature of the interest held by the lessor or the sublessor and is not necessary because the interest held by the lessee or the sublessee is not protected by a right of redemption under the common law or this Article. Subsection 2A-527(5).

The rule for determining the measure of damages recoverable by the lessor against the lessee is a function of several variables. If the lessor has elected to effect disposition under subsection (1) and such disposition is by lease that qualifies under subsection (2), the measure of damages set forth in subsection (2) will apply, absent agreement to the contrary. Sections 2A-504, 2A-103(4) and 1-102(3).

The lessor's damages will be established using the new lease agreement as a measure if the following three criteria are satisfied: (i) the lessor disposed of the goods by lease, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such disposition was in good faith, and in a commercially reasonable manner. Thus, the lessor will be entitled to recover from the lessee the accrued and unpaid rent as of the date of default, and the present value, as of the date of default, of the difference between the rent reserved under the new lease and the original lease, together with incidental damages less expenses saved in consequence of the lessee's default. If the lessor's disposition does not satisfy the criteria of subsection (2), the lessor may calculate its claim against the lessee pursuant to Section 2A-528. Section 2A-523(1)(e). Note that the reference in Section 2A-527(2)(a) and (b) is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, § 5-1, at 216-217 (1971). Section 2A-501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has

been waived, suspended or cured. Sections 2A-103(4) and 1-103.

Two of the three criteria to be met by the lessor are familiar, but the concept of the new lease agreement that is substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. The decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

While the section does not draw a bright line, it is possible to describe some of the factors that should be considered in a finding that a new lease agreement is substantially similar to the original. The various elements of the new lease agreement should be examined. Those elements include the term of the new lease (because the damages are calculated under subsection (2) as the difference between the total rent payable for the entire term of the new lease agreement and the remaining lease term of the original lease); the options to purchase or release; the lessor's representations, warranties and covenants to the lessee as well as those to be provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the amount of rent to be paid. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently, as it is important that a sense of commercial judgment pervade the finding. See Section 2A-507(2). To establish the new lease as a proper measure of damage under subsection (2), these various factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original.

The following hypothetical illustrates the difficulty of providing a bright line. Assume that A buys a jumbo tractor for $1 million and then leases the tractor to B for a term of 36 months. The tractor is delivered to and is accepted by B on May 1. On June 1 B fails to pay the monthly rent to A. B returns the tractor to A, who immediately releases the tractor to C for a term identical to the term remaining under the lease between A and B. All terms and conditions under the lease between A and C are identical to those under the original lease between A and B, except that C does not provide any property damage or other insurance

coverage, and B agreed to provide complete coverage. Coverage is expensive and difficult to obtain. The new lease should be viewed as not substantially similar to the original. However, if the lessor seeks a recovery under Section 2A-528 the new lease can be introduced into evidence to establish market rent (Section 2A-507), with a proper allowance for the lessor's cost of replacing the lost insurance coverage.

Subsection (3), which is new, provides that if the lessor's disposition is by lease that does not qualify under subsection (2), or is by sale or otherwise, Section 2A-528 governs.

Subsection (4), a revised version of subsection 2-706(5), applies to protect a subsequent buyer or lessee who buys or leases from the lessor in good faith and for value, pursuant to a disposition under this section. Note that by its terms, the rule in subsection 2A-304(1), which provides that the subsequent lessee takes subject to the original lease contract, is controlled by the rule stated in this subsection.

Subsection (5), a revised version of subsection 2-706(6), provides that the lessor is not accountable to the lessee for any profit made by the lessor on a disposition. This rule follows from the fundamental premise of the bailment for hire that the lessee under a lease of goods has no equity of redemption to protect.

Cross References:

Sections 1-102(3), 2-706(1), 2-706(5), 2-706(6), 2A-103(4), 2A-304(1), 2A-504, 2A-507(2), 2A-523(1)(e), 2A-525(2), 2A-527(5), 2A-528 and 9-507.

Definitional Cross References:

"Buyer" and "Buying". Section 2-103(1)(a).
"Delivery". Section 1-201(14).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Present value". Section 2A-103(1)(u).

"Rights". Section 1-201(36).
"Sale". Section 2-106(1).
"Security interest". Section 1-201(37).
"Value". Section 1-201(44).

§ 2A-528. LESSOR'S DAMAGES FOR NON-ACCEPTANCE OR REPUDIATION.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A-504) or determined by agreement of the parties (Section 1-102(3)), if a lessor elects to retain the goods or a lessor elects to dispose of the goods and disposition is by lease agreement that for any reason does not qualify for treatment under Section 2A-527(2), or is by sale or otherwise, the lessor may recover from the lessee as damages for non-acceptance or repudiation by the lessee (a) accrued and unpaid rent as of the date of default, (b) the present value as of the date of default of the difference between the total rent for the remaining lease term of the original lease agreement and the market rent at the time and place for tender computed for the same lease term, and (c) any incidental damages allowed under Section 2A-530, less expenses saved in consequence of the lessee's default.

(2) If the measure of damages provided in subsection (1) is inadequate to put a lessor in as good a position as performance would have, the measure of damages is the profit, including reasonable overhead, the lessor would

have made from full performance by the lessee, together with any incidental damages allowed under Section 2A-530, due allowance for costs reasonably incurred and due credit for payments or proceeds of disposition.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-708.

Changes: Substantially revised.

Purposes: Subsection (1), a substantially revised version of Section 2-708(1), states the basic rule governing the measure of lessor's damages for non-acceptance or repudiation by the lessee; repudiation is defined (Section 2A-402) to include the lessee's post acceptance default for failure to pay rent and the like. Section 2A-523(1). This measure will apply if the lessor elects to retain the goods (whether undelivered, returned by the lessee, or repossessed by the lessor after acceptance and default by the lessee) or if the lessor's disposition does not qualify under subsection 2A-527(2). Section 2A-527(3). Note that under some of these conditions, the lessor may recover damages from the lessee pursuant to the rule set forth in Section 2A-529. There is no sanction for disposition that does not qualify under subsection 2A-527(2). Application of the rule set forth in this section is subject to agreement to the contrary. Sections 2A-504, 2A-103(4) and 1-102(3).

The measure of damage is the accrued and unpaid rent as of the date of default together with the present value, as of the date of default, of the difference between market rent and the original rent for the remaining term of the lease, and incidental damages, less expenses saved in consequence of the default. Note that the reference in Section 2A-528(1)(a) and (b) is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, § 5-1, at 216-217 (1971). Section 2A-501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A-103(4) and 1-103. Market rent will be

computed pursuant to Section 2A-507. In the case of a default by the lessee, the time for tender should be interpreted as the date of the default. If, as of the date of default, the lessor has attempted and failed to obtain possession of the goods, the lessor has, among various additional rights and remedies, a cause of action against the lessee for damages due to loss of use of possession of the goods between the date of default and the date the lessor obtains possession of the goods. Sections 2A-525(3), 2A-103(4), 1-201(1). See also Section 2A-530. This conclusion is [illegible] an important policy decision to protect the lessor's residual interest in the goods. Section 2A-103(1)(g).

Subsection (2), a somewhat revised version of the provisions of [illegible]-708(2), states a measure of damages which applies in each case that subsection (1) applies but the measure of damages in subsection (1) is inadequate to put the lessor in as good a position as performance would have. The measure of damage is the lessor's profit, including overhead, together with incidental damages with allowance for costs reasonably incurred and credit for payments or proceeds of disposition. In determining the amount of due credit with respect to proceeds of disposition, a proper value should be attributed to the lessor's [illegible] interest in the goods. Sections 2A-103(1)(r) and 2A-530(4).

[illegible] profit, a court should include any expected appreciation in the goods, e.g., the foal of a leased brood mare. Also, in this subsection is intended to give the lessor the benefits of the bargain, a court should consider any reasonably expected benefit or profit expected by the lessor from the performance of the lease agreement. See Honeywell, Inc. v. [illegible] Inc., 317 F. Supp. 406, 413 (N.D. Ga. 1970); [illegible] Co., 36 N.J. Super. 128, 131, 114 A.2d 875, 877 (Ch. Div. 1955). Further, in calculating profit, the present value should be given effect. Taylor v. Commercial Credit Equip. Corp., 170 Ga. App. 322, 316 S.E.2d 788 (Ct. App. 1984). See generally Section 2A-103(1)(u).

Cross References

Sections [illegible]-708, 2A-103(1)(u), 2A-402, 2A-504, 2A-507, 2A-[illegible], and 2A-529.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Sale". Section 2-106(1).

§ 2A-529. LESSOR'S ACTION FOR THE RENT.

(1) After default by the lessee under the lease contract (Section 2A-523(1)), if the lessor complies with subsection (2), the lessor may recover from the lessee as damages:

(a) for goods accepted by the lessee and for conforming goods lost or damaged within a commercially reasonable time after risk of loss passes to the lessee (Section 2A-219), (i) accrued and unpaid rent as of the date of default, (ii) the present value as of the date of default of the rent for the remaining lease term of the lease agreement, and (iii) any incidental damages allowed under Section 2A-530, less expenses saved in consequence of the lessee's default; and

(b) for goods identified to the lease contract if the lessor is unable after reasonable effort to dispose of them at a reasonable price or the circumstances reasonably indicate that effort will be unavailing, (i)

accrued and unpaid rent as of the date of default, (ii) the present value as of the date of default of the rent for the remaining lease term of the lease agreement, and (iii) any incidental damages allowed under Section 2A-530, less expenses saved in consequence of the lessee's default.

(2) Except as provided in subsection (3), the lessor shall hold for the lessee for the remaining lease term of the lease agreement any goods that have been identified to the lease contract and are in the lessor's control.

(3) The lessor may dispose of the goods at any time before collection of the judgment for damages obtained pursuant to subsection (1). If the disposition is before the end of the remaining lease term of the lease agreement, the lessor's recovery against the lessee for damages will be governed by Section 2A-527 or Section 2A-528.

(4) Payment of the judgment for damages obtained pursuant to subsection (1) entitles the lessee to use and possession of the goods not then disposed of for the remaining lease term of the lease agreement.

(5) After a lessee has wrongfully rejected or revoked acceptance of goods, has failed to pay rent then due, or has repudiated (Section 2A-402), a lessor who is held not entitled to rent under this section must nevertheless be

awarded damages for non-acceptance under Sections 2A-527 and 2A-528.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-709.

Changes: Substantially revised.

Purposes: Subsection (1) provides another method of determining the measure of lessor's damages after default by the lessee. Absent agreement to the contrary (Section 2A-504), this Article provides the lessor, in this section and the two preceding sections, three alternate methods of computing damages recoverable from the defaulting lessee (Section 2A-523(1)(e)). This section, as well as the two preceding sections, applies to goods subject to the lease, even if such goods have been repossessed from the lessee or otherwise (Section 2A-525(2)). This is a departure from Section 2-709, the statutory analogue. The departure is not surprising given the essential difference between a sale and a lease.

Absent the right to repossess the goods, the recovery stated in subsection (1)(a) would not compensate the lessor for his or her loss. Consider a lease of a carpet cleaner by A to B, for a term of two days. A purchased the carpet cleaner for $500.00. The rent for the two day term is $75.00. If B defaulted by not paying the rent and refusing to return the carpet cleaner and A was not allowed to repossess the carpet cleaner, the measure of damage stated in this section would allow a recovery of not more than $75.00, together with incidental damages. The rule stated in this Article, which allows the lessor the right to repossess the goods from the lessee and to recover damages, is consistent with the lessor's ownership of the goods. DeKoven, Proceedings After Default by the Lessee Under a True Lease of Equipment, in 1C P. Coogan, W. Hogan, D. Vagts, Secured Transactions Under the Uniform Commercial Code, § 29B.06[4] (1986). The statutory analogue, Section 2-709, only provides an action for the price of the goods sold, which is consistent with the seller's agreement to dispose of all of his or her right, title and interest in the goods to the buyer. That measure of damage would not have been appropriate here as the lessor's agreement is to dispose of possession and use of the goods for a term; the bargain includes the return of the goods at the end of the term. It

would be anomalous to allow the lessee to improve on the bargain, i.e. retain the goods, solely by virtue of his or her default, even if that had been balanced by allowing the lessor to sue to recover the price or value of the goods.

The measure of the lessor's damages under this section is a function of a two-part rule. First, subparagraph (1)(a) establishes a rule of recovery with respect to goods accepted by the lessee (even if repossessed by the lessor) and with respect to conforming goods lost or damaged within a commercially reasonable time after risk of loss passed to the lessee. Thus, reading subsections (1), (2) and (3) together, if accepted goods are repossessed by the lessor and the lessor holds the goods for the lessee for the balance of the term, lessor's damages will be calculated pursuant to subsection (1)(a); if the lessor leases, sells or otherwise disposes of the goods, subsection (1)(a) is inapplicable and the lessor's damages will be calculated pursuant to Section 2A-528, unless the lessor's disposition was by a substantially similar lease, in which case Section 2A-527(2) applies. Second, subparagraph (1)(b) establishes a rule of recovery with respect to goods identified to the lease contract (but not accepted by the lessee - see subparagraph (1)(a)) only if the lessor is unable, after reasonable effort, to dispose of them at a reasonable price, or if circumstances indicate the effort would be unavailing.

As a condition to the lessor's election to employ the method to measure the lessor's claim against the lessee set forth in subsection (1), the lessor must comply with subsection (2), which provides that, with one exception, goods identified to the lease contract and in the lessor's control (whether as a result of repossession or otherwise) must be held for the lessee for the balance of the lease term. This eliminates the possibility of a double recovery by the lessor and preserves the value of the leasehold estate to the lessee.

Subsection (3) creates an exception to the requirement set forth as a condition to subsection (1), that goods identified to the contract and in the lessor's control be held by the lessor. (Section 2A-529(2)). If the lessor disposes of those goods prior to collection of the judgment (whether as a matter of law or agreement), the lessor's recovery is governed by the measure of damages in Section 2A-527 if the disposition is by lease that is substantially similar to the original lease, or otherwise by the measure of damages in Section 2A-528. Section 2A-523 official comment Number 11.

The relationship between subsections (2) and (3) is best stated by examining a hypothetical. Assume the lease is for a term of two years and after default by the lessee the lessor recovers the goods from the lessee and obtains judgment against the lessee for damages pursuant to subsection (1). If the lessor holds the goods so recovered until the end of the two year term, any subsequent disposition will have no effect on the lessor's judgment. If, however, the lessor determines that the lessee is judgment proof, the lessor might be wise to dispose of the goods before the end of the remaining lease term, even though the amount that the lessor then will be allowed to recover from the lessee, as determined by the provisions of Section 2A-527 or 2A-528, is less than the judgment. Subsection (3) allows the lessor to make this election at any time before collection of the judgment.

Subsection (4), which is new, further reinforces the requisites of Subsection (2). In the event the judgment for damages obtained by the lessor against the lessee pursuant to subsection (1) is satisfied, the lessee regains the right to use and possession of the remaining goods for the balance of the original lease term; a partial satisfaction of the judgment creates no right in the lessee to use and possession of the goods.

The relationship between subsections (2) and (4) is important to understand. Subsection (2) requires the lessor to hold for the lessee identified goods in the lessor's possession. Absent agreement to the contrary, whether in the lease or otherwise, under most circumstances the requirement that the lessor hold the goods for the lessee for the term will mean that the lessor is not allowed to use them. Sections 2A-103(4) and 1-203. Further, the lessor's use of the goods could be viewed as a disposition of the goods that would bar the lessor from recovery under this section, remitting the lessor to the two preceding sections for a determination of the lessor's claim for damages against the lessee.

Subsection (5), the analogue of subsection 2-709(3), further reinforces the thrust of subsection (3) by stating that a lessor who is held not entitled to rent under this section has not elected a remedy; the lessor must be awarded damages under Sections 2A-527 and 2A-528. This is a function of two significant policies of this Article - that resort to a remedy is optional, unless expressly agreed to be exclusive (Section 2A-503(2)) and that rights and remedies provided in this Article are cumulative. (Section 2A-501(2) and (4)).

Cross References:

Sections 1-203, 2-709, 2-709(3), 2A-103(4), 2A-501(2), 2A-501(4), 2A-503(2), 2A-504, 2A-523(1)(e), 2A-525(2), 2A-527, 2A-528 and 2A-529(2).

Definitional Cross References:

"Action". Section 1-201(1).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Present value". Section 2A-103(1)(u).
"Reasonable time". Section 1-204(1) and (2).

§ 2A-530. LESSOR'S INCIDENTAL DAMAGES.

Incidental damages to an aggrieved lessor include any commercially reasonable charges, expenses, or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the lessee's default, in connection with return or disposition of the goods, or otherwise resulting from the default.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-710.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Aggrieved party". Section 1-201(2).
"Delivery". Section 1-201(14).

"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

§ 2A-531. STANDING TO SUE THIRD PARTIES FOR INJURY TO GOODS.

(1) If a third party so deals with goods that have been identified to a lease contract as to cause actionable injury to a party to the lease contract (a) the lessor has a right of action against the third party, and (b) the lessee also has a right of action against the third party if the lessee:

(i) has a security interest in the goods;

(ii) has an insurable interest in the goods; or

(iii) bears the risk of loss under the lease contract or has since the injury assumed that risk as against the lessor and the goods have been converted or destroyed.

(2) If at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the lease contract and there is no arrangement between them for disposition of the recovery, his [or her] suit or settlement, subject to his [or her] own interest, is as a fiduciary for the other party to the lease contract.

(3) Either party with the consent of the other may sue for the benefit of whom it may concern.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-722.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Action". Section 1-201(1).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(1).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).

ARTICLE 1 AND ARTICLE 9: CONFORMING AMENDMENTS

§ 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) Where one of the following provisions of this Act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. Section 2-402.

Applicability of the Article on Leases. Sections 2A-105 and 2A-106.

Applicability of the Article on Bank Deposits and Collections. Section 4-102.

Bulk transfers subject to the Article on Bulk Transfers. Section 6-102.

Applicability of the Article on Investment Securities. Section 8-106.

Perfection provisions of the Article on Secured Transactions. Section 9-103.

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-105, 1978 Official Text of the Act.

Changes: Subsection (2) is amended to reference two sections of the Article on Leases (Article 2A), which is being promulgated at the same time as this amendment.

§ 1-201(37). GENERAL DEFINITIONS: "SECURITY INTEREST"

(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 interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and

(a) the original term of the lease is equal to or greater than the remaining economic life of the goods,

(b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,

(c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or

(d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

A transaction does not create a security interest merely because it provides that

(a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,

(b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,

(c) the lessee has an option to renew the lease or to become the owner of the goods,

(d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or

(e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

For purposes of this subsection (37):

(x) Additional consideration is not nominal if (i) when the option to renew the lease is granted to the lessee the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed, or (ii) when the option to become the owner of the goods is granted to the lessee the price is stated to be the fair market value of the goods determined at the time the option is to be performed. Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised;

(y) "Reasonably predictable" and "remaining economic life of the goods" are to be determined with reference to the facts and circumstances at the time the transaction is entered into; and

(z) "Present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate is not manifestly unreasonable at the time the transaction is entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-201(37), 1978 Official Text of the Act.

Changes: Substantially revised.

Purpose: This amendment to Section 1-201(37) is being promulgated at the same time that the Article on Leases (Article 2A) is being promulgated as an amendment to this Act.

One of the reasons it was decided to codify the law with respect to leases was to resolve an issue that has created considerable confusion in the courts: what is a lease? The confusion exists, in part, due to the last two sentences of the definition of security interest in the 1978 Official Text of the Act. Section 1-201(37). The confusion is compounded by the rather considerable change in the federal, state and local tax laws and accounting rules as they relate to leases of goods. The answer is important because the definition of lease determines not only the rights and remedies of the parties to the lease but also those of third parties. If a transaction creates a lease and not a security interest, the lessee's interest in the goods is limited to its leasehold estate; the residual interest in the goods belongs to the lessor. This has significant implications to the lessee's creditors. "On common law theory, the lessor, since he has not parted with title, is entitled to full protection against the lessee's creditors and trustee in bankruptcy...." 1 G. Gilmore, Security Interests in Personal Property § 3.6, at 76 (1965).

Under pre-Act chattel security law there was generally no requirement that the lessor file the lease, a financing statement, or the like, to enforce the lease agreement against the lessee or any third party; the Article on Secured Transactions (Article 9) did not change the common law in that respect. Coogan, Leasing and the Uniform Commercial Code, in Equipment Leasing - Leveraged Leasing 681, 700 n.25, 729 n.80 (2d ed. 1980). The Article on Leases (Article 2A) has not changed the law in that respect, except for leases of fixtures. Section 2A-309. An examination of the common law will not provide an adequate answer to the question of what is a lease. The definition of security interest in Section 1-201(37) of the 1978 Official Text of the Act provides that the Article on Secured Transactions (Article 9) governs security interests disguised as leases, i.e., leases intended as security; however, the definition is vague and outmoded.

Lease is defined in Article 2A as a transfer of the right to possession and use of goods for a term, in return for consideration. Section 2A-103(1)(j). The definition continues by stating that the retention or creation of a security interest is not a lease. Thus, the task of sharpening the line between true leases and security interests disguised as leases continues to be a function of this section.

The first paragraph of this definition is a revised version of the first five sentences of the 1978 Official Text of Section 1-201(37). The changes are modest in that they make a style change in the fourth sentence and delete the reference to lease in the fifth sentence. The balance of this definition is new, although it preserves elements of the last two sentences of the prior definition. The focus of the changes was to draw a sharper line between leases and security interests disguised as leases to create greater certainty in commercial transactions.

Prior to this amendment, Section 1-201(37) provided that whether a lease was intended as security (i.e., a security interest disguised as a lease) was to be determined from the facts of each case; however, (a) the inclusion of an option to purchase did not itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee would become, or had the option to become, the owner of the property for no additional consideration, or for a nominal consideration, did make the lease one intended for security.

Reference to the intent of the parties to create a lease or security interest has led to unfortunate results. In discovering intent, courts have relied upon factors that were thought to be more consistent with sales or loans than leases. Most of these criteria, however, are as applicable to true leases as to security interests. Examples include the typical net lease provisions, a purported lessor's lack of storage facilities or its character as a financing party rather than a dealer in goods. Accordingly, amended Section 1-201(37) deletes all reference to the parties' intent.

The second paragraph of the new definition is taken from Section 1(2) of the Uniform Conditional Sales Act (act withdrawn 1943), modified to reflect current leasing practice. Thus, reference to the case law prior to this Act will provide a useful source of precedent. Gilmore, Security Law, Formalism and Article 9, 47 Neb. L. Rev. 659, 671 (1968). Whether a transaction creates a lease or a security

interest continues to be determined by the facts of each case. The second paragraph further provides that a transaction creates a security interest if the lessee has an obligation to continue paying consideration for the term of the lease, if the obligation is not terminable by the lessee (thus correcting early statutory gloss, e.g. In re Royer's Bakery, Inc., 1 U.C.C. Rep. Serv. (Callaghan) 342 (Bankr. E.D. Pa. 1953)) and if one of four additional tests is met. The first of these four tests, subparagraph (a), is that the original lease term is equal to or greater than the remaining economic life of the goods. The second of these tests, subparagraph (b), is that the lessee is either bound to renew the lease for the remaining economic life of the goods or to become the owner of the goods. In re Gehrke Enters., 1 Bankr. 647, 651-52 (Bankr. W.D. Wis. 1979). The third of these tests, subparagraph (c), is whether the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration, which is defined later in this section. In re Celeryvale Transp., 44 Bankr. 1007, 1014-15 (Bankr. E.D. Tenn. 1984). The fourth of these tests, subparagraph (d), is whether the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration. All of these tests focus on economics, not the intent of the parties. In re Berge, 32 Bankr. 370, 371-73 (Bankr. W.D. Wis. 1983).

The focus on economics is reinforced by the next paragraph, which is new. It states that a transaction does not create a security interest merely because the transaction has certain characteristics listed therein. Subparagraph (a) has no statutory derivative; it states that a full payout lease does not per se create a security interest. Rushton v. Shea, 419 F. Supp. 1349, 1365 (D. Del. 1976). Subparagraph (b) provides the same regarding the provisions of the typical net lease. Compare All-States Leasing Co. v. Ochs, 42 Or. App. 319, 600 P.2d 899 (Ct. App. 1979) with In re Tillery, 571 F.2d 1361 (5th Cir. 1978). Subparagraph (c) restates and expands the provisions of former Section 1-201(37) to make clear that the option can be to buy or renew. Subparagraphs (d) and (e) treat fixed price options and provide that fair market value must be determined at the time the transaction is entered into. Compare Arnold Mach. Co. v. Balls, 624 P.2d 678 (Utah 1981) with Aoki v. Shepherd Mach. Co., 665 F.2d 941 (9th Cir. 1982).

The relationship of the second paragraph of this subsection to the third paragraph of this subsection deserves to be explored. The fixed price purchase option provides a

useful example. A fixed price purchase option in a lease does not of itself create a security interest. This is particularly true if the fixed price is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed. A security interest is created only if the option price is nominal and the conditions stated in the introduction to the second paragraph of this subsection are met. There is a set of purchase options whose fixed price is less than fair market value but greater than nominal that must be determined on the facts of each case to ascertain whether the transaction in which the option is included creates a lease or a security interest.

It was possible to provide for various other permutations and combinations with respect to options to purchase and renew. For example, this section could have stated a rule to govern the facts of In re Marhoefer Packing Co., 674 F.2d 1139 (7th Cir. 1982). This was not done because it would unnecessarily complicate the definition. Further development of this rule is left to the courts.

The fourth paragraph provides definitions and rules of construction.

§ 9-113. SECURITY INTERESTS ARISING UNDER ARTICLE ON SALES OR UNDER ARTICLE ON LEASES

A security interest arising solely under the Article on Sales (Article 2) or the Article on Leases (Article 2A) is subject to the provisions of this Article except that to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods

(a) no security agreement is necessary to make the security interest enforceable; and

(b) no filing is required to perfect the security interest; and

(c) the rights of the secured party on default by the debtor are governed (i) by the Article on Sales (Article 2) in the case of a security interest arising solely under such Article or (ii) by the Article on Leases (Article 2A) in the case of a security interest arising solely under such Article.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-113, 1978 Official Text of the Act.

Changes: This section is amended to include security interests arising under the Article on Leases (Article 2A), which is being promulgated at the same time as this amendment. Section 2A-508(5). After the effective date of the amendment to this section all references in the Act to Section 9-113 will be deemed to refer to this section, as amended. E.g., Sections 9-203(1) and 9-302(1)(f).

Cross Reference:

Article 2A, esp. Section 2A-508(5).

Definitional Cross References:

"Agreement". Section 1-201(3).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).
"Sale". Section 2-106(1).
"Security interest". Section 1-201(37).

UNIFORM STATE LAWS

What are they?

Uniform State Laws are the products of a unique organization that has been working for the improvement of state laws since 1892. The National Conference of Commissioners on Uniform State Laws, representing both state government and the legal profession, is a genuine confederation of state interests.

Today there are more than 300 practicing lawyers, judges, law professors and government officials serving as Uniform Law Commissioners (ULC). These state-appointed commissioners, selected for their wide range of legal expertise and experience, provide an immeasurable resource for drafting "uniform" and "model" state laws.

ULC Uniform Acts, Codes and Court Rules – needed where differences in state laws create specific interstate and national problems – have ranged from eliminating jurisdictional child custody disputes to addressing the legalities of electronic transfer of stock ownership.

When uniformity is neither practical nor necessary, ULC Model Acts have provided states with a concisely-structured legislative framework adaptable to their particular needs and problems – in areas such as sentencing and correction reform, and state administrative procedures.

Differences in state laws can deter the free flow of goods, credit and services; restrain full economic growth; and invite federal intervention to compel uniformity. Constitutionally, states have wide latitude for cooperating to solve these problems. ULC is their own cooperative institution for doing so, as well as for contributing to the continuing process of law reform and progress.

Back in 1892

The "Gay Nineties" rolled in on the railroad tracks that were tying the nation together. And Americans were beginning to swap horses for bicycles and motor cars. This new mobility was the prime factor from which ULC sprang.

The Alabama State Bar Association recognized, as early as 1881, the legal tangles created by wide variations in state laws. But it was not until August, 1889, that the American Bar Association decided at its 12th annual meeting to work for "uniformity of the laws" in the 44 states.

Within a year, the New York legislature authorized the governor to appoint three commissioners to explore the best way to effect uniformity of law to ease problems developing between increasingly interdependent states. The ABA endorsed New York's action. The result was the first meeting of the "Conference of State Boards of Commissioners on Promoting Uniformity of Law in the U.S."

Seven states sent commissioners to that 1892 meeting. By 1900, 32 states and two territories had law commissioners. By 1905, only Nevada and Alaska were holdouts, and they joined the parade in 1911.

National Conference
of Commissioners
on Uniform State Laws
676 North St. Clair Street
Chicago, Illinois 60611
(312) 915-0195

Uniform Law Commissioners

UNIFORM STATE LAWS

Cost and Value

States provide nearly all of the funds for ULC by means of a system of assessments based on population. Most of the money is used to support the work of the drafting committees, and to explain Uniform and Model Acts to legislators, other government officials and specialized and general audiences.

ULC gets maximum results from minimum budgets because its major asset – drafting expertise – is donated. The only compensation received by Uniform Law Commissioners is that of knowing they have provided states with solutions to their legal problems. They receive no salaries or fees for their work as commissioners.

This means that lawyers devote hundreds and even thousands of hours–amounting in some cases to millions of dollars worth of time–to the development of ULC proposals. No state could afford the bills for the legal expertise that goes into the drafting of each ULC Uniform or Model Act.

In appraising ULC's value to the states, it is also important to look at its impact on their treasuries. Most ULC proposals rely on "private law," or law governing individual relationships without intervention or regulation by any state agency – except where redress is sought in state courts for breach of a legal obligation. By contrast, "public law" provides for regulation, generally by an executive agency. ULC helps states avoid the costs of creating new regulatory agencies.

The Hard Job

When drafting is completed on an act, a Uniform Law Commissioner's work has only begun. Commissioners then work for adoption of the proposal by the states. Normal resistance to anything "new" makes this the hardest part of a commissioner's job. But the result can be workable modern state law that helps keep the federal system alive.

GENESIS of a Law

Anyone can ask ULC to draft a law. But not all requests are pressing enough to claim its time and resources. Determining the need for and feasibility of a proposed new law, then, is an important first step. The decision to draft is preceded by a thorough screening process:

- Initial screening of requests for new drafting projects is done by the Scope and Program Committee. This group evaluates the need, urgency, current state of law in the affected area, and feasibility of enactment before making a recommendation to the Executive Committee to further review the request.
- Executive Committee members look at a request in terms of ULC's financial and member resources as well as the availability of additional expertise and funding to insure success of the draft. If these appear favorable to the project, they appoint a special Drafting Committee.
- Foundation and government grants support some of ULC's drafting efforts, making it possible to expand advisory committee participation, and to retain expert reporter-draftsmen – usually lawyers experienced in the field – for maximum input and assistance to the Drafting Committee.

Drafting proceeds at meetings of this special committee held thoughout the year. After basic premises and philosophy are decided, a "first tentative draft" is developed for circulation to experts both within and outside the legal profession, to draw criticism and suggestions that will shape succeeding drafts.

Uniform and Model Acts are a minimum of two years in preparation, since they must be considered at no less than two annual meetings by all commissioners sitting as a Committee of the Whole.

Before any annual meeting presentation, a Review Committee for each act determines: 1) whether the draft conforms to the assignment; 2) what policy decisions were made by drafters; and 3) whether the draft is ready for scrutiny "line by line" by the entire Conference.

Once ULC as a whole approves an act, its final test is by a vote by states – one vote per state. A majority of states present, and no less than 20 states, must vote approval of an act before it can be officially adopted as a Uniform or a Model Act, Code or Court Rule.

This unique and lengthy process of screening, drafting, revising and polishing is responsible for the fine edge of excellence that marks ULC "products." After receiving the ULC stamp of approval, a Uniform or Model Act is officially promulgated for consideration by the states.

Legislatures are urged to adopt *Uniform Acts* exactly as written, to "promote uniformity in law among the several states."

Model Acts, on the other hand, are designed to serve as guideline legislation, which states can borrow from or adapt to suit their individual needs and conditions.

Commissioners

Each of the 50 states, the District of Columbia and Puerto Rico select lawyers to serve on their uniform state law commissions. Since ULC is a confederation of state commissions, each state sets its own rules for selection. Most have at least three, and the governor usually selects them.

Considered non-partisan, many commissioners receive their first appointment from a governor of one party, then continue under another party, thus serving for decades.

Famous commissioners include President Woodrow Wilson; Supreme Court Justices Louis D. Brandeis and William F. Rehnquist, and the Harvard Law legend, Roscoe Pound.

Updating Acts

Exemplifying a Uniform Act, the Uniform Commercial Code (UCC) structures nearly all commercial transactions in every state in the U.S. Another ULC proposal having wide influence is the Model State Administrative Procedure Act (MSAPA). Most states have adopted it, and look to its provisions to guide their state agencies.

Both UCC and MSAPA are successes that states have benefited from. But even the best of laws is outdated by technological and social change. Thus, one of the duties of the ULC leadership is to constantly review past successes, checking their relevance for today.

Several methods insure that needed updating goes on. For the Commercial Code, the problem is solved by a "Permanent Editorial Board" charged with keeping abreast of developments that require changes in the law.

The Model State Administrative Procedure Act, however, requires appointment of a new committee to revise quarter-century-old rules developed before state governments "boomed" in the 60s and 70s.

Whether a ULC proposal is brand new, a revision, or an amendment, state government can be sure that it's in step with the times.

A Tradition of Excellence

A Brief History of ULC & How It Works

It was a century ago that lawyers first recognized how wide variations in state laws could tangle interstate problems. The Alabama State Bar Association is credited with taking the first formal action to encourage development of "uniform" laws to deal with the problem. That came in an 1881 resolution.

But it was not until August, 1889, when the American Bar Association was holding its 12th annual meeting, that there was a formal move to work for "uniformity in the laws" of the then 44 states.

Within a year, the New York Legislature authorized that state's governor to appoint three commissioners "to examine the subjects of marriage and divorce, insolvency, the form of notarial certificates and other subjects; to ascertain the best means to effect an assimilation and uniformity of the laws of the states; and especially to consider whether it would be wise and practicable for the state of New York to invite other states of the Union to send representatives to a convention to draft uniform laws to be submitted for the approval and adoption of the several states. . ."

A few months later, the ABA endorsed the New York action and urged every other state, the District of Columbia and territorial legislatures to follow the example.

In the Beginning – Seven States

Other states heeded the call. When the first meeting of the "Conference of State Boards of Commissioners on Promoting Uniformity of Law in the U.S." was held in Saratoga, N.Y., Aug. 24, 1892, seven states sent commissioners. They were Delaware, Georgia, Massachusetts, Michigan, New York, New Jersey and Pennsylvania.

The new commissioners didn't waste time. They immediately completed and urged states and territories to adopt three acts – Act Relating to Acknowledgments on Written Instruments; Act Validating Wills Lawfully Executed Without the State; and Act Recognizing as Valid, Wills Probated in Another State.

These first commissioners on uniform laws also recommended that states enact laws governing payment of notes; validating contracts; divorce; and marriage. The latter included raising the marrying age to 18 for males and 16 for females.

They also adopted a table of weights and measures after noting "it will probably be a surprise to most people to learn that legal weights of a bushel . . . with the exception of wheat alone, vary in all states."

After this first burst of activity, the Conference produced no other proposals until 1896 when the Negotiable Instruments Act was completed. This was to become the only act adopted by every state and the District of Columbia.

Then There Were 32

By the turn of the 20th Century, 32 states and two territories had appointed commissioners on uniform laws. During their second decade, Uniform Law Commissioners (ULC) concentrated on legislation that made interstate commerce easier. The resulting laws dealt with sales, warehousing and transportation. A majority of states adopted all of them before these pioneer acts – along with the Negotiable Instruments Act – were superseded by the Uniform Commercial Code (UCC).

In 1905, only Nevada and the Territory of Alaska still had not appointed commissioners. But they joined the club in 1911.

In its third decade, the Conference considered and adopted legislative proposals on a number of issues and problems ranging from partnerships to child labor. And in 1915, the organization officially became the National Conference of Commissioners on Uniform State Laws.

The "Roaring 20s" drummed up new problems and ULC responded with proposals in such areas as aviation and public utilities. In the 1930s, commissioners wrestled with machine gun laws as well as torts and trusts.

Fifty-Year Assessment

As the Conference approached its Golden Anniversary year, its leadership began to reassess its role and to try to determine how ULC could better serve the federal system. Though the past had been productive, commissioners decided they could be even more useful in the future if they attacked major problems with comprehensive solutions rather than trying to cope with them a piece at a time.

The result was the launching of the project that produced the Uniform Commercial Code (UCC). In 1940, ULC officially took on the task of drafting a comprehensive code to provide guidelines for all commercial transactions. Work on some of its components already had begun. In 1947, ULC and the American Law Institute joined in a partnership that put all of the components together into a UCC that was offered to the states for their consideration in 1951. Then came the tedious battles for adoption in every state legislature. By 1967, Louisiana was the lone holdout and it still has not adopted all of UCC.

The breadth and depth of UCC is difficult to grasp. It guarantees that "commercial" transactions in California are subject to the same law as those in Maine. A child purchasing penny candy in a neighborhood shop and a manufacturer buying robot welders for his assembly lines both complete their transactions within the framework of UCC. In UCC states, the code encompasses every sale of goods from crude oil to autos; every bank check written; and all commercial paper, stock and bond transactions.

Success of UCC inspired commissioners to produce and work for adoption of a wide variety of comprehensive legislative solutions to basic state problems. These include: the Uniform Probate Code; Uniform Consumer Credit Code; Uniform Marriage and Divorce Act; Uniform Alcoholism and Intoxication Treatment Act; and a package of proposals designed to do for land transactions what UCC did for commercial transactions – provide modern law to deal with modern problems.

While it was forging its major projects over the past two decades, ULC also managed to commence and complete legislation needed by states to deal with more specific problems. These include such proposals as the Uniform Child Custody Jurisdiction Act; Uniform Anatomical Gift Act; Uniform Class Actions Act; and Uniform Determination of Death Act.

Uniform and Model Acts

In addition to "Uniform Acts," which every state is urged to adopt, ULC also drafts "Model Acts" to guide legislatures dealing with issues that need not be treated uniformly by all states. Some models – such as the Model State Administrative Procedure Act – have been adapted for use by most states.

It's important to state treasuries that most ULC proposals fall into the category of "private law" – the body of law based on English common law that governs the basic legal relationships between people. No governmental body intervenes in "private law" relationships. People conduct their affairs without interference. When a breach of a legally enforceable, private obligation occurs, the courts are available to sort out the facts and grant remedies which range from monetary payments to injunctive relief. For example, the Uniform Residential Landlord and Tenant Act governs the contractual relationship between landlord and tenant. This relationship proceeds unfettered unless a party breaches an obligation – such as a landlord's obligation to maintain fit and safe premises. If such a breach occurs, then the wronged party can seek damages and reparations for losses sustained.

This contrasts with "public law" which usually involves using an executive agency, or bureau, as a regulatory body. In that case, legislatures enact laws vesting authority in an administrative agency which then carries out the duties of investigator, rulemaker, regulator and enforcer. Because new agencies must be created to enforce public law, it usually costs more money.

Why the Conference Works

Dedicated commissioners make the Conference work. They include about 250 practicing lawyers, law professors and judges. It is the effort contributed by these people – commissioners receive no salaries or fees for their work with the Conference – that earned NCCUSL the media label of "prestigious." In this century, President Woodrow Wilson and U.S. Supreme Court Justices Louis D. Brandeis and William F. Rehnquist served as commissioners. So did such law school legends as Roscoe Pound of Harvard.

Commissioners are appointed by each of the 50 states, the District of Columbia and Puerto Rico. The number of commissioners appointed (most states have at least three) and the method of appointment varies from state to state. In most states, the governor is responsible for appointments. But commissioners usually are considered non-partisan. This leads to many commissioners being appointed by the governor of one party and reappointed by the governor of another party. In this way, some commissioners serve ULC for decades.

A Two-Part Job

Such dedicated commissioners usually relish both parts of their unpaid service. This includes drafting and then working for enactment of modern legislation designed to solve problems common to all states.

ULC's reputation was built on the high quality of its drafts. That quality is the result of a procedure structured to bring a unique blend of legal minds to bear on a problem. It begins with the choice of a drafting committee whose members are selected to insure that as much expertise and as many viewpoints as possible will be represented at the drafting table.

For example, there were a number of real estate law experts appointed to the committee responsible for preparing preliminary drafts of the land transactions package which includes the Uniform Land Transactions Act (ULTA), Uniform Simplification of Land Transfers Act (USOLTA), Uniform Condominium Act (UCA), Uniform Planned Community Act (UPCA) and Model Real Estate Cooperative Act (MRECA). These included commissioners who were law school professors as well as practicing lawyers specializing in

real estate law. Then lawyer and non-lawyer experts were invited to provide specialized knowlege to the committee. These advisers represented associations of lenders, builders, sellers, lawyers and consumers. But all decisions were made by commissioners who represent only the people of their states.

The Drafting Ordeal

Preliminary drafts of the proposals were prepared and circulated to advisers and others interested in the committee's deliberations. That included every commissioner. Eventually, the committee was ready to present its work at an annual meeting of ULC for "initial consideration" by every commissioner.

During the annual meeting, commissioners assemble for a week or more to spend every day and some nights studying each "tentative draft" prepared by the committees. The drafts are read "line-by-line" and then discussed, debated and changed. With more than 200 pairs of trained eyes probing every concept and word, it's a rare draft that leaves an annual meeting in the same form as it goes in. Because ULC is a confederation of state commissions on uniform laws, close issues are decided by polling state delegations. Regardless of the number of representatives from each state, each state has only one vote.

Shortly after the annual meeting ends, committees with uncompleted drafts begin incorporating changes made during the meeting and dealing with new problems raised by commissioners and non-commissioners.

Proposals are subjected to this rigorous procedure for at least two annual meetings before they become eligible for designation as ULC products. The final decision on whether a proposal is ready for "promulgation" to the states is made near the close of an annual meeting – again on a one-state, one-vote basis. But the procedure can take much longer. Because of the complexities of ULTA, USOLTA, UCA, UPCA and MRECA, a decade elapsed before the proposals were adopted by ULC.

Conference Proposes – State Disposes

When drafting is completed, a commissioner's job has only begun. Each now is obligated to go back to his state and work for adoption of the completed proposals.

Normal resistance to anything "new" makes this the most difficult part of a commissioner's responsibility. Remember, it took 14 years before UCC was adopted by 49 states.

But the result can be workable, modern state law that helps keep the federal system alive. The work of ULC simplifies the legal life of businesses and individuals by providing rules and procedures that are consistent from state to state. And it insures that problems can be solved close to home in state courts and agencies rather than being lost in overworked federal courts and U.S. departments and agencies.

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Introduced: 1/9/89
Referred: Labor and Commerce and
Judiciary

go00629s

IN THE SENATE

BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

SENATE BILL NO. 88

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to investment securities under the Uniform Commercial Code."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 45.01.201(5) is amended to read:

(5) "bearer" means the person in possession of an instrument, document of title, or certificated security payable to bearer or endorsed in blank;

* Sec. 2. AS 45.01.201(14) is amended to read:

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

* Sec. 3. AS 45.01.201(20) is amended to read:

(20) "holder" means a person who is in possession of a document of title or an instrument or a certificated [AN] investment security drawn, issued, or endorsed to the person or to the order of the person or to bearer or in blank;

* Sec. 4. AS 45.05.114(b) is amended to read:

(b) Unless otherwise agreed, if documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (AS 45.07.507) or of a certificated security (AS 45.08.306) or is forged or fraudulent or there is fraud in the transaction.

(1) the issuer must honor the draft or demand for payment

if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (AS 45.03.302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (AS 45.07.502) or a bona fide purchaser of a certificated security (AS 45.08.302); and

(2) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery, or other defect not apparent on the face of the documents, but a court of appropriate jurisdiction may enjoin this honor.

* Sec. 5. AS 45.08.102 is repealed and reenacted to read:

Sec. 45.08.102. DEFINITIONS AND INDEX OF DEFINITIONS. (a) In this chapter, unless the context otherwise requires,

(1) a "certificated security" is a share, participation, or other interest in property of or an enterprise of the issuer or an obligation of the issuer which is

(A) represented by an instrument issued in bearer or registered form;

(B) of a type commonly dealt in on securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and

(C) either one of a class or series or by its terms divisible into a class or series of shares, participations, interests, or obligations;

(2) an "uncertificated security" is a share, participation, or other interest in property or an enterprise of the issuer or an obligation of the issuer which is

(A) not represented by an instrument and the transfer

SB 87 cont'd

Section 2 of the bill adds a new section, AS 44.47.525. to authorize DCRA to make certain loan modifications on mortgages that it has financed under AS 44.47.370 -- 44.47.-560. In making the loan modifications, the department must find that the modification(s) will be advantageous to both the borrower and the state and would be considered prudent by private lending standards. The types of loan modifications that the department may make are (1) rescheduling principal payments; or (2) reducing interest rates within specified guidelines; or (3) both. The department is required to adopt regulations prescribing the terms and conditions of, and the procedures for, the loan modifications authorized in this bill.

The provisions and guidelines specified in sec. 2 will provide DCRA with the needed flexibility to address the needs of borrowers with mortgages that exceed their present ability to make the required payments, while assuring that a loan modification is also made in the best interests of the state.

Section 3 provides a definition of "limited commercial use."

Finally, sec. 4 provides for an effective date of July 1, 1989.

I urge your support of this bill.

Sincerely,

/s/
Steve Cowper
Governor

SB 88

SENATE BILL NO. 88 by the Rules Committee by request of the Governor, entitled:

"An Act relating to investment securities under the Uniform Commercial Code."

was read the first time and referred to the Labor and Commerce Committee and the Judiciary Committee.

Zero fiscal notes published today from Department of Law, Department of Revenue and Department of Natural Resources.

Governor's transmittal letter dated January 9:

SB 88 cont'd

Dear Senator Kelly:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill to enact the 1977 amendments to Article 8 of the Uniform Commercial Code, on investment securities. These amendments were developed by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in cooperation with the American Law Institute and the American Bar Association. These amendments, already enacted in 35 states, are essential to update Alaska's version of the Uniform Commercial Code (UCC) and recognize modern methods and necessities of financial transactions.

In trading securities, electronic transfers have become quite common and may, ultimately, make paper certificates obsolete. This bill proposes to keep up with these changes in the securities industry by introducing the concept of uncertificated securities. In the new Article 8 (AS 45.08 in Alaska's version of the UCC), the term "instrument" will no longer imply the existence of specific pieces of paper that act as evidence of obligations between people. These amendments have been endorsed by the Securities Industry Committee of the American Society of Corporate Secretaries.

This bill proposes to maintain Alaska's version of the Uniform Commercial Code as up-to-date as possible.

Sincerely,

/s/
Steve Cowper
Governor

SB 89

SENATE BILL NO. 89 by Senator Faiks, entitled:

"An Act relating to civil liability of zoos and zoo operators."

was read the first time and referred to the Judiciary Committee.

SB 90

SENATE BILL NO. 90 by Senator Faiks, entitled:

"An Act repealing the Railbelt energy fund' and providing for an effective date.

AMENDMENTS TO ARTICLE 8
OF THE UNIFORM COMMERCIAL CODE (UCC)

CONTENTS

* Fact Sheet - Article 8 Amendments to the UCC

* Summary of the Article 8 Amendments to the UCC

* "Why every state needs the Article 8 Amendments - Now"

* Questions and Answers on the 1977 Amendments to Article 8 of the UCC

* "A Certificateless Article 8 ? We Can Have It Both Ways," by Martin J. Aronstein, from The Business Lawyer, January 1976

* Endorsement of Article 8 Amendments by the Securities Industry Committee of the American Society of Corporate Secretaries

* Endorsement of Article 8 Amendments by the Securities Industry Association

* A Tradition of Excellence - a history of the Uniform Law Commissioners

* Uniform State Laws - how a uniform act is created

A Certificateless Article 8? We Can Have It Both Ways

By MARTIN J. ARONSTEIN*

IN THE aftermath of the "Paperwork Crunch" which seriously impaired the operation of the securities markets during the late 1960s, the air was filled with proposals for reform. Not surprisingly, many of these proposals focused on the elimination of the most visible manifestation of paperwork problems—the negotiable stock certificate. But it was correctly perceived that "The Certificateless Society" was incompatible with an existing legal regime firmly based on the assumption that shares of corporate stock must inevitably be represented by indispensable instruments. In an effort to resolve this incompatibility, the American Bar Association's Section of Corporation, Banking and Business Law organized a Committee on Stock Certificates. The Committee was charged with the duties of determining what legislation, if any, would be needed to facilitate the elimination of negotiable stock certificates and of drafting such legislation. The Committee issued its Report on September 15, 1975.[1] The author served as the Committee's Reporter.

This article is intended to be neither a summary of nor a substitute for the Committee's Report. Rather, its primary objective is to call the Bar's attention to the Committee's project and to enlist the cooperation of the Bar in the implementation of the Committee's recommendations. Its secondary, and somewhat selfish, objective is to permit the Reporter to express some personal views which are outside the scope of the Report and which are not necessarily shared by the Committee or its other individual members.

At the risk of sacrificing the element of surprise, it should be stated at the outset that the Committee's principal recommendations are two. The first is the relatively minor amendment of state corporation statutes to validate the issuance of stock not represented by certificates.[2] The second is a major and comprehensive revision of Article 8 and related sections in other Articles of the Uniform Commercial Code intended to govern the attributes of uncertificated shares.[3] The Committee does not recommend the adoption of general federal legislation at this time but recognizes that such legislation may be required in the future. One of the circumstances that would seem almost certain to lead to federal intervention would be the failure of the state legislatures

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* Professor of Law, University of Pennsylvania.

1. Copies of the Report may be obtained by writing to the Chairman, Donald A. Scott, Esq., The Fidelity Building, Philadelphia, PA 19109. There is a charge of $5.00 per copy.

2. Report of the Committee on Stock Certificates, Appendix A (Proposed Amendments to the Model Business Corporation Act).

3. *Id.*, Appendix B.

to act within a reasonable time. The role that the Bar can play in expediting necessary state adoption is apparent.

The Committee's Objective

The Committee's first order of business was to define the scope of its mission. Amid urgent pleas to legislate the stock certificate out of existence, it was tempting to envision the Committee as identifying or, perhaps, even inventing the ideal certificateless system and then proceeding to draft legislation that would both compel that system's universal adoption and regulate its operation. That vision was soon abandoned in favor of a more limited goal.

Initially it was recognized that any viable system had to be (1) technologically feasible, (2) legally permissible and (3) commercially acceptable. Further analysis revealed, however, that the first two of these elements did not really constitute limitations. We quickly came to the view that, given adequate time and resources, the technology was up to achieving whatever results the industry demanded. The important question was not whether a particular system could be devised but, rather, whether it could be implemented at a cost its users would be willing to pay—in short, whether it was commercially acceptable. Similarly, the drafting of legislation to permit the institution of certificateless systems was a relatively simple task requiring, in the main, amendments of a minor nature to the typical corporation statutes. At least two states have already adopted such amendments.[4] The real burden on the legislative draftsman, as we saw it, was to provide a legal environment within which parties could deal with uncertificated stock with that same high degree of confidence that the present certificate-based law now affords. Or, to phrase it somewhat differently, we attempted to create a legal framework that would not merely permit the issuance of uncertificated stock but would make its use commercially acceptable.

Thus, despite some early notions that we might re-invent the wheel, the Committee wisely decided that the industry and its related technologists were the most logical source of system development. The appropriate task for us lawyers was to assure that the law could accommodate whatever systems the industry devised. The statutory changes recommended by the Committee and set forth in the Appendices to its Report neither compel the adoption of certificateless systems nor prescribe the form such systems should take. Rather, we attempted to construct a law, as did the draftsmen of Article 9, designed to "make it possible for new [systems] . . . as they develop, to fit comfortably under its provisions."[5]

The Legal Basis of Certificatelessness

In the years before and since the Committee's organization, the world has

4 *Michigan Business Corporation Act* § 335, 15 Mich. Stat. Ann. § 21.200(335) (1974), *California Corporations Code* § 416(b).

5. *Uniform Commercial Code* § 9-101, Comment.

not stood still. Out in the marketplace, where stock is actually dealt with, the development of certificateless transfer has proceeded—apace, in the view of some, and with too deliberate speed, in the opinion of others. As the Report describes in some detail, significant strides toward "The Certificateless Society" have already been made without the benefit of any substantial statutory change. Existing certificateless systems, which may be broadly defined as methods to transfer stock without the physical movement of indispensable pieces of paper, masquerade under a variety of appellations. The common legal basis of each of these systems, however, is that somewhere a certificate exists and that someone is holding it as the shareholder's agent-bailee.

The most rudimentary form of certificatelessness is the street name brokerage account.[6] In this arrangement, the broker acts as the agent of the customer, a single undisclosed principal, and holds the certificate as the customer's bailee. Certificate movement is eliminated between customer and broker when the customer buys or sells through his broker-agent. Certificates continue to be used for transactions with the issuer, like presentment for registration of transfer, redemption or exchange, and for transfers for value to or from third party buyers, sellers and pledgees. There is, however, one common transfer for value, the customer's pledge to secure a margin loan from the broker, which, by virtue of the broker's prior possession, can be effected without certificate movement. There is also the comparatively rare transfer for value between two customers of the same broker, when, at the same time, one buys and the other sells the same security. This transfer is effected simply by the entries on the broker's books.[7] By and large, common law principles of agency, reinforced by safeguards imposed by the federal securities law and the self-regulatory organizations, have proved adequate to govern the relationship between the customer and his broker. Article 8's certificate-based law continues to govern the relationships with issuers and other third parties.

The independent securities depository is, in legal effect, an extension of the brokerage account model, but with one important exception. Like the broker, the depository holds certificates in its name and deals with the issuer and other outsiders as the agent of an undisclosed principal. The principal is the aggregate of the depository's customers, usually referred to as participants. Unlike the typical brokerage situation, however, transactions between participants are neither rare nor fortuitous but, rather, are commonplace and by design. Indeed, the primary objective of the depository is to permit transfers between the principals of a common agent without certificate movement.

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6. For the purposes of this analysis, the custody or agency accounts, maintained by the trust departments of banks for their customers, are functionally equivalent to the brokerage account.

7. *Uniform Commercial Code* § 8-313(1)(c). By its terms this section would appear to apply only when there is "a specific security in the broker's possession." It would in no event apply to a bank custodian.

As early as 1962, it was thought desirable to define expressly the legal consequences of intra-depository transfer. This was accomplished by adding section 8-320 to the official text of the Uniform Commercial Code. That section equates "the making of appropriate entries on the books"[8] of the depository to "a delivery of a security"[9] and thereby establishes the rights and duties of the respective participants between themselves and with others with whom they might deal. The developing depository system, with several depositories each maintaining accounts with the others, may be comfortably viewed as an aggregate of agents and sub-agents representing the aggregate of participants in all of them and holding the participants' certificates as bailees or sub-bailees. For the purpose of governing transactions with issuers and non-participants, which are normally effected by certificate delivery, the rest of present Article 8 continues to provide an acceptable legal framework.

The agency rationale is pushed still further, and, we believe, too far, in those systems which conceptualize the issuer or its transfer agent as the agent-bailee of all the shareholders. Existing systems premised on that rationale include the mutual funds, the increasingly popular dividend reinvestment plans and an almost wholly certificateless system which parades under the anomalous description of Transfer Agent Depository.[10] When the issuer is viewed as the bailee of its shareholders' certificates, the situation is functionally identical to that where no certificates exist. It is, so to speak, "The Certificateless Society" built on a legal foundation which was never intended to accommodate it.

The substantial disappearance of certificates from the mutual fund universe is a consequence of the commercial needs of the issuers and shareholders. In open-end mutual funds, the model transactions, the purchase of shares from the issuer and the redemption of shares by the issuer, do not involve third parties. In these two-party transactions which typically involve small numbers of shares and do not require simultaneous exchanges of money, the certificate's utility is reduced to no more than that of a simple statement from the issuer or letter of instructions from the shareholder. The commercial requirements of both parties are better and more economically satisfied without certificates than with them. Outright transfers for value between shareholders are rare, particularly in the no-load funds where the issuer stands always ready to sell or redeem shares at their net asset value.

In pledge transactions of mutual fund shares, however, the certificate continues to be demanded because it performs a necessary function. One could

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8. *Uniform Commercial Code* § 8-320(1).

9. *Id.* § 8-320(3).

10. The "Transfer Agent Custodian" concept should also be included in this group. That relationship arises when, by agreement between a particular shareholder and the issuer, certificates are not delivered to the shareholder but are held in the transfer office subject to the shareholder's instructions for further registration of transfer. It is commonly used by some brokers who have a continuing need for both customer name certificates and certificates of specific denominations to be used in making settlements.

argue, of course, that a security interest in uncertificated mutual fund shares could be perfected under section 9-305 by simply giving notice to the transfer agent in his imagined capacity as the bailee of the debtor's certificate. It is highly doubtful, however, that a prudent lender or his counsel could be persuaded to advance the loan under those circumstances. Furthermore, few, if any, transfer agents would have any institutionalized procedure for dealing with such a notice even if one were received. In the pledge situation, therefore, both the lender and the issuer take refuge in the only procedure now expressly validated by statute—the issuance of a certificate to the shareholder and the delivery of that certificate to the lender. Reliance on the agency-bailment rationale is just not commercially acceptable under the present law.

The dividend reinvestment plans, in which the typical transaction is the purchase of small numbers of shares for participating shareholders,[11] operate without certificates for essentially the same reasons that have led to certificatelessness in the mutual funds. When, however, the participant wishes to deal with his shares in another transaction, issuers respond, in almost every case, by issuing certificates.[12] Unlike mutual fund shares, however, the shares accumulated in the dividend reinvestment plan accounts are the very same intangible interests that are commonly traded in normal market transactions and used as collateral for secured loans. Officials of American Telephone & Telegraph Co., which operates the largest of such plans, are confident that they could develop adequate procedures to deal with both the outright transfer and the pledge of uncertificated shares by book-entry if only a satisfactory legal framework could be provided. The potential demand for such procedures is foreshadowed by the fact that, after only slightly more than two years of operation, AT&T was "holding," as the nominal agent-bailee for some 541,000 shareholders, more than 9 million uncertificated shares.

The Transfer Agent Depository concept differs from the dividend reinvestment plans in two important respects. First, it envisages a system where certificates are issued to a shareholder only when they are expressly requested.[13] Secondly, it contemplates that shares will not only be held in uncertificated form but may be transferred or pledged to third parties by the making of appropriate entries on the issuer's books.[14] The name, "depository," and the

11. The earliest plans and the majority of existing plans pool the dividends payable to the participants and purchase outstanding shares on the market. Each participant's account is then credited with an appropriate portion of the shares purchased. An increasing number of the newer plans use the dividends to purchase newly-issued shares directly from the issuer. AT&T gives participants a 5% discount from the market price.

12. Some corporations now handle so called "legal" transfers, *e.g.*, decedent to personal representative, without first issuing a certificate in the name of the decedent.

13. Conversion from the traditional certificated system to a Transfer Agent Depository would, in fact, require shareholders to "deposit" outstanding certificates with the issuer. A new corporation without certificates outstanding, however, would issue no certificates unless requested to do so.

14. The transfer or pledge by book-entry, validated by section 8-320, is available only to a "clearing corporation." The definition of "clearing corporation" in section 8-102(3) does not include an individual issuer or transfer agent.

contrived rationale imply that the issuer or its transfer agent is holding a certificate as the agent-bailee of the several shareholders. That certificate is either a useless formality or a patent fiction. We are told, for example, that somewhere in the AT&T transfer office there reposes a certificate representing the 9 million shares beneficially owned by those 541,000 dividend reinvestment plan participants. It seems almost ludicrous to imagine that important legal consequences would turn on whether or not that certificate is really there.

While the agency-bailment rationale lends an aura of validity to uncertificated shares that may satisfy a law professor or even a judge, it does not respond to the questions which the prudent businessman or his counsel needs to have answered before he can proceed with confidence. By what means and with what frequency must the issuer evidence the ownership of shares? What must a shareholder do, and what may an issuer require, to effect the registration of transfer? When does a purchaser become the owner of the shares he has bought? By what means can a secured lender perfect a security interest in his debtor's shares? How may an unsecured creditor reach his debtor's shares?

In short, the uncertificated share needs a governing statute to provide clear answers to those dozens of questions that existing law now provides with respect to the certificate. Without such answers, it is unreasonable to expect the expansion of wholly certificateless transfer to the kinds of transactions which account for the bulk of the industry's paperwork problems. The Committee concluded that the requisite degree of confidence, and, hence, commercial acceptability, is unlikely to be reached in the present legal framework that does not even acknowledge the existence of uncertificated shares and, therefore, utterly fails to deal with them.

The Future of System Development

It has been frequently stated that a major roadblock to the elimination of certificates would be the unsophisticated individual investor. Such an assumption is not in accordance with the facts. Holders of mutual fund shares and participants in dividend reinvestment plans have, in preponderant numbers, cheerfully foregone the possession of certificates that were unnecessary to satisfy their commercial requirements. Under existing rules of law, however, certificates are and will continue to be demanded for those transactions which they were originally developed to facilitate—the simultaneous exchange of stock for money between unrelated parties neither of which is prepared to extend unsecured credit to the other. Any system that can successfully displace stock certificates in the typical transfer for value must provide a commercially acceptable alternative to precisely that kind of exchange.

The securities depository is one such alternative. By holding its participants' stock in the depository's name, the depository assures itself that a purported transferor is the owner of the stock to be transferred and has entrusted the transfer power to the depository. By crediting the transferee's account,

the depository, in effect, represents to the transferee that the subject matter of the transfer exists and has been transferred to him. Thus, the transferee receives the same assurance that the receipt of a clean, duly indorsed certificate would afford him. It is in reliance on the depository's representation that the transferee parts with his consideration with confidence that he has received the benefit of his bargain.

The depository concept was a logical outgrowth of the clearing facilities maintained by the various stock exchanges. For years these facilities were utilized to monitor and expedite the transfer of funds and the delivery of securities between exchange members. Although these simultanous exchanges were nominally between individual members, they were made through the clearinghouse which became a de facto intermediary in the exchange. Viewing the clearinghouse as an independent party, dealing with all members, was a transition more in form than substance. The clearinghouse's function as a depository of both funds and securities followed quite naturally from its function as a mere record-keeper.

The statutory validation of book-entry transfer was initially limited, by the terms of section 8-102(3), to entities wholly-owned by a securities exchange or association. The growth of the depository concept in the United States has, therefore, taken place almost exclusively in conjunction with the exchanges. There is general agreement that the Depository Trust Co., the New York depository which now controls over 2 billion shares of stock, has served its broker participants well. It should be remembered, however, that these brokers were already participating in a system which settled the money side of transactions with essentially the same mechanism by which the securities side is now settled.

The exchange-related depository has also provided a mechanism to facilitate another kind of transfer for value—the broker's loan. In these transactions, lending banks, participating as "pledgees," are satisfied to advance funds to borrowing brokers on the strength of the depository's representation that the broker's stock, by virtue of the depository's book-entry, has been as effectively pledged as would be the case if certificates had been delivered to them by the brokers. The demonstrable saving that can be achieved by eliminating certificate delivery upon pledge and re-delivery upon release has resulted in the substantial use of this procedure by the banks.[15]

The expansion of the exchange-related depositories to include significant participation by banks (other than as pledgees), insurance companies, pension funds and other institutional investors is far from foreordained. These investors are not, as are the brokers, under a constant obligation to make daily settlements with their counterparts through an institutionalized clearing facility. They have typically made independent arrangements for C.O.D. settlements directly or through bank agents. For them, the use of a depository

15. The procedure has also made it feasible for banks located in areas remote from the financial centers to compete with the local banks for the brokers' loan business.

constitutes a departure from their traditional settlement procedures rather than an extension of an already established *modus operandi*.

Thus far, despite the intensive use of depositories by brokers, participation by non-broker eligible entities has been quite limited. There are a number of factors that have militated against bank participation and some of them have been only recently corrected. Nevertheless, there is currently very little hard evidence that the exchange-related depositories are destined to expand into a national comprehensive depository system that will obviate the need for continuing efforts to eliminate the stock certificate and its attendant problems. It should also be observed that the impact of the exchange-related depositories, even in the context of broker-to-broker settlements, is itself a function of the part to be played in the securities markets of the future by the exchanges themselves. To the extent that the exchanges become less significant in the total picture—a distinct possibility in the light of recent events—the ameliorating effect of their depository facilities will be correspondingly reduced.

As a step to encourage the use of depository facilities by non-brokers, the Banking & Securities Industry Committee sponsored an amendment to section 8-102(3) which has already been adopted by more than forty states.[16] The effect of this amendment is to permit the distribution of the capital stock of depositories among their users. This is intended to create a cooperate rather than a proprietary form of ownership and control. Depository Trust Co. has already announced plans to distribute its stock to its users during 1975. Whether this will achieve the objective of increased non-broker participation remains to be seen.

Another effect of the 8-102(3) amendment, however, is to permit the organization of depositories which are not related to a securities exchange. One such depository was organized in 1974 under the sponsorship of a group of bank transfer agents and has already achieved substantial growth.[17] Unlike the exchange-related entities, this depository sees itself only as a communications network which will permit rapid transmittal of transfer instructions to issuers and rapid acknowledgment of registration to prospective buyers and pledgees. Facilities for clearing the money side of transactions are not encompassed within the system and will have to be provided independently. Thus, for non-broker participants, the use of this system will be much less of a departure from their current practices than would be participation in an exchange-related depository. It is much too early for even its own managers to predict the extent to which such a depository will be commercially acceptable.

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16. The text of this amendment does not appear in the Official Text of the Uniform Commercial Code. It is set forth in Appendix B of the Report of the Committee on Stock Certificates.

17. By June 1975, the TAD Depository Corp. had on deposit over 12 million shares in more than 1600 different issues.

What the foregoing discussion suggests is that the concept of certificate immobilization in independent depositories is far from certain to result in a satisfactory reduction in the paperwork problems of the securities industry. The elimination of stock certificates, or, in the current fictionalized parlance, the use of the issuer or its transfer agent as a "depository," may prove to be at least a significant part of the ultimate solution. If that be the case, the burden of developing the mechanisms that will be commercially acceptable alternatives to the simultaneous certificate-for-money exchange rests upon the industry. It is our function, as lawyers, to make sure that the governing law will provide an environment in which industry-developed systems can be implemented with confidence in their legal consequences. Our proposed revision of Article 8 is an attempt to create that environment.

Drafting the Statute

Professor Jolls has suggested that a statute governing the attributes of uncertificated shares need not be nearly so complex as Article 8 and might take the form of an additional article of the Uniform Commercial Code, perhaps denominated Article 8A.[18] Our initial attempts to draft such a separate statute convinced us, for several reasons, that an integration of the rules for certificated and uncertificated shares and, necessarily, a complete revision of present Article 8 would be the more fruitful approach.

The process of putting pencil to paper for the first time exposed a number of problems that would have to be dealt with in a separate article. Parties dealing with uncertificated shares should be able to find, in the governing statute, the answers to all questions answered by present Article 8 except where the question, by its nature, has no application in the absence of a certificate. Could an issuer's lien exist? What is the effect of an issuer's restriction on transfer? Who, if anyone, could be a bona fide purchaser? Were there exceptions to the statute of frauds? Was there a statute of frauds? The dozen or so basic sections that Professor Jolls suggested might constitute an adequate statute grew quickly and substantially in number.

Even more important, our observation of what was taking place in the industry convinced us that the total elimination of stock certificates, even if ultimately realized, was a very long way off. What we saw was a system in which both certificated and uncertificated shares would continue to co-exist, in many cases, within the same issue of securities. Under those circumstances, the rules for each form of stock would, in many instances, require exceptions in the corresponding rules for the other form. For example, the seller's duty to perform, stated in section 8-314, might be satisfied not only by the delivery of a certificate but also by the transfer of an equivalent uncertificated security. Even assuming the ultimate elimination of certificates for a particular issue,

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18 Jolls, *The Uniform Commercial Code and the Certificateless Society*, 26 Bus. Law 627 (1971).

section 8-207(7) we provide that the new shares "shall also be subject to the rights of the registered pledgee."

In one instance, and only one, we departed from our general approach of merely restating the law with respect to certificated shares and purposely extended the coverage of the statute. The rule of present section 8-317, requiring certificate seizure for a valid creditor's lien, is eminently rational when certificates are issued in shareholder name and held by the shareholder. The apparent exclusivity of this remedy is inconsistent with modern security holding practices. To give an extreme, but not uncommon, example, assume that Debtor is the owner of 100 shares of Issuer stock and has asked Broker to hold the stock in street name. Broker has, in turn, deposited certificates for 5,000 shares of Issuer stock with Depository which has credited Broker's account. Depository has then delivered these certificates, together with certificates received from other brokers, to Issuer which has issued to Depository a jumbo certificate, in Depository's name, for 200,000 shares. According to section 8-317, Creditor, wishing to levy upon Debtor's interest in Issuer, can acquire no lien without seizing Debtor's certificate. But Debtor has no certificate unless one conceives that Debtor has an undivided interest in that 200,000 share certificate reposing serenely in Depository's well guarded vault. It is hard to imagine that Depository will voluntarily surrender that certificate to the sheriff or that a court would compel it to do so. Indeed, it is unlikely that Depository will be aware of Debtor's existence. Debtor's interest is known only to Broker. In revised section 8-317, Creditor obtains his lien by garnishment of Broker, thus assuring, as present section 8-317 intends, that Debtor will not be able to transfer his interest to a bona fide purchaser free of Creditor's lien.

It was with some reluctance that we failed to incorporate in the statute provisions for a certified transfer order, suggested by Professor Jolls and others. Such an order would be an instrument, analogous to a certified check, which an issuer would have agreed to honor if timely presented and which could be used in C.O.D. settlements. It was not adopted for two reasons. First, it seemed that a wholly certificateless environment would necessarily have developed commercially acceptable procedures to accomplish the equivalent of the C.O.D. settlement by electronic communication or otherwise. Such mechanisms would make the certified transfer order unnecessary. Secondly, pending the development of the procedures described, it appeared that certificates would necessarily continue to be available to effectuate C.O.D. settlements when they were required.

The Role of the SEC

The Securities Acts Amendments of 1975, for the first time, expressly involve the Securities and Exchange Commission in the regulation of clearance and settlement systems. By amendment to the Securities Exchange Act of 1934, the Commission is empowered to prescribe the form and format of

securities;[20] to facilitate the establishment of a national system for clearance and settlement,[21] to regulate clearing agencies,[22] to regulate transfer agents[23] and to "end the physical movement of securities in connection with the settlement among brokers and dealers."[24] By these amendments, Congress has assuredly not legislated the stock certificate out of existence. Nor has it, expressly or by implication, provided for any system not already sanctioned under existing law. It has, at the most, empowered the Commission to compel broker-dealers to participate in some form of certificateless system without prescribing either what that system should be or setting a time limit for participation. Beyond that, it has merely invited the Commission to submit "its recommendations, if any, for legislation to eliminate the securities certificate."[25]

The newly-granted regulatory powers of the Commission, wisely exercised, could do much to encourage the voluntary adoption and expansion of certificateless systems. The establishment of both financial and operational standards for clearing agencies, which are defined to include depositories, should have the effect of instilling confidence in potential participants in that form of certificateless transfer. SEC supervision is not the equivalent of a government guarantee against operational or financial failure, but it may, to some degree, tip the scales toward participation by some. So long as participation is voluntary, however, it will be the depositories' burden, by means of satisfactory performance and demonstrated economy, to attract additional participants.

The Commission's power to prescribe uniform standards for transfer agent capability is particularly crucial to the development of wholly certificateless systems. When certificates exist, the registration of transfer merely confirms the legal relationships already established by delivery. Without certificates, however, the completion of many transactions will necessarily await registration on the books of the issuer. Inadequate transfer agent performance can be injurious to a system based on certificates. In a system without certificates, it could be fatal.

It is apparently the view of Congress that the industry, motivated by incentives of cost minimization and increased efficiency, gives promise of producing satisfactory clearance and settlement systems without mandatory federal legislation. In effect, Congress views the Commission as a stimulus to facilitate systems development and to encourage participation, but not as a designer of particular systems or an agent to compel participation therein. It goes without saying that if the industry does not measure up to Congress'

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20 *Securities Exchange Act of 1934* § 12(1), 15 U.S.C.A. § 781(1) (Pamphlet 4, 1975).
21. *Id.* § 17A(a)(2), 15 U.S.C.A. § 78q-1(a)(2) (Pamphlet 4, 1975).
22. *Id.* § 17A(b), 15 U.S.C.A. § 78q-1(b) (Pamphlet 4, 1975).
23. *Id.* § 17A(c), 15 U.S.C.A. § 78q-1(c) (Pamphlet 4, 1975).
24. *Id.* § 17A(e), 15 U.S.C.A. § 78q-1(e) (Pamphlet 4, 1975).
25. *Id.* § 23(b)(4)(E), 15 U.S.C.A. § 78w(b)(4)(E) (Pamphlet 4, 1975).

expectations, the propensity for further federal intervention is certain to increase.

The Prospects for Adoption

In the course of its deliberations, the Committee was divided on the issue of whether to recommend legislation by Congress or by the state legislatures. In the end, the state route was espoused on the general principle that corporate and commercial law were areas in which the state legislatures traditionally acted and that this tradition should not be lightly disturbed. The countervailing argument was that federal legislation was the only way to achieve absolute uniformity and probably the best way to assure reasonable promptness. The several years taken by Congress to enact even the limited approach of the 1975 Securities Acts Amendments indicates that promptness at the federal level is far from assured. And, indeed, with respect to amendments to the Uniform Commercial Code, it is possible that promptness, with reasonable uniformity, can be achieved at the state level.

The Permanent Editorial Board for the Uniform Commercial Code provides a unique mechanism for drafting, editing and promulgating commercial statutes at the state level which is perhaps unparalleled in any other area of the law. It is contemplated that a revised Article 8, bearing the imprimatur of the Permanent Editorial Board, might be before the state legislatures as early as 1976. As to the promptness with which the state legislatures will act there is less predictability. On the one hand, the recent amendment to section 8-102(3), proposed initially in 1972, has already been adopted by more than forty states. On the other hand, the current official text which substantially revises Article 9, promulgated in the same year, has been adopted by only fourteen. If the operative distinction between these two proposals is their relative complexity, the prospects for prompt adoption of proposed Article 8 are dim.

There is, however, another important distinction between the two proposals. The 1972 version of Article 9 is intended to displace an earlier statute which addresses the same problems and, in some instances, solves them differently. Secured transactions can, however, still proceed with assurance under the earlier, unamended version. New section 8-102(3) provides for an institution, the non-exchange-owned securities depository, which could not exist under prior law. It was recognized that such an institution might significantly promote the development of comprehensive depository systems and members of the securities industry got behind the amendment and pushed the legislatures for its adoption.

If that is the explanation, the prospects for the prompt adoption of proposed Article 8 are more optimistic. At present there is no statute to govern the attributes of uncertificated stock. By its terms, present Article 8 applies only to "securities" and securities are defined, in section 8-102(1), as "instruments." A share of stock not evidenced by an instrument is without any

legal foundation in the Uniform Commercial Code with the single exception that it would be classified as a "general intangible" for purposes of Article 9.[26] If, as we believe, there is a real need for uncertificated stock the attributes of which will be governed by statutory law rather than by fictitious analogy the impetus for pushing the legislatures should materialize. If it does, the Committee's recommendation to amend the commercial law at the state level is justified both by practicality and by principle.

The situation with respect to the corporate law is different. The Model Business Corporation Act does not enjoy the almost uniform acceptance accorded to the Uniform Commercial Code's official text. State corporation statutes vary widely in both form and content and substantive non-uniformity is the rule rather than the limited exception. Each state corporation statute requires an independent analysis and revision, in sharp contrast to the Uniform Commercial Code for which amendments can be centrally drafted and packaged for export. In short, the prospects for the prompt and uniform adoption of the proposed corporate law amendments by the state legislatures are less than great.

Happily, the necessity for the prompt and uniform adoption of our recommended corporate law amendments is not nearly so pressing. The adoption of enabling legislation in just a few major commercial states would permit the issuance of certificateless stock by a large number of corporations. If only a handful of enterprising corporations incorporated in the adopting jurisdictions could successfully implement the issuance of uncertificated shares to the mutual benefit of themselves and their shareholders, similarly situated corporations in non-adopting jurisdictions can be counted on to urge adoption by their respective legislatures. Furthermore, on the basis of demonstrated successful implementation, it would be neither unexpected nor unwarranted for the Securities & Exchange Commission to recommend that Congress provide this power for all or some categories of corporations registered under the Securities Acts, thus making state adoption irrelevant.[27]

Conclusion

However illogical it may seem, I am convinced that the prompt and uniform adoption of a carefully drafted and rigorously edited commercial statute to govern the attributes of uncertificated shares is of far greater importance than the adoption of statutes to authorize their issuance. Even now, uncertificated shares, without express statutory authorization, are being voluntarily

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26. Uniform Commercial Code § 9-106. The result of that classification is to require the filing of a financing statement as the exclusive means of perfecting a security interest in uncertificated shares. *Id.* § 9-302(1).

27. Significantly, the two state legislatures that have acted have not granted the power to issue uncertificated shares to all corporations. Michigan has limited the power to issuers of "shares or other securities . . . listed on a national securities exchange" and California to "a corporation which is the issuer of securities registered under the United States Securities Exchange Act of 1934." See note 4 *supra*.

issued in the guise of certificated shares held by the issuer. The adoption of the proposed Uniform Commercial Code amendments will permit these systems to develop with that confidence in the legal consequences of transactions that is so essential to commercial acceptability.

There is an even more critical consideration. A recurrence of a paperwork crisis in the securities industry is likely to evoke demands to abolish the stock certificate by law and thereby, in effect, compel the issuance of uncertificated shares. I fear that mandatory legislation, enacted under panic conditions, may fail to provide an adequate framework for dealing with the artifacts it creates.[28] It would be far better to be prepared for uncertificated shares before they exist than to have them thrust upon us before we are ready for them.

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28 Draftsmen of corporate statutes properly do not concern themselves with the solution of nitty-gritty commercial problems. The Michigan statute, note 4 *supra*, delegates that unpleasant task to the securities exchange on which the uncertificated shares are listed. The California statute, note 4 *supra*, is more expansive and defers to its Commissioner of Corporations, the Securities & Exchange Commission or Congress. And Congress, in section 17A(e) of the 1934 Act, blithely tells the SEC "to end the physical movement of securities certificates in connection with the settlement among brokers and dealers."

ARTICLE 8 AMENDMENTS TO THE

UNIFORM COMMERCIAL CODE

Article 8 of the Uniform Commercial Code is entitled "Investment Securities." A "security" is broadly defined as an instrument which:

(1) is issued in bearer or registered form;

(2) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment;

(3) is either one of a class or series or by its terms is divisible into a class or series of instruments; and

(4) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

The commonest examples are stocks and bonds. They have a market and are bought and sold, as are "goods" under Article 2 of the UCC, and negotiable instruments under Article 3. The UCC sought to cover all the major kinds of markets in its conception of "commercial transactions." Thus, Article 8 provided a fundamental law for the buying and selling of securities.

Note, however, one aspect of this basic definition. It states that a security is an "instrument." It implies a piece of paper with appropriate writing to identify the obligation the security manifests. Therein lies the kernel for the present revision - paper. The new Article 8 contemplates the elimination of the paper. The term instrument will no longer imply the existence of specific pieces of paper which act as evidence of obligations between people.

There are a number of reasons for this anti-paper revolution. In the late 1960s, the brokers and the exchanges became overburdened with paper. The sheer load hampered the markets. Also, automation has progressed far enough to make the revolution feasible. It is easier and faster to record transfers in the computer. It is efficient and more economical. Thus, the nature of the transactions in securities is fundamentally changing.

Under the revised Article 8, an immediate distinction is made between types of securities. There are "certificated" securities and "uncertificated" securities. The "certificated" security is the one we have long known, represented on and by a piece of paper, an instrument. That piece of paper has been, and remains, the means of transfer and the evidence of obligation - when it exists. But it no longer always exists.

The "uncertificated" security is not evidenced by any piece of paper at all. It exists on its issuer's records. Its key characteristics are found in the definition. It "is not represented by an instrument and the transfer of which is registered upon books maintained for the purpose by or on behalf of the issuer.. ." Without the instrument, the mechanics of a transfer change. Also changed are the manners in which obligations are manifested.

Where there is a certificate, it physically participates in any transfer of the obligations it contains. A security passes upon proper endorsement and physical delivery of the instrument. The instrument takes part in pledges made by owners of the security to secure their own debts. It is also the foundation of the warranties each of the parties gives in a transaction involving a security. The paper is fundamental, and when it is eliminated, some changes commensurate with its elimination must take place.

When a transfer, or registration of a pledge, occurs in the case of an "uncertificated" security, it does so only on the books of the issuer. This means that an "instruction" must be given to the issuer by the appropriate person. The "instruction" normally will be in writing, and obligates the issuer to make the necessary entry on the books. The evidence of completion is a statement back from the issuer within two business days after the registration occurs. It goes to transferror, transferee, and any pledgee.

These two items are the only pieces of paper involved in the transfer, and are designed to be much simpler than the "certificated" security. The last of the two, the "Initial Transaction Statement," is the most important. It provides notice of terms, restrictions, and adverse claims to the addressee, and runs against the issuer if it does not. This is a similar function to the written instrument which constitutes a "certificated" security. The rights of purchasers which depend on this information are affected almost exactly as a purchaser's rights are affected by a "certificated" security.

There are differences, however. A purchaser of an "uncertificated" security, in general, can rise no higher than his transferror in terms of his rights. He takes as if he had his transferror's knowledge, even if he doesn't. A "certificated" security does not hold a purchaser to the knowledge of his transferror, but bases his rights on his own

knowledge. That is a distinct difference between the two forms of security.

Further, an Initial Transfer Statement warrants only that the acknowledged owner is so at the time of its issuance. It does not do so for any following time period. In contrast, a purchaser may normally assume that the holder of a "certificated" security is the owner and entitled to transfer it. In these respects, the Initial Transfer Statement does not offer the assurances of a "certificated" security.

It is perhaps anomalous to think of security interests in a security, which itself may represent a debt of the issuer. People who own securities, which are valuable property, may pledge them for their debts. They create a security interest in the creditor by so doing.

A "certificated" security is merely delivered to the pledgee with a proper endorsement. That creates the security interest. Where "uncertificated" securities are concerned, the security interest must be registered. The procedure for doing this is identical to the procedure for a transfer. An instruction is sent to, and a confirmatory statement returned from, the issuer of the security. Once registered, the owner continues all powers with respect to the security except the power of transfer. That belongs to the registered pledgee.

The "uncertificated" security offers a bit more protection to the pledgee than a "certificated" security does. If a pledge of a "certificated" security is not registered, additional securities and dividends will be distributed to the owner, not the pledgee. The procedure relating to "uncertificated" securities precludes the problem. It is also to be noted that perfection of the security interest is by possession of the instrument for a "certificated" security, and by the mere procedure of creating the interest for "uncertificated" securities. Perfection is the means of determining the priority between competing security interests.

Warranties also differ between "certificated" and "uncertificated" securities. The face of the instrument provides a basis of warranties for "certificated" securities. The presenter to an issuer for registration, the transferror to a purchaser, all warrant aspects of the transaction because of the instrument and its enforcements and signature guarantees. For "uncertificated" securities, the only warranty can be on the part of the originator of an instruction to the issuer. That person warrants that the registration is proper to the issuer, and that the transfer has no defects to a purchaser for value.

Signature guarantees, an essential part of the transfer process for widely held securities, also cannot be the same for "certificated" and "uncertificated" securities. The guarantor of

a "certificated" security warrants that the endorser is an appropriate person acting for the owner. This is evident to the guarantor from the instrument. Without the instrument, the guarantees, are limited to the genuineness of the signature, and that the endorser purports to act for owner or pledgee. There are special, boarder guarantees of an "uncertificated" security which cannot be demanded by an issuer, but which can be made to further secure a transaction.

The difference between a "certificated" security and the items of paper relating to registration of an "uncertificated" security cause a difference in the treatment of a bona fide purchaser for value, also. Essentially, a bona fide purchaser for value is held for only those things on the instrument with respect to a "certificated" security. The bona fide purchaser for value of an "uncertificated" security essentially takes free of what does not appear on the initial transaction statement. Practically, this may expose him to greater liability, but also forces him to seek a clean transaction statement before accepting liability.

Third party claims also provide a difference. For "certificated" securities, notice in writing to the issuer suffices. For "uncertificated" securities, the claim must be in the legal process before the issuer has notice. Judicial liens are also treated differently. Seizure of the security works for "certificated" securities, but not for all the "uncertificated" breed. It is necessary to serve process on the issuer.

These are some of the differences which result from the addition of the "uncertificated" security to the security markets. There has been no need to change the basic pattern of Article 8, which has served its purpose well. The amendments seek to incorporate the "uncertificated" security with the least disturbance possible.

QUESTIONS AND ANSWERS ON THE 1977 AMENDMENTS TO ARTICLE 8 OF THE UNIFORM COMMERCIAL CODE

Q: What do the 1977 Amendments to the Uniform Commercial Code (UCC) provide?

A: They permit entities creating investment securities (stocks and bonds are the commonest examples) to issue "uncertificated" securities. This kind of security would not be represented by a "certificate" and would not be transferred by passing a certificate from one person to another. Transfer would take place when the issuer creating the security records the transfer on its books.

Q: How does such a transfer take place?

A: In most instances transfers of uncertificated securities will require computerized records and electronic communications systems. In small corporations that have limited numbers of stockholders and are not publicly traded, uncertificated securities might be created without these technical advances. Under the Amendments, a transfer of any kind follows this basic sequence:

1. The current owner (transferor) of the uncertificated security sends an instruction to the issuer to record a transfer to another person (transferee). The instruction must be in the form required by the issuer.

2. The issuer records the transfer on its records.

3. The issuer returns an identical document to both the transferor and transferee confirming the transfer. This document, called an Initial Transaction Statement (ITS), must be returned within two days after the receipt of instruction. Receipt of the ITS assures that the transaction is complete.

Q: How are uncertificated securities pledged as collateral for a debt?

A: A pledge is a type of transfer under the Amendments. It requires the same sequence as any other transfer, such as a sale or a gift, except that the effect is to preserve on the issuer's books the rights of the creditor in the securities as collateral. A pledge can be recorded in two ways. The creditor can be shown on the issuer's records as the owner of the securities, as collateral for the debt. The pledge, itself, can also be recorded without an actual transfer of ownership, In either case, the creditor's

rights will be protected from any further transfer, since the issuer cannot record any subsequent transfer that conflicts with, or is superior to, the creditor's interest until that interest is removed from the record.

Q: What happens to securities represented by certificates when the Amendments are adopted?

A: There is no change in the legal status of securities represented by certificates. Issuers can continue to offer existing securities and certificates and new issues can be created with certificated securities. The Amendments do not repeal the existing rules, but establish a parallel set of rules for uncertificated securities. It is intended that the law favors neither certificated nor uncertificated securities. When an issuer considers which option to take, the choice will not be influenced by some inherent advantage or disadvantage built into the law, but only by the issuer's perception of the marketing efficiency to be gained. The Amendments expand choices for creating securities. They do not take away anything that is already available.

Q: Can an issuer create both certificated and uncertificated securities at the same time?

A: Yes. It is anticipated that corporations which convert from certificated to uncertificated securities will make the transition over an extended period of time. They will probably have stock issues that are certificated as well as uncertificated. Many issuers may choose a mixed system indefinitely. The Amendments do not restrict any system that an issuer may want to put into effect.

Q: What if the investor wants to have certificates when issued uncertificated securities?

A: If the issuer has a mixed system, with both certificated and uncertificated securities, an investor may demand, and must receive, certificates. If the issuer issues no certificated securities, they do not have to be created to meet the demand of an individual investor. The investor will have to invest elsewhere. This situation arises primarily with stocks, and investors who feel comfortable with the traditional certificates. In most cases, corporations will have mixed systems, and certificates will be available for those who want them.

There are issuers, such as mutual funds, that have never made certificates available - their customers do not expect what has never been offered. Most investors who deal through brokers maintain accounts and never see certificates, even though the large bulk of stocks and bonds are currently certificated. The majority of investors don't expect certificates anymore, and it is likely that the demand will be rare, though they will be available.

Q: Aren't computerized records and electronic transfers more open to fraud and deception than certificated transfers?

A: Securities are valuable property and targets of the unscrupulous and dishonest. Certificates are stolen, signatures are forged; paper may be counterfeited, even after the most elaborate precautions. In short, there are risks inherent for certificated securities, and issuers, financial institutions, brokers, and investors have to take precautions to protect rights represented by certificates. The UCC was never concerned with these problems, except to establish certain basic liabilities. The practices of the securities industry, bolstered by the establishment of these liabilities. The practices of the securities industry, the criminal law, have been primarily responsible for protecting these valuable interests. The system has worked very well, though never perfectly.

The Amendments treat uncertificated securities the same way the UCC has treated certificated securities. Certain basic liabilities are established, but the practices of the securities industry, backed by the criminal law, is the primary defense against fraud and deception. The risks are different with computers and electronic transfer systems, but they are not insurmountable. The banking system already operates largely on electronic transfers of money and while no system of transfers will ever be perfect, it appears that a high level of safety is possible and probable. Indeed, if the market place did not have a high level of safety, nobody would enter the market. That is the best guarantee that systems adopted will be very safe before they are utilized.

Q: Do the 1977 Amendments to the UCC affect securities regulation at the state or federal level?

A: The short answer is no. The UCC has provided the basic transfer rules for investment securities. It has never been concerned with issues of regulation, such as registration of securities issues or disclosure to investors. The Amendments make no change in this pattern. Uncertificated securities are subject to the same regulatory requirements as certificated securities, and the existence or non-existence of the certificate makes no difference whatsoever.

Q: How many states have adopted the 1977 Amendments to the UCC?

A: To date, 35 states, including California, Delaware, Massachusetts, New York, Illinois, and Texas - all states that rank high in quantity of securities trading. With the adoption of the Amendments in Delaware and New York, the opportunity for issues of uncertificated securities expanded enormously. No state that wishes to stay current with the fundamental law respecting investment securities can afford to delay adopting these Amendments.

Q: What will a state gain by enacting the 1977 Amendments to the UCC?

A: Corporations, brokers, financial institutions, mutual funds, and others involved in the creation and sale of investment securities will have the most up-to-date law available to them. They will be able to take immediate advantage of these Amendments. Brokers will also be able to deal in uncertificated securities issued by out-of-state issuers of securities without thought as to the validity of such transfers on behalf of local customers.

A Few Facts About

THE ARTICLE 8 AMENDMENTS TO THE UNIFORM COMMERCIAL CODE

PURPOSE: To provide states with a legal framework for the transfer of uncertificated securities, similar to the rules for certificates found in the original Article 8.

ORIGIN: Completed by the Uniform Law Commissioners in 1977, in cooperation with the American Bar Association and the American Law Institute.

ENDORSED BY: New York Stock Exchange
Securities Industry Association
American Society of Corporate Secretaries

STATE ADOPTIONS:

Arkansas	Maine	Oklahoma
California	Maryland	Oregon
Colorado	Massachusetts	Rhode Island
Connecticut	Michigan	South Dakota
Delaware	Minnesota	Tennessee
Florida	Montana	Texas
Hawaii	Nevada	Utah *
Idaho	New Hampshire	Virginia
Illinois	New Mexico	Washington
Indiana	New York	West Virginia
Kansas	North Dakota	Wisconsin
Kentucky	Ohio	Wyoming

1989 INTRODUCTIONS:

Alaska	Iowa	New Jersey
District of Columbia	Mississippi	North Carolina
	Nebraska	Vermont

NEED A SPEAKER? These persons are avaible to provide testimony or give presentations on the Article 8 Amendments:

Martin J. Aronstein Univ. of Pennsylvania Permanent Editorial Board for the UCC	Robert Haydock Boston, Mass. Permanent Editorial Board for the UCC
William E. Hogan New York University Permanent Editorial Board for the UCC	Donald Scott Philadelphia, PA Permanent Editorial Board for the UCC

For information on arranging a speaker, contact John McCabe or Katie Robinson at 312-915-0195.

* 1989 Adoptions

SECURITIES INDUSTRY ASSOCIATION
120 Broadway, New York, N.Y. 10271 · 212 608-1500

January 31, 1984

John M. McCabe
Legislative Director
National Conference of Commissioners
on Uniform State Laws
645 North Michigan Avenue - Suite 510
Chicago, IL 60611

Dear Mr. McCabe:

This is to advise you that the Board of Directors of SIA, through their Executive Committee, at a meeting held on January 18, 1984, passed a resolution endorsing an amendment to the Uniform Commercial Code setting out legal rights and responsibilities for transferring securities without using certificates. The Board endorsed the legislation which is proposed by your Conference and which has passed in the State of New York as well as seven other states.

For your information, because of a rather crowded agenda and a time problem, this matter did not reach the Board's attention in their meeting held in November of 1983. This explains the delay in getting back to you on this matter.

I wish you continued success in your ventures.

Very truly yours,

Bill Fitzpatrick

William J. Fitzpatrick
General Counsel

WJF:es

AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC.

1270 AVENUE OF THE AMERICAS • NEW YORK 10020 • TELEPHONE: 212-765-2620

April 25, 1985

Mr. John M. McCabe
Legislative Director
National Conference of Commissioners
on Uniform State Laws
645 North Michigan Avenue
Suite 510
Chicago, Illinois 60611

Dear Mr. McCabe:

The Securities Industry Committee of the American Society of Corporate Secretaries endorsed the 1977 Amendments to Article 8 of the Uniform Commercial Code at its meeting in New York on October 18, 1983. The Society supports the adoption of these Amendments by all states in the near future so that the laws of the various states pertaining to the transfer of securities can be made wholly uniform.

Very truly yours,

Stephen P. Norman
Chairman
Securities Industry Committee
American Society of Corporate
Secretaries Inc.

SPN:ldk

UNIFORM COMMERCIAL CODE
ARTICLE 2A - LEASES

CONTENTS

* Fact Sheet - UCC - 2A, Leases

* Why States Should Adopt UCC Article 2A - Leases

* Summary of UCC - 2A, Leases

* "Old Wine in New Bottles: UCC Article 2A - Leases," by Edwin E. Huddleson, III, Esq., from The Journal of Equipment Lease Financing.

* A Tradition of Excellence - A History of the Uniform Law Commissioners

* Uniform State Laws - How a Uniform Act Is Created

A Few Facts About

THE UNIFORM COMMERCIAL CODE. ARTICLE 2A - LEASES

PURPOSE: To provide states with a legal framework for any transaction, regardless of form, that creates a lease.

ORIGIN: Completed by the Uniform Law Commissioners in 1986.

ENDORSED BY: American Bar Association
American Law Institute

STATE ADOPTIONS: California
Oklahoma
South Dakota*

1989 INTRODUCTIONS:

Alaska	Mississippi	North Dakota
Florida	Nebraska	Oregon
Illinois	Nevada	Rhode Island
Maine	New Hampshire	Utah
Massachusetts	New York	Washington
Minnesota		West Virginia

NEED A SPEAKER? These persons are available to provide testimony or give presentations on the Article 2A Amendments:

Marion Benfield, Jr.	Fred H. Miller
Champaign, Illinois	Norman, Oklahoma
Drafting Committee	Drafting Committee

For information on arranging a speaker, contact John McCabe or Katie Robinson at 312-915-0195.

* 1989 Adoptions

Old Wine in New Bottles: UCC Article 2A-Leases

Edwin E. Huddleson, III, Esq.

Introduction

Over the past decade, commentators and practicing lawyers have debated the desirability of a uniform state law on equipment leasing. The "statutory codification" movement was a natural reaction to the explosive growth of equipment leasing after World War II. Beginning in 1980, the American Bar Association undertook serious studies to define the scope and substance of a uniform state law on the leasing of goods.

The Commissioners on Uniform State Laws, acting in 1985 after three years of restudy by a drafting committee of law professors and attorneys, approved a proposed state law on equipment leasing: the Uniform Personal Property Leasing Act (UPPLA). UPPLA was then rewritten stylistically to make it a part of the Uniform Commercial Code (UCC). Today a new UCC Article 2A-Leases has been approved by the commissioners and is awaiting approval by the American Law Institute in May 1987. Thereafter, the new statute will be formally presented for enactment to the state legislatures.

Edwin E. Huddleson, III, is a partner in the law firm of Volpe, Boskey and Lyons, which represented AAEL throughout the drafting committee sessions that created new UCC Article 2A-Leases.

Overview of the Statute

UCC Article 2A-Leases is a uniform state law on equipment leasing, with standardized provisions on warranties and remedies that are variable by agreement between the lessor and lessee. The statute expands the scope of the UCC to cover leases of goods. But it is not a comprehensive code. It leaves several areas of state law to be developed by other law, particularly consumer protection statutes and so-called "products liability" case law. To avoid conflict with state certificate of title statutes (which cover automobiles, trailers, boats and other often-leased goods), the new statute defers to those other statutes. Within its own sphere, however, it addresses several issues that are important for equipment leasing.

The statute is divided into six parts: (1) General provisions. These include definitions ("consumer lease," statutory "finance lease,") as well as provisions governing choice of law in consumer leases, unconscionability, and options to accelerate at will. (2) Formation and construction of lease contract. Warranties, both express and implied, are dealt with here. Other Provisions in Part 2 address statute of frauds, when the lessee obtains an insurable interest, risk of loss and the special status of "finance leases" in the law of warranties. (3) Effect of lease contract. Third party rights are covered here, as are priority disputes between lien creditors or secured parties and lessees, and competing claims in fixtures. (4) Performance of lease contract: repudiated, substituted and excused. One provision here (§2A-404) imposes an automatic "hell or high water" obligation on lessees to pay rent under a statutory "finance lease" that is not a consumer lease. Other sections in Part 4 cover topics such as adequate assurance of performance, anticipatory repudiation, and substituted and excused performance. (5) Default. Outlined in Part 5 are general provisions concerning default (statute of limitations, procedure in event of default), as well as the statutory (not contracted for) remedies of both the lessee and the lessor on the other party's default. (6) "Exhibit A to Article 2A-Leases" contains an amendment to old UCC §1-201(37), clarifying the definition of a true lease.

Within reasonable limits, the new statute preserves the freedom of contract of the lessor and the lessee to write specific lease agreements that vary or differ from UCC Article 2A-Leases.[1] The statute's standardized provisions on warranties and remedies, not affecting the rights of third parties, are variable by agreement between the lessor and the lessee. This is a powerful rebuttal to critics: Lessors and lessees who don't like the standardized provisions in the new statute can write their lease agreement to provide otherwise.

UCC Article 2A-Leases: Its Central Provisions

The core issues covered by UCC Article 2A-Leases include the definition of a true lease, remedies and measure of damages after default, warranties, the special status of "finance leases," "consumer lease" issues, the rejection of mandatory UCC filing (or public notice) requirements for true leases, and fixtures. These provisions, which are the subject of this article, will largely determine the success or failure of the new statute. Threats of stormy opposition to UCC Article 2A-Leases already have arisen, particularly from some vehicle lessors who are engaged in "open-end" "finance leasing" to consumers.[2] Overall, however, the new statute succeeds remarkably well in capturing the best of earlier commercial law decisions on equipment leasing. To a great extent, UCC Article 2A-Leases simply mirrors the common law on bailments for hire—that classic benchmark of reasonableness and gut equity in the law of equipment leasing.

True Leases of Goods Distinguished from Conditional Sales

One threshold issue confronting the drafters of new UCC Article 2A-Leases was how to define a true lease of goods, as opposed to a conditional sale or disguised security interest. True leases have long been distinguished from sales for many purposes in commercial law, including determining remedies on default, a lessor's rights under §365 of the Bankruptcy Code,[3] and whether a transaction is covered by state usury laws.[4] Moreover, a secured sale, unlike a lease, is subject to UCC Article 9, which sets rules of priority and generally requires the filing of a financing statement for secured interests. True leases henceforth will generally be governed by the provisions of new UCC Article 2A-Leases, while secured sales will be covered by UCC Article 9.

The commissioners on Uniform State Laws, after considering a variety of suggestions, decided to clarify the definition of a true lease with an amendment to old UCC §1-201(37) suggested by AAEL. The thrust of the AAEL proposal was to preserve common law principles and reaffirm the importance of the residual as a source of potential gain or loss in the business of equipment leasing.

The old common law principles, elaborated in the new amendment to UCC §1-201(37), provide significantly more guidance than current law as to what is the essence of a true lease. True leases are still defined by reference to and comparison with "security interests." The structure of the amended statutory definition is to first state the general rule:

> "Whether a transaction creates a lease or security interest is determined by the facts of each case."

Then, several specific factors are identified that will *destroy* true lease status and create a "security interest." Finally, other factors are listed that are consistent with true lease status.

Where the lessee cannot terminate the obligation to pay rents for the lease term, there are two basic factors, either of which will destroy true lease status: (1) where the term of the lease extends for the full economic life of the goods; or (2) where the lessee has an option to become the owner for "nominal" additional consideration. Where either factor exists, the transaction is not a true lease, because the lessor will receive no meaningful residual. The comment emphasizes that "these tests focus on economics, not the intent of the parties."[5]

Other factors are specified, in the final part of amended §1-201(37), which are consistent with true lease status. These include:

- a "full payout" lease (where the present value of the lessee's payments are substantially equal to the fair market value of the goods at the outset of the lease);
- typical "net lease" provisions where the lessee assumes the risk of loss, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs;
- the mere existence of an option to renew the lease or buy the goods; and
- options to renew or buy at a fixed price equal to or greater than reasonably predictable fair market value (as predicted at the outset of the lease).

Moreover, the amended statutory definition deletes all reference to "the parties' intent." The comment explains that most of the criteria that courts have relied upon to show intent—including "typical net lease provisions, a purported lessor's lack of storage facilities or its character as a financing party rather than a dealer in goods"—are "as relevant to true leases as to security interests." Objective criteria, not a search for subjective intention, is the order of the day.

These are significant clarifications of the law. Yet no attempt was made to answer all questions, since the variety of transactions that parties to a "lease" can produce is almost unlimited. The overall general standard is that whether a transaction is a lease, or a "security interest," will be determined on the basis of all the facts and circumstances.

Options to Renew or Buy

One linchpin in the definition of a true lease is the subject of options. Originally, the drafting committee considered tying the definition of an option in a true lease to artificial percentages and formulas for determining what constitutes "nominal consideration" for options to renew or buy. But AAEL objected to this approach. The commissioners then adopted the functional approach suggested by AAEL, tracking the earlier common law.

Where the option price in a lease is "*stated to be the fair market value of the goods*," the statute creates a safe harbor validating such options as consistent with true lease status. On the other hand, another part of the new statute repeats old UCC §1-201(37) by stating that, where the lessee cannot terminate the lease (simply walk away from it), a transaction creates a "security interest" (and not a true lease) if:

> "(d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement."

Transactions are *not* true leases where the parties anticipate, when they enter into a transaction, that the option will

be irresistible in the sense that the option price is extremely low in comparison to the value of the property.[6] As noted above, another part of the amended true lease definition validates certain *fixed-price options* as clearly consistent with "true lease" status by stating:

> "A transaction does not create a security interest merely because it provides that..."
>
> "(e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed."

This safe harbor for true leases with fixed-priced purchase options should be helpful to equipment lessors, particularly in bankruptcy and usury cases.

One criticism leveled at the new, amended UCC §1-201(37) is that it fails to validate, as clearly consistent with true lease status, agreements with fixed-price options whenever the fixed-price option

> "approximates reasonably predictable fair marked value."

But this criticism is unsound. The only purpose of substituting "approximates" for "equal to or greater than" would be to attempt to validate, as clearly consistent with true lease status, agreements with fixed-price options at *less* than predictable fair market value. This is unwarranted. When the lessor and the lessee agree at the outset to give the lessee a discount on the option price (so that the option is less than reasonably predictable fair market value), they have written a "bargain" option agreement that "tilts the scales" to encourage exercise of the option. That sort of agreement may not be a true lease.

Moreover, it makes no sense to use a vague word like "approximates" in what is supposed to be a bright-line safe harbor test for valid fixed-price options in a true lease. No business justification exists: The safe harbor validating fixed-price options "equal to or greater than reasonably predictable fair market value" covers a wide range of predicted option values.[7] This should give businessmen all the flexibility they need.

TRAC Leases

"Open-end" leases, with terminal rental adjustment clauses (TRAC), have been widely used in the motor vehicle leasing industry for over 30 years. TRAC motor vehicle leases are specifically recognized as true leases by the federal tax laws. But the case law is divided on whether TRAC leases are true leases under state law. The commissioners decided that amended UCC §1-201(37) would be silent on whether TRAC leases are true leases.

"Open-end" leases also raise the issue of whether TRAC provisions (or some variations of them) are validated by the liberal provisions of new §2A-504 on "liquidation of damages" (see part III b *infra*). Viewed as liquidated damage formulas, some narrowly-drawn TRAC provisions may be reasonable: One common lease provision, according to the comment in new §2A-504, leaves the lessor with potential profits from a residual sale, while essentially making the lessee a guarantor of the estimated residual value set out in the lease. This "one-sided" TRAC provision leaves the lessor with a meaningful interest in the residual. Other kinds of narrowly-drafted TRAC-like provisions, which charge the lessee for excessive use or poor maintenance (as opposed to changes in value due to market trends), also seem consistent with true lease status.

Outspoken critics of new UCC Article 2A-Leases include some motor vehicle lessors who fault the new statute for failing to specifically validate "open-end" TRAC leases as true leases. But the statute mirrors the common law. To this date, the weight of the case law has not recognized broadly-phrased "open-end" TRAC leases as true leases under state law. Moreover, some equipment lessors in the past have opposed according true lease status to "open-end" TRAC leases outside the specific context of motor vehicle leasing. The commissioners acted reasonably in simply preserving the status quo with respect to "open-end" leases.

Remedies

One major impetus for the new statute was dissatisfaction among equipment lessors, and their lawyers, with inconsistent and unpredictable

court decisions on the *remedies* available under a true lease. UCC Article 2A clarifies the law on lease remedies: Ordinarily, the lessor's remedies available for breach of a true lease will be those specified in the lease agreement. Yet UCC Article 2A provides a minimum safety net set of remedies (including a measure of damages for the lessee's breach), which will apply if the lease agreement is silent (or held invalid) on remedies issues.

Repossession and Disposition

Whether a default has occurred, as well as issues about repossession and other post-default rights and remedies under a true lease, are to be decided in the first instance by reference to the lease agreement. (UCC §2A-501, §2A-503). Both judicial and self-help remedies are available (§2A-501). Within wide limits, the statute allows the parties in a true lease to craft their own set of rights and remedies in the lease agreement.[8]

UCC §2A-525 specifically confirms the lessor's right to repossess the goods on the lessee's default. Advance notice of default or enforcement need not be given to the defaulting party (§2A-502). Ordinarily, the lessor is expected to mitigate damages by re-leasing or selling the repossessed goods. But where it proves impractical for the lessor to dispose of the goods at a reasonable price after repossession, he may hold the goods and recover accelerated rentals as damages (§2A-529(1)(b)).

Two types of provisions exist, in UCC Article 2A, on the lessor's damage remedies for the lessee's default: those that apply to contractual liquidated damage clauses; and those provisions that apply where the lease contract is silent (or invalid) on damages.

Contractually specified damages. UCC §2A-504(1) validates liquidated damages clauses that comply with this basic "reasonableness" test:

> "Damages payable by either party for default, or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default or other act or omission."

This validates formulas as well as amounts, and drops some of the limitations on liquidated damage clauses that appeared in the old law of sales.

The comments provide little specific guidance on how the "reasonableness" standard in new UCC §2A-504 should be applied. The courts are left to wrestle with several recurring questions, as best they can, under the general standard of "reasonableness."

Residual risks on lessees. One question concerns the validity of default remedies that essentially push the whole residual risk onto the lessee. This issue may arise particularly for sweeping liquidated damages clauses in short-term consumer leases: especially where the lease runs for only a short time in relation to the expected useful life of the goods, it may not be "reasonable" (§2A-504) to stick the lessee with the risk that the market value of the lessor's residual may drop.

Cumulative remedies. There are some old cases holding that "cumulative remedy" provisions, in and of themselves, may render a liquidated damages clause invalid. But such provisions should pass muster under the new leasing statute so long as the total cumulative remedy sought is simply one satisfaction (not a double recovery) and is "reasonable in light of the then anticipated harm caused by the default or other act or omission" (§2A-504).

Accelerated rentals. Ordinarily, a liquidated damages clause with provision for accelerated rentals is enforceable by the lessor, if coupled with a contractual provision requiring the lessor to mitigate damages by sale or re-lease after repossession.[9] Without strong proof of reasonableness, however, a liquidated damage clause providing for acceleration of future rentals (without mitigation) is likely to be struck down. Moreover, at least in contested cases, the courts are likely to continue past precedent by holding, under the "reasonableness" test in new §2A-504, that the lessor's recovery for future lost rentals must be discounted to present value.[10] UCC §2A-109 specifies that the lessor can invoke an acceleration clause only when he "in good faith believes that the prospect of payment or performance is impaired."[11]

Election of remedies. Where a liquidated damages clause is otherwise valid, the "reasonableness" test in UCC §2A-504 should overrule earlier cases that required a lessor under a true lease to elect between repossessing the equipment, on the one hand, or suing for the accelerated rent and leaving the equipment in place, on the other. These old cases improperly extended the rule against double recovery. But the lessor's repossession and simultaneous recovery of accelerated rents does *not* necessarily result in double recovery or unjust enrichment. No double recovery results, for example, where a defaulting lessee is credited with proceeds from the sale or re-lease of equipment after repossession.[12]

Partial invalidity. Will the invalidity of *part* of a liquidated damage clause invalidate the whole clause, throwing the lessor back onto the statutory (non-contract) remedies in UCC Article 2A? Section 2A-504(2) states:

> "If the lease agreement provides for liquidation of damages, and such provision does not comply with [the "reasonableness" test in] subsection (1), or such provision is an exclusive or limited remedy that circumstances cause to fail of its essential purpose, remedy may be had as provided in this Article."

Equipment lease liquidated damages clauses often set out alternative damage measures, so that no single alternative is "an exclusive or limited remedy" (§2A-504(2)). For such multipart liquidated damages clauses, partial invalidity may not always be fatal to the whole clause, if the invalid part is written to be reasonably segregable from the rest. This result would be consistent with the new statutory section on "unconscionability" (§2A-108): It states where a court finds a clause unconscionable, it has discretion under §2A-108 to refuse to enforce the whole contract or it may simply "blue pencil" out the offending clause and enforce the remainder of the lease contract.

(b) *Where the lease agreement is silent (or held invalid) on damages remedies*

The only time UCC Article 2A will control measure of damages

remedies is when the lease agreement is silent (or held invalid) on damages remedies. Two basic statutory (not contracted for) measure of damages standards are spelled out for the lessor. These apply in different situations: (1) where the lessor repossesses and then sells or re-leases the goods (§2A-527(2), §2A-528)); and (2) where the lessor repossesses and holds the goods for the lessee for the remainder of the lease term (§2A-529).

1. Where the lessor repossesses and then sells or re-leases the goods, after the lessee's default, the lessor's satutory (non-contract) damages consist of the sum of (1) past unpaid rentals, plus (2) reasonable lost future rentals (measured by the present value of the difference between total scheduled future rentals and the "market rent" for future use of the goods)[13], plus (3) incidental damages less "expenses saved in consequence of the lessee's default." UCC §2A-507, 52A-528. The concept of "market rent," defined in new 52A-507, is essentially fair market rent as determined "at the time of the default."

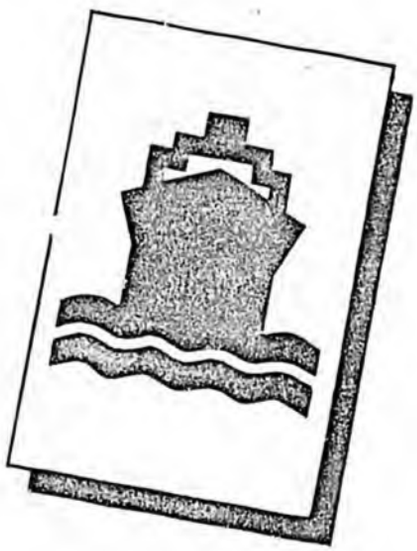
One objection to the "rent-to-rent" comparison in this standard is that it makes it difficult to prove damages where the lessor repossesses and then sells the goods. The statutory "rent-to-rent" comparison has been employed in California statutes to measure damages under a lease of goods.[14] Yet the "rent-to-rent" comparison clearly takes a different approach to damages than "finance lease" liquidated damage clauses that define the lessor's measure of damages as the sum of (1) past unpaid rentals, plus (2) the present value of accelerated future rentals, plus (3) the lessor's estimated residual value, minus (4) the net proceeds from a commercially reasonable sale of the goods on the lessor's default, up to the point where such proceeds equal the sum of (2) plus (3). This sort of contract clause puts the risk on the *lessee* (not the lessor) that the value of the goods will drop after one enters into the lease.

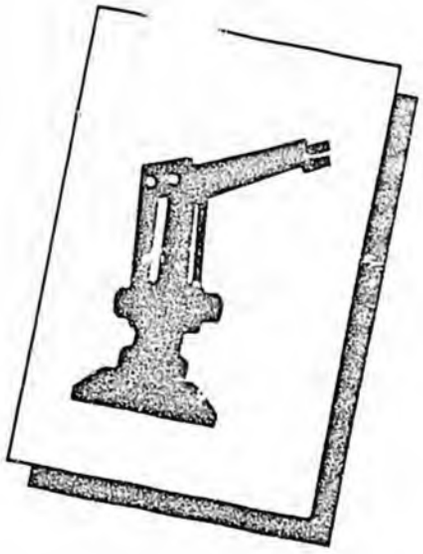
True lessors own the residual and, on the lessee's default, the lessor's remedies should include recovery of the residual or its value. UCC Article 2A's statutory (noncontract) damages scheme clearly allows this recovery. And new §2A-527(5) makes it clear that the "lessor is not accountable to the lessee for any profit made on any disposition." But the new statute puts the burden on the lessor to recover the value of the residual through sale or re-lease. And it puts the risk on the *lessor* (not the lessee) that the value of the residual might drop after entering into the lease.

The commissioners decided that this is exactly where the risk belongs for statutory (noncontract) measure of damages. Where goods are leased for only a short time in relation to their useful life, it seems unfair (as not in accord with the common expectancies of the parties, in the absence of any agreement on the point) to stick the *lessee* with the risk that the value of the goods will drop after the lease is transacted. The only situations where it might be fair to saddle the lessee with that risk—*by statutory fiat in the absence of any contractual agreement on the point*—are those involving "long-term" true leases.[15] This category might be difficult to define in a statute. Moreover, the statutory (non-contract) measure of damages in UCC Article 2A applies only where the contract is silent or is struck down (as unconscionable or otherwise unenforceable) on measure of damages. The commissioners decided that there was no warrant to *guarantee* "long-term" true lessors a "home run" measure of damages in the statute, when all lessors could readily protect themselves by writing appropriate liquidated damages clauses in their lease agreements.

UCC §2A-528(2) provides an important alternative measure of damages—lost profits "including reasonable overhead" plus incidental damages—for lessors who repossess and then sell or re-lease the goods, but who (under the statutory rent-to-rent measure of damages) would not wind up "in as good a position as performance would have" put them. Though this measure of damages is phrased as an alternative, it may frequently be available to the merchant lessor.

2. Where the lessor repossesses, and it proves impractical to dispose of the goods at a reasonable price, he has the option of holding the goods for the





lessee for the remainder of the lease term, and recovering damages equal to the sum of (1) past rents due, plus (2) the present value of accelerated future rentals, plus (3) incidental damages "less expenses saved in consequence of the lessee's default." UCC §2A-529(1)(b).[16] This statutory (noncontract) measure of damages may be particularly important for "merchant lessors" who have more equipment in inventory than customers.

Over several years, commentators have debated whether such "merchant lessors" should be under a duty to mitigate damages by selling or re-leasing the goods after the lessee's default and repossession by the lessor. UCC §2A-529(1)(b) accords the merchant lessor (or any other lessor) the full present value of accelerated rentals, without offset, where it is impractical for the lessor to dispose of repossessed goods at a reasonable price. Yet the statute tracks earlier law by requiring the lessor to mitigate damages, where practical, before recovery will be allowed for accelerated rentals.

The same statutory (noncontract) recovery for accelerated rentals (without offset) is also generally available to statutory "finance lessors," without special efforts at mitigation of damages, for goods accepted by the lessee. §2A-529(1)(a). This seems appropriate. Typically the finance lessee selects the goods, which often are uniquely suited for the finance lessee's business (and no other).

Warranties

The old common law, as well as UCC §2-314 and 2-315, recognized two implied warranties—merchantability and fitness for a particular purpose—for transactions involving goods. These implied warranties impose strict liability, without regard to negligence or fault. The weight of authority is that these implied warranties apply to merchant lessors, under true leases as well as sales. Well-drafted lease agreements, as a consequence, have long been based on the assumption that these warranties would apply at least to merchant lessors (who dealt in goods), if not to "finance lessors" (who advanced money but had no special knowledge of the goods).

One salutary effect of new UCC Article 2A is to clarify and standardize the law of warranties for true leases. There are special statutory provisions dealing with warranties in the case of statutory "finance leases"—where the lessor does not select, manufacture or supply the goods out of inventory (see part III D *infra*). Otherwise, the new statute tracks the old sales article concerning the creation of express warranties (§2A-210), implied warranties of fitness, title and merchantability (§2A-211 through §2A-213), and accumulation of warranties (§2A-215).

The old sales article's requirements for conspicuous disclaimers of warranties are also repeated in the new leasing statute (§2A-214). Waiver of defense clauses—whereby the lessee agrees not to assert certain types of claims or defenses against the lessor's assignee—are approved by the new leasing statute to the same extent as allowed by old UCC Article 9.

With respect to breach of warranty issues, there are again special provisions for statutory "finance leases" (discussed in part III D *infra*). Otherwise, UCC Article 2A essentially tracks the old sales article. This is true, for example, for the lessee's remedies and damages (§2A-508, 2A-518, 2A-519, 2A-520), and the lessee's rights to reject the leased goods (§2A-509 and 2A-517).

UCC Article 2A's provisions do not spell out the relationship between Article 2A and the case law on strict liability in tort.[17] This reflects the commissioners' recognition that products liability is a rapidly developing field, as well as the view that Article 2A is basically a statement of "contract" (rather than "tort") principles. The whole area of products liability of merchant lessors will be left for the courts to develop.

Treatment of Finance Leases

Traditionally, a finance lessor has been thought of as a passive lessor, whose transactions remain functionally the equivalent of an extension of credit. It is typically the lessee (not the lessor) who selects the goods in a "finance lease," without relying upon the lessor. Moreover, a finance lessor often has neither the opportunity nor

the expertise to inspect the goods to discover any defects in them. Recognizing these special circumstances, the cases and authorities consistently held that finance lessors did not owe implied warranties of fitness and merchantability with respect to the leased goods.

The impact of new UCC Article 2A on "finance leases" is limited. Where a lessor qualifies under UCC Article 2A as a *statutory* finance lessor, the new statute basically provides him with automatic exemptions by statute from implied warranties of fitness and merchantability. But a lessor always can write a lease contract to exclude warranties, making himself a finance lessor *by contract*. Where a lessor writes the lease contract to exclude such warranties, and in addition qualifies as a new UCC Article 2A *statutory* finance lessor, he will have two independent grounds (or double protection) for exempting himself from such warranties. These new statutory provisions, of course, only apply to "finance leases" that are true leases.

Definition of Statutory "Finance Lease."

To create a *statutory* "finance lease," the lessor essentially must have no function in picking the goods for the lessee's use. The statutory definition in new UCC §2A-103(1)(g) is:

> "Finance lease" means a lease in which (i) the lessor does not select, manufacture or supply the goods, (ii) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease, and (iii) either the lessee receives a copy of the contract evidencing the lessor's purchase of the goods on or before signing the lease contract, or the lessee's approval of the contract evidencing the lessor's purchase of the goods is a condition to effectiveness of the lease contract."

There is no limitation that a statutory finance lessor can supply only money, or that he must not perform maintenance.[18] To ensure the lessee's reliance on the supplier, nor the lessor, the lessor must acquire the goods "in connection with the lease." The scope of this phrase, "in connection with," is to be determined by the courts on a case-by-case basis.

One controversial part of UCC Article 2A is the third requirement in the definition of a statutory "finance lease:" the lessee must receive a copy of (or approve) the lessor's purchase contract with the manufacturer or supplier. No earlier authorities contained this requirement. But its purpose is to ensure that the lessee receives specific notice of the supplier's warranties covering the goods. This seems only fair before cutting off the lessee's warranty rights against the lessor and subjecting the lessee to automatic statutory "hell or high water" clause liability under a statutory "finance lease" (§2A-407). The commissioners decided that—particularly in light of a lessor's ability to make himself a "finance lessor" *by contract*—the new statute should be conservative in giving lessors an automatic exemption *by statute* from warranties.

The comments to §2A-103(1)(g) state that the leasebacks in many sales-and-leaseback transactions will qualify as statutory finance leases. Moreover, lessors who are merchants may qualify as statutory finance lessors. The comment to §2A-103(1)(g) also says that "where the lessor is an affiliate of the supplier no special rule applies; whether the transaction qualifies as a finance lease will be determined by the facts of each case." Excluded from *statutory* finance lessor status are manufacturers and individuals who are regular dealers in the leased asset. Also excluded is the lessor who obtains the asset out of inventory, since he did not acquire the asset for a particular lease transaction. Yet an independent automobile dealer/lessor, who obtains a car for a particular lessee, for example, may be able to qualify as a *statutory* finance lessor under new UCC §2A-103(g).

Statutory "Finance Leases:" Special Provisions.

UCC Article 2A makes it clear that a statutory finance lessor does not assume any implied warranties with respect to the lease. He is held only to express warranties (§2A-210) and the warranty of title (§2A-211(1)). Moreover, under a statutory finance lease that is not a consumer lease, the lessee's promises (especially to pay rent) are made irrevocable and independent (§2A-407, §2A-508(6)).

Only *commercial* finance leases (not consumer leases) qualify for the statutory imposition of automatic "hell or high water" obligations on the lessee under new UCC §2A-407. The comments to §2A-407 leave open the possibility that the parties to a "consumer lease" might *agree* to a hell-or-high-water clause in the lease agreement. But the comments also make it clear that other "consumer protection" statutes and evolving case law on consumer rights put severe restraints on the enforceability of such clauses in consumer leases.

The statutory finance lessee is the automatic beneficiary of all warranties under the supply contract (§2A-209(1)). But such a lessee generally cannot revoke acceptance of the goods (§2A-516, §2A-517(1)). To have any rights against the lessor, the finance lessee would have to reject goods immediately. Other special rules dealing with statutory "finance leases" include the provision (§2A-219) that risk of loss passes to the lessee (not the lessor).

These special provisions in the new statute, for statutory "finance leases," mirror the provisions commonly found in most finance lease contracts.

Two separate and independent kinds of "finance leases" will exist in the wake of UCC Article 2A: contractual "finance leases" and statutory "finance leases." One effect of this new regime is to short-circuit the courts' development of a common law definition of "finance lease" in the law of warranties. Where the written lease agreement does not cover warranties, a transaction must fall within the narrow Article 2A definition of a statutory "finance lease" to exempt the lessor from warranty liability. But this seems of minimal practical significance: The nearly universal practice of finance lessors is to "contract out" of warranties in their lease agreements.

Overall, the "finance lease" provisions in new Article 2A will provide certainty, and some additional protections, for lessors able to qualify as statutory finance lessors. Other lessors can protect themselves as finance lessors by contract.

"Consumer Lease" Issues

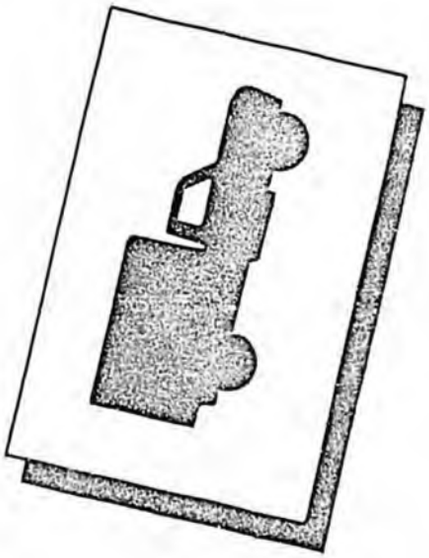
UCC Article 2A-Leases in general does not deal with consumer protec-

tion. This is left to other laws. But the new statute does contain some protections for lessees in "consumer leases," which are defined in new UCC §2A-103(1)(e):

> "Consumer lease" means a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee, except an organization, who takes under the lease primarily for a personal, family, or household purpose, if the total payments to be made under the lease contract, excluding payments for options to renew or buy, do not exceed $25,000.

Whereas the federal Consumer Leasing Act of 1976 defines "consumer lease" in terms of leases "for a period of time exceeding four months" (15 U.S.C. §1667)1)), new UCC Article 2A covers even shorter-term "consumer leases." A lease primarily for an agricultural purpose falls outside the "consumer lease" protections of UCC Article 2A.

The major "consumer lease" provisions in the new statute include new UCC §2A-106 (limiting abusive choice-of-law and choice-of-forum clauses in consumer leases); new UCC §2A-108 (2), (4) (where court finds consumer lease contract or claim collection activity under consumer lease to be "unconscionable," it may grant appropriate relief including attorneys' fees); new UCC §2A-109 (burden on lessor to justify acceleration of rentals in a consumer lease). The commissioners and the drafting committee rejected proposals for including other, more sweeping "consumer protection" provisions.



UCC Filings (or Notice) Not Required for Leased Personal Property

Yet another major issue was whether to establish a mandatory system requiring the filing of UCC financing statements for personal property covered by a true lease. UCC Article 2A was made subject to state certificate of title statutes, with the result that goods covered by those statutes generally must comply only with the filing (or notice) requirements in those statutes. The more general question remained whether there should be a general filing (or notice) requirement for leased goods, with a list of exceptions covering short-term leases and other "special cases" where filing was impractical.

Traditionally, equipment lessors have *not* been required to file UCC financing statements, or to give other public notice of their interests in the goods under a true lease.[19] The drafting committee heard conflicting views on whether current law on filing and notice should be changed. But the majority of businessmen and practicing lawyers in the field of equipment leasing seemed to favor the status quo. Technical faults in filing (misdescription of goods or failing to file in all the right places, for example) should not be controlling on a lessor's rights to multimillion dollar equipment, AAEL argued. To be sure, mandatory UCC filings might cut down on litigation concerning the "true lease" status of questioned transactions. But such litigation would not disappear: Even where a true lease was covered by mandatory UCC filings, the true lease/security interest determination would still have to be made by the courts in a variety of contexts (*e.g.*, bankruptcy law, remedies, usury law). Moreover, additional filings of UCC financing statements might overwhelm an already over-burdened UCC filing system. When the issue of mandatory UCC filings for leased goods was discussed within the American Bar Association, the majority of lawyers polled was opposed to the concept.

Taking these factors into account, the commissioners concluded that existing law on UCC filings (or notice) was working reasonably well. There was no compelling reason to overthrow it. UCC Article 2A therefore generally rejects the concept of mandatory UCC filings (or other required notice) for personal property covered by a true lease. The only exception concerns "fixture filings" (discussed below).

"Vendor in possession" doctrine for sales-and-leasebacks abolished. The new statute also *abolishes* the so-called "vendor in possession doctrine" which has long created state law difficulties for sales-and-leasebacks of equipment. This will be welcome news to lessors. The old "vendor in possession" doctrine (making retention of possession by the vendor fraudulent *per se* or *prima facie* fraudulent) is an ancient anachronism

that has been recognized in one form or another in many states.[20] New UCC §2A-308(3) abolishes it for transactions in which the buyer "bought for value and in good faith."[21] The statute also expressly provides in §2A-302 that separation of ownership and possession *per se* does not affect the enforceability of a lease contract. The old, unlamented "vendor in possession" doctrine for leases is no more.

Optional UCC filings permitted. Optional filing of UCC financing statements is still permitted under new Article 2A, as under current law, for any true (or doubtful) lease. Incentives remain for lessors to file UCC financing statements: Though new amended UCC §1-201(37) clarifies the definition of a true lease, it does not eliminate all ambiguities. UCC filings for leases provide protection to the person filing if it is later determined that the "lease" was a secured sale. Moreover, the filing of a UCC financing statement may not be considered as a factor in determining whether or not the transaction is a true lease or a secured sale (see UCC §9-408 (1977)).

Fixtures: Modest Reform

Over the years the subject of "fixtures" has triggered many battles between real estate interests and equipment lessors. New UCC Article 2A attempts to resolve some of the recurring problems in this area by imposing new UCC filing requirements for leased fixtures.

Two basic sets of priority rules are set forth in the new statute to determine the priority of competing interests in fixtures: one for unfiled lessors, the other for lessors who have made a "fixture filing." Traditional common law protections for unfiled lessors of fixtures are generally preserved in §2A-309(5).[22] Unfiled lessors obtain the benefit of a very modest reform expanding the category of "readily removable" goods.[23] The statute gives more rights, however, to the fixture lessor who makes a "fixture filing" in the office where a mortgage on the real estate would be recorded. Without such a "fixture filing," the lessor may lose out to real estate interests, since under new UCC §2A-309(7) the priority of the lessor's interest will be determined by real estate priority rules.

This imposes, in effect, a new "fixture filing" requirement for lessors of fixtures. But double filings in both personal property and real estate records have long been industry practice. The statute's new requirement for a "fixture filing" in real estate records implements the views of thoughtful commentators.[24] And new §2A-309(8) makes it clear that, where a lessor of fixtures has priority over conflicting real estate interests, the lessor (or the lessee) may *remove* the goods on the lessee's default (as well as in other circumstances), as long as he pays "the cost of repair of any physical injury."[25]

The commissioners may well revisit the subject of "fixtures" again in the future. Though the search continues for the most reasonable balance between competing real estate interests and lessors of fixtures, new UCC Article 2A provides some helpful clarification in this overly-technical area of the law.

Conclusion

The impact of new UCC Article 2A-Leases will underline the importance of careful drafting for leases of motor vehicles and equipment. The statute clarifies the differences between a true lease and a "security interest." Moreover, it provides some helpful clarification and uniformity in the law of warranties and lessors' remedies.

Threatened stormy opposition to the new UCC Article 2A seems overstated and unwarranted. Bernard J. McKenna, chairman of AAEL, went to the heart of the matter: "The new statute rejects a simplistic approach which might have blurred the distinction between a true lease and a financing. The short of the matter is that if you can't write a good solid lease agreement, you're in trouble. That's always been true and it always will be true, with or without the new UCC provisions on leasing."

Footnotes:

[1] Other statutes and case law (particularly in the area of "consumer protection") may limit the unbridled "contractual freedom" of the parties, of course. Yet the main limitations on "contractual freedom" in UCC Article 2A-Leases itself is the injunction against unconscionable lease clauses (2A-108). Other well established limits on "contractual freedom"—such as the requirement that contractual waivers of implied warranties be "conspicuous"—are picked up in the new statute (§2A-214). There are also scattered provisions according protections to lessees in "consumer leases," such as §2A-106 (limiting abusive choice-of-law and choice-of-forum clauses in consumer leases) and §2A-109 (placing burden on the lessor to justify acceleration of rentals in a consumer lease). Moreover, the new statute incorporates the general UCC rules that the obligations of good faith, diligence, reasonableness and care are not disclaimable by agreement.

[2] "THREAT OF NEW UNIFORM PERSONAL PROPERTY LEASING ACT" trumpeted the front-page headline of CAR RENTAL/LEASING INSIDER, Weekly Newsletter (June 9, 1986). "Open-end" vehicle lessors have criticized the new statute's failure to validate "open-end" leases of vehicles as true leases, as well as the provisions in UCC Article 2A-Leases covering "finance leases" and warranties and remedies in leases to consumers. *See* CAR RENTAL/LEASING INSIDER, Weekly Newsletter (June 16, 1986); AUTOMOTIVE FLEET MAGAZINE p. 130 (August 1986). These issues are discussed in parts III A, C, D and E *infra*.

[3] True lessors under §365 of the Bankruptcy Code generally have a better chance than secured lenders of obtaining current payments, as well as repossessing the goods, when the lessee/debtor is in bankruptcy. Under §365 of the Bankruptcy Code, the lessee (or bankruptcy trustee) must assume a true lease or reject it in its entirety, and if assumed, must give "adequate assurances" that prior defaults will be cured and that performance (payment of rentals) will take place in the future. The secured creditor, on the other hand, is covered by §361-§363 (not §365) of the Bankruptcy Code: The buyer-debtor in bankruptcy has the right to continue to use any of the collateral property, with or without the consent of the seller-lender, so long as the secured lender is given "adequate protection" that the *value* of the property will be preserved. Cf. *In re American Mariner Industries*, 734 F.2d 426 (9th Cir. 1984.)

[4] True leases (as opposed to disguised loans or "forebearances" of money) may be exempt from state usury laws.

[5] Throughout this article, references to the comments denote the Official Comments to new UCC Article 2A-Leases in ALI Council Draft No. 1 (December 1, 1986), now being revised.

[8] One theme that runs through the cases and authorities is that the owner/lessor in a true lease must have, at the outset, some legitimate possibility for return or other disposition of the leased property before the end of the economic life of the property. *See, e.g., In re Marhoefer Packing Co.*, 674 F.2d 1139, 1143, 1145 (7th Cir. 1982). With respect to options to renew or buy, under state law, the essence of a true lease may be that the *original agreement* should leave the lessor with a significant economic stake in the residual and should not "tilt the scales" to require or encourage the lessee to exercise the option for the remaining economic life of the property. Cf. *id.* at 1144-1145; Mooney, *True Lease or Lease "Intended as Security"*, in Coogan, Hogan, Vagts & McDonnell, *Secured Transactions Under the UCC* (Matthew Bender 1986).

[9] This is because the economic uncertainties of life (such as changes in the rate of inflation, and technological obsolescence) are such that a wide range of values should qualify as "reasonably predictable" option prices in any given transaction.

[10] One important issue for counsel drafting a lease agreement is raised by new §2A-508(5), which authorizes the lessee to sell the goods, if the lease agreement says nothing to the contrary, where the lessee rightfully rejects the goods, or justifiably revokes acceptance.

[11] DeKoven, *Proceedings After Default By the Lessee Under a True Lease of Equipment* in 1C Coogan, Hogan, Vagts & McDonnell, *Secured Transactions Under the UCC*, §29B.06[5](b) (Matthew Bender 1986).

[12] *See, e.g., Heller Financial v. Burry*, 633 F.Supp. 706 (N.D.Ill. 1986) [court reduces accelerated future rentals to present value]; *In re Winston Mills, Inc.*, 6 B.R. 587 (Bkrpt S.D.N.Y. 1980) [same].

[13] With respect to a consumer lease, the burden of establishing good faith is on the party invoking the acceleration clause; otherwise the burden of establishing lack of good faith is on the lessee. UCC §2A-109(2).

[14] DeKoven, *Leases of Equipment: Puritan Leasing Co. v. August, A Dangerous Decision*, 12 U.San Fran.L.Rev.257,277-278 (1978).

[15] Where the goods are re-leased "by lease contract substantially similar to the original lease contract and the lease contract is made in good faith and in a commercially reasonable manner," then the lessor's *lost future rentals* (apart from other damages) are measured by the present value of the the difference between the "total rent for the remaining lease term of the original lease" and the "total rent for the lease term of the new lease contract." UCC §2A-527(2).

[16] California Civil Code §3308 permits liquidated damage clauses in a lease providing that, after the lessee defaults and the lease has been terminated, the lessor may recover the present value of accelerated future rentals minus the "reasonable rental value" of the goods for the remainder of the lease term. Where this measure of damages is selected, it is exclusive.

[17] Of course, if the original term of the lease runs for essentially the entire remaining economic life of the goods, and the lessee is obligated throughout the term so that he cannot simply "walk away" from the lease, then the transaction is not a true lease at all but a security interest covered by UCC Article 9.

[18] This statutory measure of damages applies "for goods identified to the lease contract if the lessor is unable after reasonable effort to dispose of them at a reasonable price or the circumstances reasonably indicate that effort will be unavailing." UCC 2A-529 (1) (b). This statutory remedy is optional. At any time before the collection of the judgment for this statutory remedy (accelerated rents), the lessor may choose to dispose of the goods by sale or re-lease, in which case his remedies are limited by the "rent-to-rent" test discussed above. 2A-529 (3). If the lessee pays the judgment for accelerated rents, then the lessee is entitled to "use and possession of the goods not then disposed of for the remaining lease term of the lease agreement." 2A-529 (4).

[19] One commentator on products liability has explained that the true lease/sale distinction "has no bearing on product liability. Instead, the criterion of superior knowledge of a merchant is the prerequisite to nonconsenual product liability. A merchant-lessor, as one who deals in goods and thus has superior knowledge, should be a target defendant. In contrast, a finance-lessor should remain immune from product liability as one who, in the ordinary course of business, makes advances against goods but is not a merchant." Carlin, *Product Liability for the Equipment Lessor? Merchant-Lessor versus Finance-Lessor* printed in ch 8 of *Equipment Leasing-Leveraged Leasing* (2d ed. Fritch & Reisman 1980) p. 848.

[20] Where the lessor does perform maintenance, or other functions other than the supply of money, the comment to §2A-103 (1) (g) states that "express warranties, covenants and the common law will protect the lessee." This leaves open the possibility that a statutory finance lessor who performs maintenance, under a so-called "operating lease," may be held liable for negligently failing to discover defects during maintenance.

[21] *See, e.g., In re Marhoefer Packing Co.*, 674 F.2d 1139 (7th Cir. 1982); *In re Leasing Consultants, Inc.*, 486 F.2d 367 (2d Cir. 1973); *Allen v. Cohen*, 310 F. 2d 312 (2d Cir. 1962).

[22] *See* Coogan, *Leasing and the Uniform Commericial Code* in *Equipment Leasing-Leveragea Leasing* pp. 827-846 (2d ed. Fritch & Reisman 1980).

[23] The statute states in pertinent part: §2A-308. SPECIAL RIGHTS OF CREDITORS * * * (3) A creditor of a seller may treat a sale or an indentification of goods to a contract for sale as void if as against the creditor retention of possession by the seller is fraudulent under any statute or rule of law, *but retention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith.* [Emphasis added]. The Comment to §2A-308 confirms: "Notwithstanding any statute or rule of law that would treat such retention as fraud, whether *per se, prima facie*, or otherwise, the retention is not fraudulent if the buyer bought for value and in good faith. This provision overrides Section 2-402 (2) to the extent it would otherwise apply to a sale-leaseback transaction."

[24] Thus, for example, new UCC §2A-309 (5)(d) reflects the earlier UCC Article 9 and common law provisions allowing removal of trade fixtures. *See* UCC §9-313 (5)(b); *Lemmons v. United States*, 496 F.2d 864, 869-872 (Ct.Cl. 1974); *see also* 3 Witkin, Summary of California Law, *Personal Property* §§60-66, *Real Property* §469-470.

[25] New UCC §2A-309 (5)(a) gives an *unfiled* lessor of fixtures priority over competing real estate interests if "the fixtures are readily removable factory or office machines, *readily removable equipment that is not primarily used or leased for use in the operation of the real estate*, or readily removable replacements of domestic appliances that are goods subject to a consumer lease, and before the goods become fixtures the lease contract is enforceable" [new provisions in italics]. The Comment to §2A-309 indicates that, aside from leased equipment that is "integral to the operation of real estate e.g., heating and air conditioning equipment" other "readily removable equipment" constituting fixtures can be repossessed by an unfiled lessor. Owners and encumbrancers of real estate, on the other hand, will be able to rely on the continuing availability of fixtures that are essential to the operation of the land and building itself.

[26] *See* Leary, *The Procrustean Bed of Finance Leasing*, 56 N.Y.U.L. Rev. 1061, 1089-1093 (1981); Gilmore, *Security Interests in Personal Property* §30.5 (1965).

[27] The specific language of new §2A-309(8) gives the lessor or the lessee the right to remove the goods from the real estate, on the other party's default (as well as in other circumstances), but requires that he or she "must reimburse any encumbrancer or owner of the real estate who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation."

UNIFORM COMMERCIAL CODE, ARTICLE 2A - LEASES

The Uniform Commercial Code (UCC) Article 2A - Leases, governs true leases of goods. In a true lease, the lessor gives possession and right to use the goods to the lessee for a fixed period of time in return for rent. The title to the property and a meaningful residual interest remain with the lessor.

A "finance lease" is a true lease in which the lessor is not the fundamental supplier of the goods leased, but leases goods tc lessees as a means of financing their acquisition. UCC - 2A governs "finance leases" as well as other true leases, but "finance leases" are treated differently from other true leases in certain respects. The principal differences in treatment will be discussed in subsequent paragraphs of this summary.

UCC - 2A is largely derived from the sales article of the UCC - Article 2. It provides basic contract rules, including matters of offer and acceptance, statutes of frauds, warranties, assignment of interests, and remedies upon breach of contract. There are five parts to the UCC - 2A: (1) General Provisions, (2) Formation and Construction of a Lease Contract, (3) Effect of a Lease Contract, (4) Performance of a Lease Contract, and (5) Default.

GENERAL PROVISIONS

The General Provisions include the large, general definitions section and general rules pertaining to the construction of leasing contracts, including conflict of law provisions, choice of forum rules, and interpretation of remedies. Most of these provisions are drawn from Article 2 of the UCC.

UCC - 2A creates an entity called the "lessee in the ordinary course of business." The definition parallels the "buyer in the ordinary course of business" in the UCC. Both take property free of prior encumbrances, under the appropriate conditions, and are essential to commercial enterprise.

UCC - 2A also defines "supplier" as "a person from whom a lessor buys or leases goods to be leased under a finance lease." This definition is important because goods in a "finance lease" must come from another source than a lessor.

FORMATION AND CONSTRUCTION OF A LEASE CONTRACT

In a sale transaction, the UCC provides warranties of title and against infringement by any claims of another person. There are similar warranties in UCC - 2A, although title is not

protected, since title remains in the lessor. But the lessor does warrant the lessee's enjoyment of the leasehold interest against "a claim to or interest in the goods that arose from an act or omission of the lessor. " This warranty applies to all lease contracts. Infringement, however, is not warranted against in finance leases, and this warranty only binds a merchant-lessor, who deals regularly in goods of the kind.

Implied warranties are of two kinds, merchantability and fitness for a particular purpose. Both kinds of implied warranty are directly derived from the Article 2 of the UCC. The warranty of merchantability operates between merchants, and assures the resalability of goods. The fitness warranty presumes a purpose and reliance upon the lessor to supply goods fit for the purpose. Both kinds of implied warranties can be excluded or modified by agreement.

Implied warranties of quality (and against infringement) by lessors do not similarly apply to finance leases. UCC - 2A instead passes any implied warranties of the supplier-seller to the lessor-buyer under Article 2, to the lessee under a finance lease. The finance lessor does not directly make such warranties.

EFFECT OF A LEASE CONTRACT

Generally, a lessee's rights under a lease contract or the residual rights of a lessor are freely transferable, unless the contract prohibits the transfer or unless transfer risks the other party's contract rights. An assignment, so-called, of lease rights is treated as any transfer is, and is presumed to transfer both rights and obligation, unless otherwise specified in the agreement.

If a subsequent lease is entered when there is an existing lease, the subsequent lease is subject to the prior lease. However, a subsequent "lessee in the ordinary course of business," who deals with a lessor who is a merchant dealing in goods of the kind leased and to whom the goods are entrusted under the prior lease, will take goods free of the prior, existing lease contract.

Another third party issue dealt with in Part 3 of UCC - 2A is lien priorities. Here, UCC - 2A becomes analogous to provisions in UCC, Article 9. A statutory materialmen's lien has priority over any interest in a lease contract, unless other law sets a different priority. Otherwise, lessee's creditors take subject to the lease contract. Lessor's creditors with prior interests to those arising under a lease contract, generally, take priority over interests arising under the contract.

However, a "lessee in the ordinary course of business" takes free of any prior perfected security interests, unless the lessee

has specific knowledge of their existence. A prior interest of a lessee takes priority over a subsequent interest of a lessor's creditor. But there are special instances in which a creditor of a lessor has priority over a lessee's interest, even though the lease interest is prior in time. Included are instances in which depriving the creditor of possession of the collateral would be fraudulent to the creditor "under any statute or rule of law."

Goods that become fixtures present priority problems when leased. Fixtures are defined as goods "so related to particular real estate that an interest in them arises under real estate law." Who has priority between the lessor and those holding the real estate interests?

Generally, if goods are leased and become fixtures, the lessor with prior interest in them has priority over those with the real estate interests - if the lessor perfects his or her prior interest with a fixture filing under Article 9 of the UCC. A fixture filing is made by placing an appropriate financing statement in the real estate records. There are instances in which a lessor can retain an interest against the real estate holder without filing, but a fixture filing will generally be essential.

"Accessions" also present a special problem. An "accession" occurs when leased goods "are installed in or affixed to other goods." Any existing rights in a lease contract are superior to any rights in the whole in which leased goods become accession after the lease contract is entered. If the lease contract arises at the time goods become accessions or after, earlier interests in the whole have priority, If someone purchases the whole after a lease contract, rights under the lease contract take priority over the purchaser's rights. However, a "buyer in the ordinary course of business," or a prior creditor who makes advances without knowledge of the lease contract, takes priority over a lessor or lessee, even though the lease contract precedes the purchase or advance in time.

PERFORMANCE OF A LEASE CONTRACT

Part 4 of UCC - 2A deals with performance and repudiation of a contract, with substituted performance and with excused performance. If performance is to be impaired, however, UCC - 2A gives contracting parties the latitude to minimize losses.

For example, a party to a lease contract who has reasonable grounds for insecurity as to the performance of the other party, may demand written assurance of performance. Until written assurance is provided, the demanding party may suspend his or her performance. If assurance is not given in a reasonable time, the contract may be treated as repudiated.

When performance is impaired without the fault of either

party, because of such events as failure of an agreed means of transport, a commercially reasonable substitute must be accepted. There are instances in which performance may be excused: "If performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was basic assumption on which the lease contract was made." The lessor must notify the lessee (and the supplier if there is a finance lease) of delay or non-delivery. These are examples of the options open to contracting parties.

DEFAULT

Upon default, UCC - 2A provides remedies in Part 5, including damages and equitable remedies, such as specific performance. UCC - 2A permits cover. That is, a party may seek goods from another source to limit losses. Mitigation of damages is encouraged. The general measure of any damage is actual loss.

LEASE TRANSACTIONS AS SECURED TRANSACTIONS

The last issue of importance addressed in UCC - 2A is an added appendix, consisting of a crucial amendment to Section 1-201(37) of the UCC, which defines the term security interest. If a lease involves a "security interest," it is subject to Article 9 of the UCC. A lease involves a security interest, dependent upon four alternative factors or characteristics.

If the term of the lease is equal or greater than the remaining economic life of the goods; if there is a renewal option for no additional consideration or nominal consideration; if there is mandatory renewal or the lessee becomes owner at the end of the lease term; or if the lessee has the option to purchase at the end of the lease term for no additional consideration, or any combination of these factors, the lease would tend to be treated as creating a security interest and would be subject to Article 9.

CONCLUSION

UCC - 2A is comprehensive, dealing with every phase of leasing transactions. It draws a great share of its concepts from Article 2 of the UCC, but it is adapted to the peculiarities of the leasing form. It is an important advance in commercial law.

WHY STATES SHOULD ADOPT ARTICLE 2A

OF THE UNIFORM COMMERCIAL CODE - LEASES

The leasing of large scale items ranging from oil-drilling platforms to automobiles is big business in this country, with an estimated dollar volume reaching $150 billion. Yet the laws governing leasing have not kept pace with the intricacies of today's leasing arrangements, resulting in considerable uncertainty for lessors and lessees alike.

To fill this gap, the Uniform Law Commissioners approved a new amendment to the Uniform Commercial Code: Article 2A - Leases. UCC-2A provides for the fundamentals of the leasing contract, including the formation of the contract, provisions for express and implied warranties, and damages for breach of a leasing contract.

Historically, we have thought of financed purchase transactions as conditional sales. As sales, such transactions fall under the UCC, particularly Articles 2 and 9. But a leasing transaction, even though very similar to a conditional sale in many ways, is not clearly subject to the UCC. The rights and remedies of the lessor and lessee, therefore, are not well defined, and courts have characterized these transactions differently from jurisdiction to jurisdiction. Many troubling issues have been extensively and confusingly litigated.

UCC-2A gives leasing transactions an appropriate underpinning in the law. Because of the broad similarities between lease and sales transactions, that underpinning is largely derived from the sales article of the UCC - Article 2. Hence the new article is 2A, indicating its relationship to Article 2. Article 2 has been adopted in every state except Louisiana.

There are a number of reasons all states should adopt UCC - Article 2A, Leases:

LEASES SHOULD BE A PART OF THE UCC

Since leases are an important part of business and commercial law, they should be governed by the Uniform Commercial Code. Further, the leasing business is interstate in character. Uniformity is as important to the conduct of leasing transactions as it is to sales transactions.

LEASES AS SECURED TRANSACTIONS

Perhaps the most important question answered in UCC-2A is when leases are subject to UCC-Article 9 on "Secured Transactions." Certain lease contracts establish what effectively are conditional sales, in which the lessor is no different from a creditor subject to Article 9.

The prior law has never effectively dealt with the issue, and concrete standards are established in UCC-2A and an accompanying amendment to UCC-1-201(37), which is a basic definition section in the UCC. Under these provisions, a secured transaction occurs when the lessor has no meaningful residual rights in goods when the lease expires. In a true lease, the rights to the goods revert to the lessor when the lease term ends. But if the contract terms indicate that the rights to this residue are valueless, then it can be inferred that the lease really amounted to a conditional sale of the goods. Article 9 then should and would apply.

FINANCE LEASES

UCC-2A creates a separate category of leases called "finance leases" to eliminate existing confusion over the rights of parties in such leases. Finance leases are characterized by the unique position of the lessor - as purchaser of goods only for the purpose of delivering them to a lessee pursuant to a lease contract.

Because the lessor is not the real supplier of the goods, and acts merely to finance the goods in the hands of the lessee, certain of lessee's rights are best served by imposing obligations on the real supplier and by limiting some rights against the lessor. UCC-2A does not give a lessee implied warranties against a lessor in a finance lease, but passes the lessor's warranties against the real supplier under Article 2 on the lessee.

UCC-2A also further limits a lessee's already limited rights to reject goods, once accepted under the contract, or to cancel, terminate, modify, excuse or substitute performance under the lease contract. The lessee relies upon warranty rights against the supplier, and the lessor is treated as the financing entity it really is.

REMEDIES

Prior law does not provide clear remedies for leasing transactions. Because the parties to lease contracts share substantial characteristics with the parties to sales contracts,

the full panoply of UCC-Article 2 remedies can easily be translated and applied to lease contracts.

UCC-2A not only provides clear measures of damages upon breach of contract, but also provides: clear standards for anticipatory repudiation by a party to a contract when anticipated performance by another party becomes insecure; for rejection of goods that do not conform to the contract; for excused non-performance of the contract; and for specific performance under appropriate circumstances.

UCC-2A remedies carry over the original Article 2 policies of encouraging cure of default without litigation and of mitigation of damages whenever and wherever possible.

WARRANTIES

UCC-2A establishes and standardizes warranties for true leases. It follows closely Article 2 of the UCC, but it does not protect title, since title remains with the lessor. Rather than title, UCC-2A warrants against infringement with lease rights.

There are two kinds of implied warranties: merchantability and fitness for a particular purpose. Both are directly derived from Article 2 of the UCC. The warranty of merchantability assures the resalability of goods between merchants. The fitness warranty presumes a purpose and reliance upon the lessor to supply goods fit for the purpose. These warranties can be excluded or modified by agreement.

UCC-2A implied warranties do not apply to finance leases. In that case the implied warranties under Article 2 of the supplier to the lessor are passed on to the lessee.

CONSUMER LEASES

UCC-2A defines a consumer lease as a lease in which the lessee takes the lease primarily for a personal, family or household purpose, when the total payments do not exceed $25,000.

UCC-2A does provide some protection for lessees in a consumer lease. Among other things, there is a burden on the lessor to justify acceleration of rentals in a consumer lease. But most consumer protection is left to other laws.

FIXTURE AND ACCESSION PROBLEM

UCC-2A settles recurring problems of what to do with leased goods that become fixtures and accessions and who has priority in each case.

Fixtures are defined as "goods so related to particular real estate that an interest in them arises under real estate law." Generally, if goods are leased and become fixtures, the lessor with prior interest in them has priority over those with the real estate interests - if the lessor perfects his or her prior interest with a fixture filing under UCC - Article 9.

An accession occurs when leased goods are "installed in or affixed to other goods." Any existing rights in a lease contract are superior to any rights in the whole in which leased goods become accession after the lease contract is entered.

CONCLUSION

The changes in leasing transactions in recent years make it clear that modernization is long overdue. States now depend on the common law to resolve disputes over lease contracts. This creates great uncertainty, particularly for companies that conduct business in more than one state, since case law conflicts from state to state. Additionally, some important issues have never been adequately addressed in the common law, and UCC - 2A answers these immediate needs.

Representative Dave Donley, Chair
House Labor & Commerce Committee

DATE: 4-12-89

PLACE: C#17

SUBJECT OF MEETING:

HB 67

NAME	REPRESENTING	BUSINESS/PERSONAL MAILING ADDRESS	ZIP	(H) PHONE	(W) PHONE	DO YOU WANT TO TESTIFY?		WHAT SUBJECT/ WHICH BILL?
Art Peterson	Dept. of Law			~~3600~~	3600	(Y)	N	SB 88 and HB 67
John M McCabe	Gaylord Jewelry Commissioner	676 N. St. Clair, #1700, Chicago, IL 60611		312-915-0149		(Y)	N	SB. 88 H.B. 67
						Y	N	
						Y	N	
						Y	N	
						Y	N	
						Y	N	
						Y	N	
						Y	N	
						Y	N	
						Y	N	
						Y	N	