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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.

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..."
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> "(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.

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CORRECTION

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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:

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"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.

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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 th "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):
Legislative Finance
Legislative Sponsor
Requestor
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
Suite 510
Chicago, Illinois 60611

Uniform Commercial Code
Article 2A. Leases

National Conference of Commissioners on Uniform State Laws

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ABA ADVISOR, SECTION OF CORPORATION,
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Ronald M. Bayer, Los Angeles, California

ABA ADVISOR, SECTION OF TAXATION

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

PART 2. FORMATION AND CONSTRUCTION OF LEASE CONTRACT

PART 5. DEFAULT

ARTICLE 1 AND ARTICLE 9: CONFORMING AMENDMENTS

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