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has notice of the lessee's entering the finance lease when the supply contract is modified or rescinded.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

OFFICIAL COMMENT

Uniform Statutory Source: None.

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

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

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

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

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

Cross References:

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

Definitional Cross References:

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

§ 2A-210. EXPRESS WARRANTIES.

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

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

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

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

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-313.

Changes: Revised to reflect leasing practices and terminology.

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

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

Cross References:

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

Definitional Cross References:

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

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

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

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

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

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-312.

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

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

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

Cross References:

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

Definitional Cross References:

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

§ 2A-212. IMPLIED WARRANTY OF MERCHANTABILITY.

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

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

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

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

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

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

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

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

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-314.

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

Definitional Cross References:

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

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

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-315.

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

Definitional Cross References:

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

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

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

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

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

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

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

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

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

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

OFFICIAL COMMENT

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

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

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

Cross References:

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

Definitional Cross References:

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

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

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

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

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

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-317.

Definitional Cross Reference:

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

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

ALTERNATIVE A

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

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

ALTERNATIVE B

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

ALTERNATIVE C

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

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-318.

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

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

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

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

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

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

Cross References:

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

Definitional Cross References:

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

§ 2A-217. IDENTIFICATION.

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

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

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

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501.

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

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

Cross References:

Sections 2-501 and 2A-218.

Definitional Cross References:

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

§ 2A-218. INSURANCE AND PROCEEDS.

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

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

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

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

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501.

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

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

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

Cross References:

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

Definitional Cross References:

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

§ 2A-219. RISK OF LOSS.

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

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

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

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

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

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

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

OFFICIAL COMMENT

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

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

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

Cross References:

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

Definitional Cross References:

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

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

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

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

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

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

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-510.

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

Definitional Cross References:

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

§ 2A-221. CASUALTY TO IDENTIFIED GOODS.

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

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

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-613.

Changes: Revised to reflect leasing practices and terminology.

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

Cross References:

Section 2-613.

Definitional Cross References:

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

PART 3. EFFECT OF LEASE CONTRACT

§ 2A-301. ENFORCEABILITY OF LEASE CONTRACT.

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

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-201.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

4. Section 2A-306 creates a rule with respect to priority disputes between holders of liens for services or materials furnished with respect to goods subject to a lease contract and the lessor or the lessee under that contract. Section 2A-307 creates a rule with respect to priority disputes between the lessee and creditors of the lessor and priority disputes between the lessor and creditors of the lessee.

5. Section 2A-308 creates a series of rules relating to allegedly fraudulent transfers and preferences. The most significant rule is that set forth in subsection (3) which validates sale-leaseback transactions if the

buyer-lessor can establish that he or she bought for value and in good faith.

6. Finally, Sections 2A-309 and 2A-310 create a series of rules with respect to priority disputes between various third parties and a lessor of fixtures or accessions, respectively, with respect thereto.

Cross References:

Article 1, esp. Section 1-201(37), and Sections 2-104(1), 2A-103(1)(j), 2A-103(1)(l), 2A-103(1)(n), 2A-103(1)(o) and 2A-103(1)(w), 2A-103(3), 2A-103(4), 2A-201, 2A-301 through 2A-303, 2A-303(1), 2A-303(1)(a), 2A-303(1)(b), 2A-304 through 2A-307, 2A-307(1), 2A-307(2)(a), 2A-308 through 2A-310, 2A-508, 2A-511(4), 2A-523, Article 9, esp. Sections 9-201 and 9-408.

Definitional Cross References:

"Creditor". Section 1-201(12).
 "Goods". Section 2A-103(1)(h).
 "Lease contract". Section 2A-103(1)(l).
 "Party". Section 1-201(29).
 "Purchaser". Section 1-201(33).
 "Term". Section 1-201(42).

§ 2A-302. TITLE TO AND POSSESSION OF GOODS.

Except as otherwise provided in this Article, each provision of this Article applies whether the lessor or a third party has title to the goods, and whether the lessor, the lessee, or a third party has possession of the goods, notwithstanding any statute or rule of law that possession or the absence of possession is fraudulent.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-202.

Changes: Section 9-202 was modified to reflect leasing terminology and to clarify the law of leases with respect to fraudulent conveyances or transfers.

Purposes: The separation of ownership and possession of goods between the lessor and the lessee (or a third party) has created problems under certain fraudulent conveyance statutes. See, e.g., In re Ludlum Enters., 510 F.2d 996 (5th Cir. 1975); Suburbia Fed. Sav. & Loan Ass'n v. Bel-Air Conditioning Co., 385 So. 2d 1151 (Fla. Dist. Ct. App. 1980). This section provides, among other things, that separation of ownership and possession per se does not affect the enforceability of the lease contract. Sections 2A-301 and 2A-308.

Cross References:

Sections 2A-301, 2A-308 and 9-202.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
 "Lessee". Section 2A-103(1)(n).
 "Lessor". Section 2A-103(1)(p).

§ 2A-303. ALIENABILITY OF PARTY'S INTEREST UNDER LEASE CONTRACT OR OF LESSOR'S RESIDUAL INTEREST IN GOODS; DELEGATION OF PERFORMANCE; ASSIGNMENT OF RIGHTS.

(1) Any interest of a party under a lease contract and the lessor's residual interest in the goods may be transferred unless

(a) the transfer is voluntary and the lease contract prohibits the transfer; or

(b) the transfer materially changes the duty of or materially increases the burden or risk imposed on the other party to the lease contract, and within a reasonable time after notice of the transfer the other party demands that the transferee comply with subsection (2) and the transferee fails to comply.

(2) Within a reasonable time after demand pursuant to subsection (1)(b), the transferee shall:

(a) cure or provide adequate assurance that he [or she] will promptly cure any default other than one arising from the transfer;

(b) compensate or provide adequate assurance that he [or she] will promptly compensate the other party to the lease contract and any other person holding an interest in the lease contract, except the party whose interest is being transferred, for any loss to that party resulting from the transfer;

(c) provide adequate assurance of future due performance under the lease contract; and

(d) assume the lease contract.

(3) Demand pursuant to subsection (1)(b) is without prejudice to the other party's rights against the transferee and the party whose interest is transferred.

(4) An assignment of "the lease" or of "all my rights under the lease" or an assignment in similar general

terms is a transfer of rights, and unless the language or the circumstances, as in an assignment for security, indicate the contrary, the assignment is a delegation of duties by the assignor to the assignee and acceptance by the assignee constitutes a promise by him [or her] to perform those duties. This promise is enforceable by either the assignor or the other party to the lease contract.

(5) Unless otherwise agreed by the lessor and the lessee, no delegation of performance relieves the assignor as against the other party of any duty to perform or any liability for default.

(6) A right to damages for default with respect to the whole lease contract or a right arising out of the assignor's due performance of his [or her] entire obligation can be assigned despite agreement otherwise.

(7) To prohibit the transfer of an interest of a party under a lease contract, the language of prohibition must be specific, by a writing, and conspicuous.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-210.

Changes: The provisions of Section 2-210 were incorporated in this Article, with substantial modifications to reflect leasing terminology and practice, as well as certain developments of the law with respect to creditors' rights.

Purposes: Unlike Section 2-210, which deals with voluntary transfers of rights and duties under a sales contract, this section deals with involuntary as well as

voluntary transfers of rights and duties under a lease contract. Voluntary transfers are permitted unless prohibited by the lease contract or, as is also the case for involuntary transfers, there is a material change in the duty of, or a material increase in the burden or risk to, the other party to the lease contract and the transferee fails to comply with the conditions in subsection (2) within a reasonable time after a demand, which need not be in writing, has been made for such compliance.

Subsection (2) establishes four criteria that must be satisfied by the transferee after a demand has been made. These criteria are modeled on the requirements contained in the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. § 365 (1982 & Supp. II 1984), governing the assumption and assignment of an unexpired lease or executory contract by a trustee in bankruptcy. Section 2-210(5) resolves this issue for sales by allowing the other party to demand assurances from the transferee (Section 2-609). Section 365 of the Bankruptcy Code, a modern version of the provisions of Section 2-609, provided a better model for resolving this issue for leases.

Sections 9-206 and 9-318 are also relevant in this context. Section 9-206 sanctions an agreement by a lessee not to assert certain types of claims or defenses against the lessor's assignee. Section 9-318 deals with, among other things, the other party's rights against the assignee where Section 9-206(1) does not apply. Since the definition of contract under Section 1-201(11) includes a lease agreement, the definition of account debtor under Section 9-105(1)(a) includes a lessee of goods and Section 9-206 applies to lease agreements; thus, there is no need to restate those sections in this Article. However, the reference to "defenses or claims arising out of a sale" in Section 9-318(1) should be interpreted broadly to include defenses or claims arising out of a lease. This should follow as Section 9-318(1) codifies the common law rule with respect to contracts, including contracts of sale and contracts of lease. Further, Section 9-318(4) should be interpreted to allow the rule of this section to control with respect to transfers of leases.

Subsection (4) is taken almost verbatim from the provisions of Section 2-210(4). The subsection states a rule of construction that distinguishes a commercial assignment, which substitutes the assignee for the assignor as to rights and duties, and an assignment for security or financing assignment, which substitutes the assignee for the assignor only as to rights. Note that the assignment for security or financing assignment is a subset of all security interests.

Security interest is defined to include "any interest of a buyer of ... chattel paper". Section 1-201(37). Chattel paper is defined to include a lease. Section 9-105(1)(b). Thus, a buyer of leases is the holder of a security interest in the leases. That conclusion should not influence this issue, as the policy is quite different. Whether a buyer of leases is the holder of a commercial assignment, or an assignment for security or financing assignment should be determined by the language of the assignment or the circumstances of the assignment.

While it is recognized that a lease contract may impose restrictions on the transfer of an interest of a party under a lease, such restrictions are not generally favored in law. Subsection (7) balances these competing interests and ensures that both parties knowingly impose prohibitions on transfer, by providing that the language of prohibition be specific, by a writing, and conspicuous.

Cross References:

Sections 1-201(11), 1-201(37), 2-210, 2-609, 9-105(1)(a), 9-206, and 9-318.

Definitional Cross References:

"Agreed" and "Agreement". Section 1-201(3).
 "Conspicuous". Section 1-201(10).
 "Goods". Section 2A-103(1)(h).
 "Lease". Section 2A-103(1)(j).
 "Lease contract". Section 2A-103(1)(l).
 "Lessee". Section 2A-103(1)(n).
 "Lessor". Section 2A-103(1)(p).
 "Lessor's residual interest". Section 2A-103(1)(q).
 "Notice". Section 1-201(25).
 "Party". Section 1-201(29).
 "Person". Section 1-201(30).
 "Reasonable time". Section 1-204(1) and (2).
 "Rights". Section 1-201(36).
 "Term". Section 1-201(42).
 "Writing". Section 1-201(46).

§ 2A-304. SUBSEQUENT LEASE OF GOODS BY LESSOR.

(1) Subject to the provisions of Section 2A-303, a subsequent lessee from a lessor of goods under an existing lease contract obtains, to the extent of the leasehold interest transferred, the leasehold interest in the goods that the lessor had or had power to transfer, and except as provided in subsection (2) and Section 2A-527(4), takes subject to the existing lease contract. A lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value, but only to the extent set forth in the preceding sentence. When goods have been delivered under a transaction of purchase the lessor has that power even though:

(a) the lessor's transferor was deceived as to the identity of the lessor;

(b) the delivery was in exchange for a check which is later dishonored;

(c) it was agreed that the transaction was to be a "cash sale"; or

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A subsequent lessee in the ordinary course of business from a lessor who is a merchant dealing in goods of that kind to whom the goods were entrusted by the existing lessee before the interest of the subsequent lessee became

enforceable against the lessor obtains, to the extent of the leasehold interest transferred, all of the lessor's and the existing lessee's rights to the goods, and takes free of the existing lease contract.

(3) A subsequent lessee from the lessor of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this State or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403.

Changes: While Section 2-403 was used as a model for this section, the provisions of Section 2-403 were significantly revised to reflect leasing practices and to integrate this Article with certificate of title statutes.

Purposes: This section must be read in conjunction with, as it is subject to, the provisions of Section 2A-303, which govern voluntary and involuntary transfers of rights and duties under a lease contract, including the lessor's residual interest in the goods.

This section must also be read in conjunction with Section 2-403. This section and Section 2A-305 are derived from Section 2-403, which states a unified policy on good faith purchases of goods. Given the scope of the definition of purchaser (Section 1-201(33)), a person who bought goods to lease as well as a person who bought goods subject to an existing lease from a lessor will take pursuant to Section 2-403. Further, a person who leases such goods from the person who bought them should also be protected under Section 2-403, first because the lessee's rights are derivative and second because the definition of purchaser should be interpreted to include one who takes by lease; no negative implication should be drawn from the inclusion of lease in the definition of purchase in this Article. Section 2A-103(1)(v).

There are hypotheticals that relate to an entrustee's unauthorized lease of entrusted goods to a third party that are outside the provisions of Sections 2-403, 2A-304 and 2A-305. Consider a sale of goods by M, a merchant, to B, a buyer. After paying for the goods B allows M to retain possession of the goods as B is short of storage. Before B calls for the goods M leases the goods to L, a lessee. This transaction is not governed by Section 2-403(2) as L is not a buyer in the ordinary course of business. Section 1-201(9). Further, this transaction is not governed by Section 2A-304(2) as B is not an existing lessee. Finally, this transaction is not governed by Section 2A-305(2) as B is not M's lessor. Section 2A-307(2) resolves the potential dispute between B, M and L. By virtue of B's entrustment of the goods to M and M's lease of the goods to L, B has a cause of action against M under the common law. Sections 2A-103(4) and 1-103. See, e.g., Restatement (Second) of Torts §§ 222A-243. Thus, B is a creditor of M. Sections 2A-103(4) and 1-201(12). Section 2A-307(2) provides that B, as M's creditor, takes subject to M's lease to L. Thus, if L does not default under the lease, L's enjoyment and possession of the goods should be undisturbed. However, B is not without recourse. B's action should result in a judgment against M providing, among other things, a turnover of all proceeds arising from M's lease to L, as well as a transfer of all of M's right, title and interest as lessor under M's lease to L, including M's residual interest in the goods. Section 2A-103(1)(q).

Subsection (1) states a rule with respect to the leasehold interest obtained by a subsequent lessee from a lessor of goods under an existing lease contract. The interest will include such leasehold interest as the lessor has in the goods as well as the leasehold interest that the lessor had the power to transfer. Thus, the subsequent lessee obtains unimpaired all rights acquired under the law of agency, apparent agency, ownership or other estoppel, whether based upon statutory provisions or upon case law principles. Sections 2A-103(4) and 1-103. In general, the subsequent lessee takes subject to the existing lease contract, including the existing lessee's rights thereunder. Furthermore, the subsequent lease contract is, of course, limited by its own terms, and the subsequent lessee takes only to the extent of the leasehold interest transferred thereunder.

Subsection (1) further provides that a lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value. In addition, subsections (1)(a) through (d) provide specifically

for the protection of the good faith subsequent lessee for value in a number of specific situations which have been troublesome under prior law.

The position of an existing lessee who entrusts leased goods to its lessor is not distinguishable from the position of other entrusters. Thus, subsection (2) provides that the subsequent lessee in the ordinary course of business takes free of the existing lease contract between the lessor entruster and the lessee entruster, if the lessor is a merchant dealing in goods of that kind. Further, the subsequent lessee obtains all of the lessor entruster's and the lessee entruster's rights to the goods, but only to the extent of the leasehold interest transferred by the lessor entruster. Thus, the lessor entruster retains the residual interest in the goods. Section 2A-103(1)(q). However, entrustment by the existing lessee must have occurred before the interest of the subsequent lessee became enforceable against the lessor. Entrusting is defined in Section 2-403(3) and that definition applies here. Section 2A-103(3).

Subsection (3) states a rule with respect to a transfer of goods from a lessor to a subsequent lessee where the goods are subject to an existing lease and covered by a certificate of title. The subsequent lessee's rights are no greater than those provided by this section and the applicable certificate of title statute, including any applicable case law construing such statute. Where the relationship between the certificate of title statute and Section 2-403, the statutory analogue to this section, has been construed by a court, that construction is incorporated here. Sections 2A-103(4) and 1-102(1) and (2). The better rule is that the certificate of title statutes are in harmony with Section 2-403 and thus would be in harmony with this section. E.g., Atwood Chevrolet-Olds v. Aberdeen Mun. School Dist., 431 So.2d 926, 928 (Miss. 1983); Godfrey v. Gilsdorf, 476 P.2d 3, 6, 86 Nev. 714, 718 (1970); Martin v. Nager, 192 N.J. Super. 189, 197-98, 469 A.2d 519, 523 (Super. Ct. Ch. Div. 1983). Where the certificate of title statute is silent on this issue of transfer, this section will control.

Cross References:

Sections 1-102, 1-103, 1-201(33), 2-403, 2A-103(1)(v), 2A-103(3), 2A-103(4), 2A-303 and 2A-305.

Definitional Cross References:

"Agreed". Section 1-201(3).
 "Delivery". Section 1-201(14).
 "Entrusting". Section 2-403(3).
 "Good faith". Sections 1-201(19) and 2-103(1)(b).
 "Goods". Section 2A-103(1)(h).
 "Lease". Section 2A-103(1)(j).
 "Lease contract". Section 2A-103(1)(l).
 "Leasehold interest". Section 2A-103(1)(m).
 "Lessee". Section 2A-103(1)(n).
 "Lessee in the ordinary course of business". Section
 2A-103(1)(o).
 "Lessor". Section 2A-103(1)(p).
 "Merchant". Section 2-104(1).
 "Purchase". Section 2A-103(1)(v).
 "Rights". Section 1-201(36).
 "Value". Section 1-201(44).

§ 2A-305. SALE OR SUBLEASE OF GOODS BY LESSEE.

(1) Subject to the provisions of Section 2A-303, a buyer or sublessee from the lessee of goods under an existing lease contract obtains, to the extent of the interest transferred, the leasehold interest in the goods that the lessee had or had power to transfer, and except as provided in subsection (2) and Section 2A-511(4), takes subject to the existing lease contract. A lessee with a voidable leasehold interest has power to transfer a good leasehold interest to a good faith buyer for value or a good faith sublessee for value, but only to the extent set forth in the preceding sentence. When goods have been delivered under a transaction of lease the lessee has that power even though:

(a) the lessor was deceived as to the identity of the lessee;

(b) the delivery was in exchange for a check which is later dishonored; or

(c) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A buyer in the ordinary course of business or a sublessee in the ordinary course of business from a lessee who is a merchant dealing in goods of that kind to whom the goods were entrusted by the lessor obtains, to the extent of the interest transferred, all of the lessor's and lessee's rights to the goods, and takes free of the existing lease contract.

(3) A buyer or sublessee from the lessee of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this State or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403.

Changes: While Section 2-403 was used as a model for this section, the provisions of Section 2-403 were significantly revised to reflect leasing practice and to integrate this Article with certificate of title statutes.

Purposes: This section, a companion to Section 2A-304, states the rule with respect to the leasehold interest obtained by a buyer or sublessee from a lessee of goods under an existing lease contract. Cf. Section 2A-304 official comment. Note that this provision is consistent with existing case law, which prohibits the bailee's transfer of title to a good faith purchaser for value under Section 2-403(1). Rohweder v. Aberdeen Product. Credit Ass'n, 765 F.2d 109 (8th Cir. 1985).

Subsection (2) is also consistent with existing case law. American Standard Credit, Inc. v. National Cement Co., 643 F.2d 248, 269-70 (5th Cir. 1981); but cf. Exxon Co., U.S.A. v. TLW Computer Indus., 37 U.C.C. Rep. Serv. (Callaghan) 1052, 1057-58 (D. Mass. 1983). Unlike Section 2A-304(2), this subsection does not contain any requirement with respect to the time that the goods were entrusted to the merchant. In Section 2A-304(2) the competition is between two customers of the merchant lessor; the time of entrusting was added as a criterion to create additional protection to the customer who was first in time: the existing lessee. In subsection (2) the equities between the competing interests were viewed as balanced.

There appears to be some overlap between Section 2-403(2) and Section 2A-305(2) with respect to a buyer in the ordinary course of business. However, an examination of this Article's definition of buyer in the ordinary course of business (Section 2A-103(1)(a)) makes clear that this reference was necessary to treat entrusting in the context of a lease.

Subsection (3) states a rule of construction with respect to a transfer of goods from a lessee to a buyer or sublessee, where the goods are subject to an existing lease and covered by a certificate of title. Cf. Section 2A-304 official comment.

Cross References:

Sections 2-403, 2A-103(1)(a), 2A-304 and 2A-305(2).

Definitional Cross References:

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

"Buyer in the ordinary course of business". Section 2A-103(1)(a).

"Delivery". Section 1-201(14).
 "Entrusting". Section 2-403(3).
 "Good faith". Sections 1-201(19) and 2-103(1)(b).
 "Goods". Section 2A-103(1)(h).
 "Lease". Section 2A-103(1)(j).
 "Lease contract". Section 2A-103(1)(l).
 "Leasehold interest." Section 2A-103(1)(m).
 "Lessee". Section 2A-103(1)(n).
 "Lessee in the ordinary course of business". Section
 2A-103(1)(o).
 "Lessor". Section 2A-103(1)(p).
 "Merchant". Section 2-104(1).
 "Rights". Section 1-201(36).
 "Sale". Section 2-106(1).
 "Sublease". Section 2A-103(1)(w).
 "Value". Section 1-201(44).

§ 2A-306. PRIORITY OF CERTAIN LIENS ARISING BY OPERATION OF
LAW.

If a person in the ordinary course of his [or her] business furnishes services or materials with respect to goods subject to a lease contract, a lien upon those goods in the possession of that person given by statute or rule of law for those materials or services takes priority over any interest of the lessor or lessee under the lease contract or this Article unless the lien is created by statute and the statute provides otherwise or unless the lien is created by rule of law and the rule of law provides otherwise.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-310.

Changes: The approach reflected in the provisions of Section 9-310 was included, but revised to conform to leasing terminology and to expand the exception to the special priority granted to protected liens to cover liens created by rule of law as well as those created by statute.

Purposes: This section should be interpreted to allow a qualified lessor or a qualified lessee to be the competing lienholder if the statute or rule of law so provides. The reference to statute includes applicable regulations and cases; these sources must be reviewed in resolving a priority dispute under this section.

Cross Reference:

Section 9-310.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
 "Lease Contract". Section 2A-103(1)(l).
 "Lessee". Section 2A-103(1)(n).
 "Lessor". Section 2A-103(1)(p).
 "Lien". Section 2A-103(1)(r).
 "Person". Section 1-201(30).

§ 2A-307. PRIORITY OF LIENS ARISING BY ATTACHMENT OR LEVY ON, SECURITY INTERESTS IN, AND OTHER CLAIMS TO GOODS.

(1) Except as otherwise provided in Section 2A-306, a creditor of a lessee takes subject to the lease contract.

(2) Except as otherwise provided in subsections (3) and (4) of this section and in Sections 2A-306 and 2A-308, a creditor of a lessor takes subject to the lease contract:

(a) unless the creditor holds a lien that attached to the goods before the lease contract became enforceable, or

(b) unless the creditor holds a security interest in the goods that under the Article on Secured Transactions (Article 9) would have priority over any

other security interest in the goods perfected by a filing covering the goods and made at the time the lease contract became enforceable, whether or not any other security interest existed.

(3) A lessee in the ordinary course of business takes the leasehold interest free of a security interest in the goods created by the lessor even though the security interest is perfected and the lessee knows of its existence.

(4) A lessee other than a lessee in the ordinary course of business takes the leasehold interest free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the lease or more than 45 days after the lease contract becomes enforceable, whichever first occurs, unless the future advances are made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the 45-day period.

OFFICIAL COMMENT

Uniform Statutory Source: None for subsections (1) and (2). Subsections (3) and (4) are derived from the provisions of Section 9-307(1) and (3), respectively.

Changes: The provisions of Section 9-307(1) and (3) were incorporated, and modified to reflect leasing terminology and the basic concepts reflected in this Article.

Purposes: Subsection (1) states a general rule of priority that a creditor of the lessee takes subject to the lease contract. The term lessee (Section 2A-103(1)(n)) includes sublessee. Therefore, this subsection not only

covers disputes between the prime lessor and a creditor of the prime lessee but also disputes between the prime lessor, or the sublessor, and a creditor of the sublessee. Section 2A-301 official comment. Further, by using the term creditor (Section 1-201(12)), this subsection will cover disputes with a general creditor, a secured creditor, a lien creditor and any representative of creditors. Section 2A-103(4).

Subsection (2) states a general rule of priority that a creditor of a lessor takes subject to the lease contract. Note the discussion above with regard to the scope of these rules. Section 2A-301 official comment. Thus, the section will not only cover disputes between the prime lessee and a creditor of the prime lessor but also disputes between the prime lessee, or the sublessee, and a creditor of the sublessor.

To take priority over the lease contract, and the interests derived therefrom, the creditor must come within one of two exceptions stated within the rule. First, subsection (2)(a) provides that where the creditor holds a lien (Section 2A-103(1)(r)) that attached before the lease contract became enforceable (Section 2A-301), the creditor does not take subject to the lease. Second, subsection (2)(b) provides that when the creditor holds a security interest (Section 1-201(37)) that would have priority over a hypothetical secured creditor holding a security interest perfected by a filing made at the time the lease contract became enforceable (Section 2A-301), the creditor does not take subject to the lease. With respect to this provision the hypothetical secured creditor is not the holder of a purchase money security interest entitled to special priority: first, the facts and circumstances relating to the security interest described in Section 2A-307(2)(b) would not create a purchase money security interest as defined in Section 9-107, and second, assuming arguendo that it did create a purchase money security interest, the facts and circumstances relating to the security interest described in Section 2A-307(2)(b) would not create a special priority under the provisions of Section 9-312(3) or (4). Thus, the priority rules of Section 9-312(5) govern the security interest held by the hypothetical secured creditor. The use of a hypothetical creditor as a statutory means to resolve disputes between competing interests is not without precedent. The Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. § 544(a) (1982 & Supp. II 1984)."

The rule stated in subsection (2)(b) is best understood by reviewing a hypothetical. Assume that a

merchant engaged in the business of selling and leasing musical instruments obtained possession of a truck load of musical instruments on deferred payment terms from a supplier of musical instruments. To secure payment of such credit the merchant granted the supplier a security interest in the instruments; the security interest was perfected by filing on January 15. The merchant, as lessor, entered into a lease to an individual of one of the musical instruments supplied by the supplier; the lease became enforceable on March 1. Under the rule stated in subsection (2)(b) a priority dispute between the supplier, as the lessor's secured creditor, and the lessee would be determined by assuming that on March 1 (the day the lease became enforceable) the merchant had granted a security interest in such musical instruments to a hypothetical secured creditor and the hypothetical secured creditor perfected such security interest by filing on March 1. Under the priority rules of the Article on Secured Transactions (Article 9) the hypothetical secured creditor would lose in a priority dispute with the supplier. Section 9-312(5)(a). Thus, under the rule stated in subsection (2)(L), the supplier's security interest in the musical instrument would have priority over the lease contract. However, subsection (2)(b) states that its rule is subject to the rules of subsections (3) and (4). Under this hypothetical the lessee should qualify as a "lessee in the ordinary course of business". Section 2A-103(1)(o). Subsection (3) also makes clear that the lessee in the ordinary course of business will win even if he or she knows of the existence of the supplier's security interest.

Subsections (3) and (4), which are modeled on the provisions of Section 9-307(1) and (3), respectively, state two exceptions to the priority rule stated in subsection (2) with respect to a creditor who holds a security interest. The lessee in the ordinary course of business will be treated in the same fashion as the buyer in the ordinary course of business, given a priority dispute with a secured creditor over goods subject to a lease contract.

Cross References:

Sections 1-201(12), 1-201(37), 2A-103(1)(n), 2A-103(1)(o), 2A-103(1)(r), 2A-103(4), 2A-301 official comment, Article 9, esp. Sections 9-307(1), 9-307(3) and 9-312(5)(a).

Definitional Cross References:

"Creditor". Section 1-201(12).
 "Goods". Section 2A-103(1)(h).
 "Knowledge" and "Knows". Section 1-201(25).
 "Lease". Section 2A-103(1)(j).
 "Lease contract". Section 2A-103(1)(l).
 "Leasehold interest". Section 2A-103(1)(m).
 "Lessee". Section 2A-103(1)(n).
 "Lessee in the ordinary course of business". Section 2A-103(1)(o).
 "Lessor". Section 2A-103(1)(p).
 "Lien". Section 2A-103(1)(r).
 "Party". Section 1-201(29).
 "Pursuant to commitment". Section 2A-103(3).
 "Security interest". Section 1-201(37).

§ 2A-308. SPECIAL RIGHTS OF CREDITORS.

(1) A creditor of a lessor in possession of goods subject to a lease contract may treat the lease contract as void if as against the creditor retention of possession by the lessor is fraudulent under any statute or rule of law, but retention of possession in good faith and current course of trade by the lessor for a commercially reasonable time after the lease contract becomes enforceable is not fraudulent.

(2) Nothing in this Article impairs the rights of creditors of a lessor if the lease contract (a) becomes enforceable, not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security, or the like, and (b) is made under circumstances which under any statute or rule of law apart

from this Article would constitute the transaction a fraudulent transfer or voidable preference.

(3) A creditor of a seller may treat a sale or an identification of goods to a contract for sale as void if as against the creditor retention of possession by the seller is fraudulent under any statute or rule of law, but retention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-402(2) and (3)(b).

Changes: Rephrased and new material added to conform to leasing terminology and practice.

Purposes: Subsection (1) states a general rule of avoidance where the lessor has retained possession of goods if such retention is fraudulent under any statute or rule of law. However, the subsection creates an exception under certain circumstances for retention of possession of goods for a commercially reasonable time after the lease contract becomes enforceable.

Subsection (2) also preserves the possibility of an attack on the lease by creditors of the lessor if the lease was made in satisfaction of or as security for a pre-existing claim, and would constitute a fraudulent transfer or voidable preference under other law.

Finally, subsection (3) states a new rule with respect to sale-leaseback transactions, i.e., transactions where the seller sells goods to a buyer but possession of the goods is retained by the seller pursuant to a lease contract

registered, of a financing statement concerning goods that are or are to become fixtures and conforming to the requirements of subsection (5) of Section 9-402;

(c) a lease is a "purchase money lease" unless the lessee has possession or use of the goods or the right to possession or use of the goods before the lease agreement is enforceable;

(d) a mortgage is a "construction mortgage" to the extent it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates; and

(e) "encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests.

(2) Under this Article a lease may be of goods that are fixtures or may continue in goods that become fixtures, but no lease exists under this Article of ordinary building materials incorporated into an improvement on land.

(3) This Article does not prevent creation of a lease of fixtures pursuant to real estate law.

(4) The perfected interest of a lessor of fixtures has priority over a conflicting interest of an encumbrancer or owner of the real estate if:

(a) the lease is a purchase money lease, the conflicting interest of the encumbrancer or owner arises before the goods become fixtures, the interest of the lessor is perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and the lessee has an interest of record in the real estate or is in possession of the real estate; or

(b) the interest of the lessor is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the lessor's interest has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the lessee has an interest of record in the real estate or is in possession of the real estate.

(5) The interest of a lessor of fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate if:

(a) the fixtures are readily removable factory or office machines, readily removable equipment that is not primarily used or leased for use in the operation of the real estate, or readily removable replacements of domestic appliances that are goods subject to a consumer lease, and before the goods become fixtures the lease contract is enforceable; or

(b) the conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the lease contract is enforceable; or

(c) the encumbrancer or owner has consented in writing to the lease or has disclaimed an interest in the goods as fixtures; or

(d) the lessee has a right to remove the goods as against the encumbrancer or owner. If the lessee's right to remove terminates, the priority of the interest of the lessor continues for a reasonable time.

(6) Notwithstanding paragraph (a) of subsection (4) but otherwise subject to subsections (4) and (5), the interest of a lessor of fixtures is subordinate to the conflicting interest of an encumbrancer of the real estate under a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent given to refinance a construction mortgage, the conflicting interest of an encumbrancer of the real estate under a mortgage has this priority to the same extent as the encumbrancer of the real estate under the construction mortgage.

(7) In cases not within the preceding subsections, priority between the interest of a lessor of fixtures and the conflicting interest of an encumbrancer or owner of the real estate who is not the lessee is determined by the priority rules governing conflicting interests in real estate.

(8) If the interest of a lessor has priority over all conflicting interests of all owners and encumbrancers of the real estate, the lessor or the lessee may (a) on default, expiration, termination, or cancellation of the lease agreement by the other party but subject to the provisions of the lease agreement and this Article, or (b) if necessary to enforce his [or her] other rights and remedies under this Article, remove the goods from the real estate, free and clear of all conflicting interests of all owners and encumbrancers of the real estate, but he [or she] must reimburse any encumbrancer or owner of the real estate who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

(9) Even though the lease agreement does not create a security interest, the interest of a lessor of fixtures is perfected by filing a financing statement as a fixture filing for leased goods that are or are to become fixtures in accordance with the relevant provisions of the Article on Secured Transactions (Article 9).

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-313.

Changes: Revised to reflect leasing terminology and to add new material.

Purposes: While Section 9-313 provided a model for this section, certain provisions were substantially revised.

Section 2A-309(1)(c), which is new, defines purchase money lease to exclude leases where the lessee had possession or use of the goods or the right thereof before the lease agreement became enforceable. This term is used in subsection (4)(a) as one of the conditions that must be satisfied to obtain priority over the conflicting interest of an encumbrancer or owner of the real estate.

Section 2A-309(4), which states one of several priority rules found in this section, deletes reference to office machines and the like (Section 9-313(4)(c)) as well as certain liens (Section 9-313(4)(d)). However, these items are included in subsection (5), another priority rule that is more permissive than the rule found in subsection (4) as it applies whether or not the interest of the lessor is perfected. In addition, subsection (5)(a) expands the scope of the provisions of Section 9-313(4)(c) to include readily removable equipment not primarily used or leased for use in the operation of real estate; the qualifier is intended to exclude from the expanded rule equipment integral to the operation of real estate, e.g., heating and air conditioning equipment.

The rule stated in subsection (7) is more liberal than the rule stated in Section 9-313(7) in that issues of priority not otherwise resolved in this subsection are left for resolution by the priority rules governing conflicting interests in real estate, as opposed to the Section 9-313(7) automatic subordination of the security interest in fixtures.

The rule stated in subsection (8) is more liberal than the rule stated in Section 9-313(8) in that the right of removal is extended to both the lessor and the lessee and the occasion for removal includes expiration, termination or cancellation of the lease agreement, and enforcement of rights and remedies under this Article, as well as default. The new language also provides that upon removal the goods are free and clear of conflicting interests of owners and encumbrancers of the real estate.

Finally, subsection (9) provides a mechanism for the lessor of fixtures to perfect its interest by filing a financing statement under the provisions of the Article on Secured Transactions (Article 9), even though the lease agreement does not create a security interest. Section 1-201(37). The relevant provisions of Article 9 must be interpreted permissively to give effect to this mechanism as it implicitly expands the scope, perfection and priority provisions of Article 9 to govern transactions that create a lease of fixtures, even though the lease agreement does not create a security interest. This mechanism is similar to that provided in Section 2-326(3)(c) for the seller of goods on consignment, even though the consignment is not "intended as security". Section 1-201(37). Given the lack of litigation with respect to the mechanism created for consignment sales, this new mechanism should prove effective. Note, however, that this is a more pervasive change in Article 9 than that wrought by expanding the filing system to accommodate permissive filing for leases. U.C.C. § 9-408 app. II (West 1983)(Reasons for 1972 Adoption of New Section).

Cross References:

Sections 1-201(37), 2A-309(1)(c), 2A-309(4), Article 9, esp. Sections 9-313, 9-313(4)(c), 9-313(4)(d), 9-313(7), 9-313(8) and 9-408.

Definitional Cross References:

"Agreed". Section 1-201(3).
 "Cancellation". Section 2A-103(1)(b).
 "Conforming". Section 2A-103(1)(d).
 "Consumer lease". Section 2A-103(1)(e).
 "Goods". Section 2A-103(1)(h).
 "Lease". Section 2A-103(1)(j).
 "Lease agreement". Section 2A-103(1)(k).
 "Lease contract". Section 2A-103(1)(l).
 "Lessee". Section 2A-103(1)(n).
 "Lessor". Section 2A-103(1)(p).
 "Lien". Section 2A-103(1)(r).
 "Mortgage". Section 9-105(1)(j).
 "Party". Section 1-201(29).
 "Person". Section 1-201(30).
 "Reasonable time". Section 1-204(1) and (2).
 "Remedy". Section 1-201(34).
 "Rights". Section 1-201(36).

"Security interest". Section 1-201(37).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Writing". Section 1-201(46).

§ 2A-310. LESSOR'S AND LESSEE'S RIGHTS WHEN GOODS BECOME
ACCESSIONS.

(1) Goods are "accessions" when they are installed
in or affixed to other goods.

(2) The interest of a lessor or a lessee under a
lease contract entered into before the goods became
accessions is superior to all interests in the whole except
as stated in subsection (4).

(3) The interest of a lessor or a lessee under a
lease contract entered into at the time or after the goods
became accessions is superior to all subsequently acquired
interests in the whole except as stated in subsection (4) but
is subordinate to interests in the whole existing at the time
the lease contract was made unless the holders of such
interests in the whole have in writing consented to the lease
or disclaimed an interest in the goods as part of the whole.

(4) The interest of a lessor or a lessee under a
lease contract described in subsection (2) or (3) is
subordinate to the interest of

(a) a buyer in the ordinary course of business or a
lessee in the ordinary course of business of any interest
in the whole acquired after the goods became accessions;
or

(b) a creditor with a security interest in the whole perfected before the lease contract was made to the extent that the creditor makes subsequent advances without knowledge of the lease contract.

(5) When under subsections (2) or (3) and (4) a lessor or a lessee of accessions holds an interest that is superior to all interests in the whole, the lessor or the lessee may (a) on default, expiration, termination, or cancellation of the lease contract by the other party but subject to the provisions of the lease contract and this Article, or (b) if necessary to enforce his [or her] other rights and remedies under this Article, remove the goods from the whole, free and clear of all interests in the whole, but he [or she] must reimburse any holder of an interest in the whole who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-314.

Changes: Revised to reflect leasing terminology and to add new material.

Purposes: Subsections (1) and (2) restate the provisions of subsection (1) of Section 9-314 to clarify the definition of accession and to add leasing terminology to the priority rule that applies when the lease is entered into before the goods become accessions. Subsection (3) restates the provisions of subsection (2) of Section 9-314 to add leasing terminology to the priority rule that applies when the lease is entered into on or after the goods become accessions. Unlike the rule with respect to security interests, the lease is merely subordinate, not invalid.

Subsection (4) creates two exceptions to the priority rules stated in subsections (2) and (3). Subsection (4) deletes the special priority rule found in the provisions of Section 9-314(3)(b) as the interests of the lessor and lessee are entitled to greater protection.

Finally, subsection (5) is modeled on the provisions of Section 9-314(4) with respect to removal of accessions, restated to reflect the parallel changes in Section 2A-309(8).

Neither this section nor Section 9-314 governs where the accession to the goods is not subject to the interest of a lessor or a lessee under a lease contract and is not subject to the interest of a secured party under a security agreement. This issue is to be resolved by the courts, case by case.

Cross References:

Sections 2A-309(8), 9-314(1), 9-314(2), 9-314(3)(b), 9-314(4).

Definitional Cross References:

"Agreed". Section 1-201(3).
 "Buyer in the ordinary course of business". Section 2A-103(1)(a).
 "Cancellation". Section 2A-103(1)(b).
 "Creditor". Section 1-201(12).
 "Goods". Section 2A-103(1)(h).
 "Holder". Section 1-201(20).
 "Knowledge". Section 1-201(25).
 "Lease". Section 2A-103(1)(j).
 "Lease contract". Section 2A-103(1)(l).
 "Lessee". Section 2A-103(1)(n).

"Lessee in the ordinary course of business". Section 2A-103(1)(o).

"Lessor". Section 2A-103(1)(p).

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

"Person". Section 1-201(30).

"Remedy". Section 1-201(34).

"Rights". Section 1-201(36).

"Security interest". Section 1-201(37).

"Termination". Section 2A-103(1)(z).

"Value". Section 1-201(44).

"Writing". Section 1-201(46).

PART 4. PERFORMANCE OF LEASE CONTRACT:

REPUDIATED, SUBSTITUTED AND EXCUSED

§ 2A-401. INSECURITY: ADEQUATE ASSURANCE OF PERFORMANCE.

(1) A lease contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.

(2) If reasonable grounds for insecurity arise with respect to the performance of either party, the insecure party may demand in writing adequate assurance of due performance. Until the insecure party receives that assurance, if commercially reasonable the insecure party may suspend any performance for which he [or she] has not already received the agreed return.

(3) A repudiation of the lease contract occurs if assurance of due performance adequate under the circumstances of the particular case is not provided to the insecure party within a reasonable time, not to exceed 30 days after receipt of a demand by the other party.

(4) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to commercial standards.

(5) Acceptance of any nonconforming delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-609.

Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (3) (Section 2-609(4)), the adjective "justified" modifies demand. The adjective was deleted here as unnecessary, implying no substantive change.

Definitional Cross References:

"Aggrieved party". Section 1-20.(2).
 "Agreed". Section 1-201(3).
 "Between merchants". Section 2-104(3).
 "Conforming". Section 2A-103(1)(d).
 "Delivery". Section 1-201(14).
 "Lease contract". Section 2A-103(1)(1).
 "Party". Section 1-201(29).
 "Reasonable time". Section 1-204(1) and (2).
 "Receipt". Section 2-103(1)(c).
 "Rights". Section 1-201(36).
 "Writing". Section 1-201(46).

§ 2A-402. ANTICIPATORY REPUDIATION.

If either party repudiates a lease contract with respect to a performance not yet due under the lease contract, the loss of which performance will substantially

impair the value of the lease contract to the other, the aggrieved party may:

(a) for a commercially reasonable time, await retraction of repudiation and performance by the repudiating party;

(b) make demand pursuant to Section 2A-401 and await assurance of future performance adequate under the circumstances of the particular case; or

(c) resort to any right or remedy upon default under the lease contract or this Article, even though the aggrieved party has notified the repudiating party that the aggrieved party would await the repudiating party's performance and assurance and has urged retraction. In addition, whether or not the aggrieved party is pursuing one of the foregoing remedies, the aggrieved party may suspend performance or, if the aggrieved party is the lessor, proceed in accordance with the provisions of this Article on the lessor's right to identify goods to the lease contract notwithstanding default or to salvage unfinished goods (Section 2A-524).

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-610.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Aggrieved party". Section 1-201(2).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

§ 2A-403. RETRACTION OF ANTICIPATORY REPUDIATION.

(1) Until the repudiating party's next performance is due, the repudiating party can retract the repudiation unless, since the repudiation, the aggrieved party has cancelled the lease contract or materially changed the aggrieved party's position or otherwise indicated that the aggrieved party considers the repudiation final.

(2) Retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform under the lease contract and includes any assurance demanded under Section 2A-401.

(3) Retraction reinstates a repudiating party's rights under a lease contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-611.

Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (2) (Section 2-611(2)) the adjective "justifiably" modifies demanded. The adjective was deleted here (as it was in Section 2A-401) as unnecessary, implying no substantive change.

Definitional Cross References:

"Aggrieved party". Section 1-201(2).
"Cancellation". Section 2A-103(1)(b).
"Lease contract". Section 2A-103(1)(1).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).

§ 2A-404. SUBSTITUTED PERFORMANCE.

(1) If without fault of the lessee, the lessor and the supplier, the agreed berthing, loading, or unloading facilities fail or the agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable, but a commercially reasonable substitute is available, the substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation:

(a) the lessor may withhold or stop delivery or cause the supplier to withhold or stop delivery unless the lessee provides a means or manner of payment that is commercially a substantial equivalent; and

(b) if delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the lessee's obligation unless the regulation is discriminatory, oppressive, or predatory.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-614.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Agreed". Section 1-201(3).
 "Delivery". Section 1-201(14).
 "Fault". Section 2A-103(1)(f).
 "Lessee". Section 2A-103(1)(n).
 "Lessor". Section 2A-103(1)(p).
 "Supplier". Section 2A-103(1)(x).

§ 2A-405. EXCUSED PERFORMANCE.

Subject to Section 2A-404 on substituted performance, the following rules apply:

(a) Delay in delivery or nondelivery in whole or in part by a lessor or a supplier who complies with paragraphs (b) and (c) is not a default under the lease contract if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the lease contract was made or by compliance in good faith with any applicable foreign or domestic

governmental regulation or order, whether or not the regulation or order later proves to be invalid.

(b) If the causes mentioned in paragraph (a) affect only part of the lessor's or the supplier's capacity to perform, he [or she] shall allocate production and deliveries among his [or her] customers but at his [or her] option may include regular customers not then under contract for sale or lease as well as his [or her] own requirements for further manufacture. He [or she] may so allocate in any manner that is fair and reasonable.

(c) The lessor seasonably shall notify the lessee and in the case of a finance lease the supplier seasonably shall notify the lessor and the lessee, if known, that there will be delay or nondelivery and, if allocation is required under paragraph (b), of the estimated quota thus made available for the lessee.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-615.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Contract". Section 1-201(11).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Knows". Section 1-201(25).

"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Sale". Section 2-106(1).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).

§ 2A-406. PROCEDURE ON EXCUSED PERFORMANCE.

(1) If the lessee receives notification of a material or indefinite delay or an allocation justified under Section 2A-405, the lessee may by written notification to the lessor as to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (Section 2A-510):

(a) terminate the lease contract (Section 2A-505(2)); or

(b) except in a finance lease that is not a consumer lease, modify the lease contract by accepting the available quota in substitution, with due allowance from the rent payable for the balance of the lease term for the deficiency but without further right against the lessor.

(2) If, after receipt of a notification from the lessor under Section 2A-405, the lessee fails so to modify the lease agreement within a reasonable time not exceeding 30

days, the lease contract lapses with respect to any deliveries affected.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-616(1) and (2).

Changes: Revised to reflect leasing practices and terminology. Note that subsection 1(a) allows the lessee under a lease, including a finance lease, the right to terminate the lease for excused performance (Sections 2A-404 and 2A-405). However, subsection 1(b), which allows the lessee the right to modify the lease for excused performance, excludes a finance lease that is not a consumer lease. This exclusion is compelled by the same policy that led to codification of provisions with respect to irrevocable promises. Section 2A-407.

Definitional Cross References:

"Consumer lease". Section 2A-103(1)(e).
 "Delivery". Section 1-201(14).
 "Finance lease". Section 2A-103(1)(g).
 "Goods". Section 2A-103(1)(h).
 "Installment lease contract". Section 2A-103(1)(i).
 "Lease agreement". Section 2A-103(1)(k).
 "Lease contract". Section 2A-103(1)(l).
 "Lessee". Section 2A-103(1)(n).
 "Lessor". Section 2A-103(1)(p).
 "Notice". Section 1-201(25).
 "Reasonable time". Section 1-204(1) and (2).
 "Receipt". Section 2-103(1)(c).
 "Rights". Section 1-201(36).
 "Termination". Section 2A-103(1)(z).
 "Value". Section 1-201(44).
 "Written". Section 1-201(46).

§ 2A-407. IRREVOCABLE PROMISES: FINANCE LEASES.

(1) In the case of a finance lease that is not a consumer lease the lessee's promises under the lease contract

become irrevocable and independent upon the lessee's acceptance of the goods.

(2) A promise that has become irrevocable and independent under subsection (1):

(a) is effective and enforceable between the parties, and by or against third parties including assignees of the parties, and

(b) is not subject to cancellation, termination, modification, repudiation, excuse, or substitution without the consent of the party to whom the promise runs.

OFFICIAL COMMENT

Uniform Statutory Source: None.

Purposes: This section extends the benefits of the classic "hell or high water" clause to a finance lease that is not a consumer lease. This section is self-executing; no special provision need be added to the contract. This section makes covenants in a finance lease irrevocable and independent due to the function of the finance lessor in a three party relationship: the lessee is looking to the supplier to perform the essential covenants and warranties. Section 2A-209. Thus, upon the lessee's acceptance of the goods the lessee's promises to the lessor under the lease contract become irrevocable and independent. The provisions of this section remain subject to the obligation of good faith (Sections 2A-103(4) and 1-203), and the lessee's revocation of acceptance (Section 2A-517).

The section requires the lessee to perform even if the lessor's performance after the lessee's acceptance is not in accordance with the lease contract; the lessee may, however, have and pursue a cause of action against the lessor, e.g., breach of certain limited warranties (Sections 2A-210 and 211(1)). This is appropriate because the benefit of the supplier's promises and warranties to the lessor under the supply contract is extended to the lessee under the finance lease. Section 2A-209. Despite this balance, this

section excludes a finance lease that is a consumer lease. That a consumer be obligated to pay notwithstanding defective goods or the like is a principle that is not tenable under case law (Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967)), state statute (Unif. Consumer Credit Code §§ 3.403-.405, 7A U.L.A. 126-31 (1974)), or federal statute (15 U.S.C. § 1666i (1982)).

The relationship of the three parties to a transaction that qualifies as a finance lease is best demonstrated by a hypothetical. A, the potential lessor, has been contacted by B, the potential lessee, to discuss the lease of an expensive line of equipment that B has recently placed an order for with C, the manufacturer of such goods. The negotiation is completed and A, as lessor, and B, as lessee, sign a lease of the line of equipment for a 60-month term. B, as buyer, assigns the purchase order with C to A. If this transaction creates a lease (Section 2A-103(1)(j)), this transaction should qualify as a finance lease. Section 2A-103(1)(g).

The line of equipment is delivered by C to B's place of business. After installation by C and testing by B, B accepts the goods by signing a certificate of delivery and acceptance, a copy of which is sent by B to A and C. One year later the line of equipment malfunctions and B falls behind in its manufacturing schedule.

Under this Article, because the lease is a finance lease, no warranty of fitness or merchantability is extended by A to B. Sections 2A-212(1) and 2A-213. Absent an express provision in the lease agreement, application of Section 2A-210 or Section 2A-211(1), or application of the principles of law and equity, including the law with respect to fraud, duress, or the like (Sections 2A-103(4) and 1-103), B has no claim against A. B's obligation to pay rent to A continues as the obligation became irrevocable and independent when B accepted the line of equipment (Section 2A-407(1)). B has no right of set-off with respect to any part of the rent still due under the lease. Section 2A-508(6). However, B may have another remedy. Despite the lack of privity between B and C (the purchase order with C having been assigned by B to A), B may have a claim against C. Section 2A-209(1).

This section is silent as to whether a "hell or high water" clause, *i.e.*, a clause that is to the effect of this section, is enforceable if included in a finance lease that is a consumer lease or a lease that is not a finance lease. That issue will continue to be determined by the facts of

each case. Sections 2A-104, 2A-103(4), 9-206 and 9-318. However, with respect to finance leases that are not consumer leases courts have enforced "hell or high water" clauses. In re O.P.M. Leasing Servs., 21 Bankr. 993, 1006 (Bankr. S.D.N.Y. 1982).

Subsection (2) further provides that a promise that has become irrevocable and independent under subsection (1) is enforceable not only between the parties but also against third parties. Thus, the finance lease can be transferred or assigned without disturbing enforceability. Further, subsection (2) also provides that the promise cannot, among other things, be cancelled or terminated without the consent of the lessor.

Cross References:

Sections 1-103, 1-203, 2A-103(1)(g), 2A-103(1)(j), 2A-103(4), 2A-104, 2A-209, 2A-209(1), 2A-210, 2A-211(1), 2A-212(1), 2A-213, 2A-517(1)(b), 9-206 and 9-318.

Definitional Cross References:

"Cancellation". Section 2A-103(1)(b).
 "Consumer lease". Section 2A-103(1)(e).
 "Finance lease". Section 2A-103(1)(g).
 "Goods". Section 2A-103(1)(h).
 "Lease contract". Section 2A-103(1)(1).
 "Lessee". Section 2A-103(1)(n).
 "Party". Section 1-201(29).
 "Termination". Section 2A-103(1)(z).

PART 5. DEFAULT

A. IN GENERAL

§ 2A-501. DEFAULT: PROCEDURE.

(1) Whether the lessor or the lessee is in default under a lease contract is determined by the lease agreement and this Article.

(2) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement has rights and remedies as provided in this Article and, except as limited by this Article, as provided in the lease agreement.

(3) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement may reduce the party's claim to judgment, or otherwise enforce the lease contract by self-help or any available judicial procedure or nonjudicial procedure, including administrative proceeding, arbitration, or the like, in accordance with this Article.

(4) Except as otherwise provided in this Article or the lease agreement, the rights and remedies referred to in subsections (2) and (3) are cumulative.

(5) If the lease agreement covers both real property and goods, the party seeking enforcement may proceed under this Part as to the goods, or under other applicable law as to both the real property and the goods in accordance with his [or her] rights and remedies in respect of the real property, in which case this Part does not apply.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-501.

Changes: Substantially revised.

Purposes: Subsection (1) is new and represents a departure from the Article on Secured Transactions (Article 9) as the subsection makes clear that whether a party to the lease agreement is in default is determined by

the agreement as well as this Article. Sections 2A-508 and 2A-523. It further departs from Article 9 in recognizing the potential default of either party, a function of the bilateral nature of the obligations between the parties to the lease contract.

Subsection (2) is a version of the first sentence of Section 9-501(1), revised to reflect leasing terminology.

Subsection (3), an expansive version of the second sentence of Section 9-501(1), lists the procedures that may be followed by the party seeking enforcement; in effect, the scope of the procedures listed in subsection (3) is consistent with the scope of the procedures available to the foreclosing secured party.

Subsection (4) establishes that the parties' rights and remedies are cumulative. DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.S.F. L. Rev. 257, 276-80 (1978).

Section 9-501(3), which, among other things, states that certain rules, to the extent they give rights to the debtor and impose duties on the secured party, may not be waived or varied, was not incorporated in this Article. Given the significance of freedom of contract in the development of the common law as it applies to bailments for hire and the lessee's lack of an equity of redemption, there was no reason to impose that restraint.

Cross References:

Sections 2A-508, 2A-523, Article 9, esp. Sections 9-501(1) and 9-501(3).

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
 "Lease agreement". Section 2A-103(1)(k).
 "Lease contract". Section 2A-103(1)(l).
 "Lessee". Section 2A-103(1)(n).
 "Lessor". Section 2A-103(1)(p).
 "Party". Section 1-201(29).
 "Remedy". Section 1-201(34).
 "Rights". Section 1-201(36).

§ 2A-502. NOTICE AFTER DEFAULT.

Except as otherwise provided in this Article or the lease agreement, the lessor or lessee in default under the lease contract is not entitled to notice of default or notice of enforcement from the other party to the lease agreement.

OFFICIAL COMMENT

Uniform Statutory Source: None.

Purposes: This section makes clear that absent agreement to the contrary or provision in this Article to the contrary, e.g., Section 2A-516(3)(a), the party in default is not entitled to notice of default or enforcement. While a review of Part 5 of Article 9 leads to the same conclusion with respect to giving notice of default to the debtor, it is never stated. Although Article 9 requires notice of disposition and strict foreclosure, the different scheme of lessors' and lessees' rights and remedies developed under the common law, and codified by this Article, generally does not require notice of enforcement; furthermore, such notice is not mandated by due process requirements. However, certain sections of this Article do require notice. E.g., Section 2A-517(2).

Cross References:

Sections 2A-516(3)(a), 2A-517(2), and Article 9, esp. Part 5.

Definitional Cross References:

"Lease agreement". Section 2A-103(1)(k).
 "Lease contract". Section 2A-103(1)(l).
 "Lessee". Section 2A-103(1)(n).
 "Lessor". Section 2A-103(1)(p).
 "Notice". Section 1-201(25).
 "Party". Section 1-201(29).

§ 2A-503. MODIFICATION OR IMPAIRMENT OF RIGHTS AND REMEDIES.

(1) Except as otherwise provided in this Article, the lease agreement may include rights and remedies for default in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article.

(2) Resort to a remedy provided under this Article or in the lease agreement is optional unless the remedy is expressly agreed to be exclusive. If circumstances cause an exclusive or limited remedy to fail of its essential purpose, or provision for an exclusive remedy is unconscionable, remedy may be had as provided in this Article.

(3) Consequential damages may be liquidated under Section 2A-504, or may otherwise be limited, altered, or excluded unless the limitation, alteration, or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

(4) Rights and remedies on default by the lessor or the lessee with respect to any obligation or promise collateral or ancillary to the lease contract are not impaired by this Article.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-719 and 2-701.

Changes: Rewritten to reflect lease terminology and to clarify the relationship between this section and Section 2A-504.

Purposes: A significant purpose of this Part is to provide rights and remedies for those parties to a lease who fail to provide them by agreement or whose rights and remedies fail of their essential purpose or are unenforceable. However, it is important to note that this implies no restriction on freedom to contract. Sections 2A-103(4) and 1-102(3). Thus, subsection (1), a revised version of the provisions of Section 2-719(1), allows the parties to the lease agreement freedom to provide for rights and remedies in addition to or in substitution for those provided in this Article and to alter or limit the measure of damages recoverable under this Article. Except to the extent otherwise provided in this Article (e.g., Sections 2A-105, 106 and 108(1) and (2)), this Part shall be construed neither to restrict the parties' ability to provide for rights and remedies or to limit or alter the measure of damages by agreement, nor to imply disapproval of rights and remedy schemes other than those set forth in this Part.

Subsection (2) makes explicit with respect to this Article what is implicit in Section 2-719 with respect to the Article on Sales (Article 2): if an exclusive remedy is held to be unconscionable, remedies under this Article are available. Section 2-719 official comment 1.

Subsection (3), a revision of Section 2-719(3), makes clear that consequential damages may also be liquidated. Section 2A-504(1).

Subsection (4) is a revision of the provisions of Section 2-701. This subsection leaves the treatment of default with respect to obligations or promises collateral or ancillary to the lease contract to other law. Sections 2A-103(4) and 1-103. An example of such an obligation would be that of the lessor to the secured creditor which has provided the funds to leverage the lessor's lease transaction; an example of such a promise would be that of the lessee, as seller, to the lessor, as buyer, in a sale-leaseback transaction.

Cross References:

Sections 1-102(3), 1-103, Article 2, esp. Sections 2-701, 2-719, 2-719(1), 2-719(3), 2-719 official comment 1, and Sections 2A-103(4), 2A-105, 2A-106, 2A-108(1), 2A-108(2), 2A-504 and 2A-504(1).

Definitional Cross References:

"Agreed". Section 1-201(3).
 "Consumer goods". Section 9-109(1).
 "Lease agreement". Section 2A-103(1)(k).
 "Lease contract". Section 2A-103(1)(l).
 "Lessee". Section 2A-103(1)(n).
 "Lessor". Section 2A-103(1)(p).
 "Person". Section 1-201(30).
 "Remedy". Section 1-201(34).
 "Rights". Section 1-201(36).

§ 2A-504. LIQUIDATION OF DAMAGES.

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

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

(3) If the lessor justifiably withholds or stops delivery of goods because of the lessee's default or insolvency (Section 2A-525 or 2A-526), the lessee is entitled to restitution of any amount by which the sum of his [or her] payments exceeds:

(a) the amount to which the lessor is entitled by virtue of terms liquidating the lessor's damages in accordance with subsection (1); or

(b) in the absence of those terms, 20 percent of the then present value of the total rent the lessee was obligated to pay for the balance of the lease term, or, in the case of a consumer lease, the lesser of such amount or \$500.

(4) A lessee's right to restitution under subsection (3) is subject to offset to the extent the lessor establishes:

(a) a right to recover damages under the provisions of this Article other than subsection (1); and

(b) the amount or value of any benefits received by the lessee directly or indirectly by reason of the lease contract.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-718(1), (2), (3) and 2-719(2).

Changes: Substantially rewritten.

Purposes: Many leasing transactions are predicated on the parties' ability to agree to an appropriate amount of damages or formula for damages in the event of default or other act or omission. The rule with respect to sales of goods (Section 2-718) may not be sufficiently flexible to accommodate this practice. Thus, consistent with the common law emphasis upon freedom to contract with respect to bailments for hire, this section has created a revised rule that allows greater flexibility with respect to leases of goods.

Subsection (1), a significantly modified version of the provisions of Section 2-718(1), provides for liquidation of damages in the lease agreement at an amount or by a formula. Section 2-718(1) does not by its express terms include liquidation by a formula; this change was compelled by modern leasing practice. Subsection (1), in a further expansion of Section 2-718(1), provides for liquidation of damages for default as well as any other act or omission.

A liquidated damages formula that is common in leasing practice provides that the sum of lease payments past due, accelerated future lease payments, and the lessor's estimated residual interest, less the net proceeds of disposition (whether by sale or re-lease) of the leased goods is the lessor's damages. Tax indemnities, costs, interest and attorney's fees are also added to determine the lessor's damages. Another common liquidated damages formula utilizes a periodic depreciation allocation as a credit to the aforesaid amount in mitigation of a lessor's damages. A third formula provides for a fixed number of periodic payments as a means of liquidating damages. Stipulated loss or stipulated damage schedules are also common. Whether these formulae are enforceable will be determined in the context of each case by applying a standard of reasonableness in light of the harm anticipated when the formula was agreed to. Whether the inclusion of these formulae will affect the classification of the transaction as a lease or a security interest is to be determined by the facts of each case. Section 1-201(37). E.g., In re Noack, 44 Bankr. 172, 174-75 (Bankr. E.D. Wis. 1984).

This section does not incorporate two other tests that under sales law determine enforceability of liquidated damages, *i.e.*, difficulties of proof of loss and inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. The ability to liquidate damages is critical to modern leasing practice; given the parties' freedom to contract at common law, the policy behind

retaining these two additional requirements here was thought to be outweighed. Further, given the expansion of subsection (1) to enable the parties to liquidate the amount payable with respect to an indemnity for loss or diminution of anticipated tax benefits resulted in another change: the last sentence of Section 2-718(1), providing that a term fixing unreasonably large liquidated damages is void as a penalty, was also not incorporated. The impact of local, state and federal tax laws on a leasing transaction can result in an amount payable with respect to the tax indemnity many times greater than the original purchase price of the goods. By deleting the reference to unreasonably large liquidated damages the parties are free to negotiate a formula, restrained by the rule of reasonableness in this section. These changes should invite the parties to liquidate damages. Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 Yale L.J. 199, 278 (1963).

Subsection (2), a revised version of Section 2-719(2), provides that if the liquidated damages provision is not enforceable or fails of its essential purpose, remedy may be had as provided in this Article.

Subsection (3)(b) of this section differs from subsection (2)(b) of Section 2-718; in the absence of a valid liquidated damages amount or formula the lessor is permitted to retain 20 percent of the present value of the total rent payable under the lease. The alternative limitation of \$500 contained in Section 2-718 is deleted as unrealistically low with respect to a lease other than a consumer lease.

Cross References:

Sections 1-201(37), 2-718, 2-718(1), 2-718(2)(b) and 2-719(2).

Definitional Cross References:

"Consumer lease". Section 2A-103(1)(e).
 "Delivery". Section 1-201(14).
 "Goods". Section 2A-103(1)(h).
 "Insolvent". Section 1-201(23).
 "Lease agreement". Section 2A-103(1)(k).
 "Lease contract". Section 2A-103(1)(l).
 "Lessee". Section 2A-103(1)(n).

"Lessor". Section 2A-103(1)(p).
"Lessor's residual interest". Section 2A-103(1)(q).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).
"Value". Section 1-201(44).

§ 2A-505. CANCELLATION AND TERMINATION AND EFFECT OF
CANCELLATION, TERMINATION, RESCISSION, OR FRAUD ON
RIGHTS AND REMEDIES.

(1) On cancellation of the lease contract, all obligations that are still executory on both sides are discharged, but any right based on prior default or performance survives, and the cancelling party also retains any remedy for default of the whole lease contract or any unperformed balance.

(2) On termination of the lease contract, all obligations that are still executory on both sides are discharged but any right based on prior default or performance survives.

(3) Unless the contrary intention clearly appears, expressions of "cancellation," "rescission," or the like of the lease contract may not be construed as a renunciation or discharge of any claim in damages for an antecedent default.

(4) Rights and remedies for material misrepresentation or fraud include all rights and remedies available under this Article for default.

(5) Neither rescission nor a claim for rescission of the lease contract nor rejection or return of the goods may bar or be deemed inconsistent with a claim for damages or other right or remedy.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-106(3) and (4), 2-720 and 2-721.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Cancellation". Section 2A-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Termination". Section 2A-103(1)(z).

§ 2A-506. STATUTE OF LIMITATIONS.

(1) An action for default under a lease contract, including breach of warranty or indemnity, must be commenced within 4 years after the cause of action accrued. By the original lease contract the parties may reduce the period of limitation to not less than one year.

(2) A cause of action for default accrues when the act or omission on which the default or breach of warranty is based is or should have been discovered by the aggrieved party, or when the default occurs, whichever is later. A

cause of action for indemnity accrues when the act or omission on which the claim for indemnity is based is or should have been discovered by the indemnified party, whichever is later.

(3) If an action commenced within the time limited by subsection (1) is so terminated as to leave available a remedy by another action for the same default or breach of warranty or indemnity, the other action may be commenced after the expiration of the time limited and within 6 months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action that have accrued before this Article becomes effective.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-725.

Changes: Substantially rewritten.

Purposes: Subsection (1) does not incorporate the limitation found in Section 2-725(1) prohibiting the parties from extending the period of limitation. Breach of warranty and indemnity claims often arise in a lease transaction; with the passage of time such claims often diminish or are eliminated. To encourage the parties to commence litigation under these circumstances makes little sense.

Subsection (2) states two rules for determining when a cause of action accrues. With respect to default, the rule

of Section 2-725(2) is not incorporated in favor of a more liberal rule of the later of the date when the default occurs or when the act or omission on which it is based is or should have been discovered. With respect to indemnity, a similarly liberal rule is adopted.

Cross References:

Sections 2-725(1) and 2-725(2).

Definitional Cross References:

"Action". Section 1-201(1).
"Aggrieved party". Section 1-201(2).
"Lease contract". Section 2A-103(1)(1).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Termination". Section 2A-103(1)(z).

§ 2A-507. PROOF OF MARKET RENT: TIME AND PLACE.

(1) Damages based on market rent (Section 2A-519 or 2A-528) are determined according to the rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the time of the default.

(2) If evidence of rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the times or places described in this Article is not readily available, the rent prevailing within any reasonable time before or after the time described or at any other place or for a different lease term which in commercial judgment or

under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the difference, including the cost of transporting the goods to or from the other place.

(3) Evidence of a relevant rent prevailing at a time or place or for a lease term other than the one described in this Article offered by one party is not admissible unless and until he [or she] has given the other party notice the court finds sufficient to prevent unfair surprise.

(4) If the prevailing rent or value of any goods regularly leased in any established market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of that market are admissible in evidence. The circumstances of the preparation of the report may be shown to affect its weight but not its admissibility.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-723 and 2-724.

Changes: Revised to reflect leasing practices and terminology. Section 2A-519(2) provides an example of one of the several times this Article refers to a determination of market rent prevailing at a given time or place. Section 2A-507(2).

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Usage of trade". Section 1-205.
"Value". Section 1-201(44).

B. DEFAULT BY LESSOR

§ 2A-508. LESSEE'S REMEDIES.

(1) If a lessor fails to deliver the goods in conformity to the lease contract (Section 2A-509) or repudiates the lease contract (Section 2A-402), or a lessee rightfully rejects the goods (Section 2A-509) or justifiably revokes acceptance of the goods (Section 2A-517), then with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (Section 2A-510), the lessor is in default under the lease contract and the lessee may:

- (a) cancel the lease contract (Section 2A-505(1));
- (b) recover so much of the rent and security as has been paid, but in the case of an installment lease contract the recovery is that which is just under the circumstances;

(c) cover and recover damages as to all goods affected whether or not they have been identified to the lease contract (Sections 2A-518 and 2A-520), or recover damages for nondelivery (Sections 2A-519 and 2A-520).

(2) If a lessor fails to deliver the goods in conformity to the lease contract or repudiates the lease contract, the lessee may also:

(a) if the goods have been identified, recover them (Section 2A-522); or

(b) in a proper case, obtain specific performance or replevy the goods (Section 2A-521).

(3) If a lessor is otherwise in default under a lease contract, the lessee may exercise the rights and remedies provided in the lease contract and this Article.

(4) If a lessor has breached a warranty, whether express or implied, the lessee may recover damages (Section 2A-519(4)).

(5) On rightful rejection or justifiable revocation of acceptance, a lessee has a security interest in goods in the lessee's possession or control for any rent and security that has been paid and any expenses reasonably incurred in their inspection, receipt, transportation, and care and custody and may hold those goods and dispose of them in good faith and in a commercially reasonable manner, subject to the provisions of Section 2A-527(5).

(6) Subject to the provisions of Section 2A-407, a lessee, on notifying the lessor of the lessee's intention to do so, may deduct all or any part of the damages resulting from any default under the lease contract from any part of the rent still due under the same lease contract.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-711 and 2-717.

Changes: Substantially rewritten.

Purposes: This section is an index to Sections 2A-509 through 522 and their effect on the lessee's rights and remedies after the lessor's default. The lessor and the lessee can otherwise agree; thus, the parties can, among other things, raise or lower the threshold of events that give rise to a lessor's default or create a new scheme of rights and remedies triggered by the occurrence of the default. Sections 2A-103(4) and 1-102(3).

Subsection (1), a substantially rewritten version of the provisions of Section 2-711(1), lists three cumulative remedies of the lessee where the lessor has failed to deliver conforming goods or has repudiated the contract, or the lessee has rightfully rejected or justifiably revoked. Sections 2A-501(2) and (4). This Article rejects any doctrine of election of remedy. To determine if one remedy bars another in a particular case is a function of whether the lessee has been put in as good a position as if the lessor had fully performed the lease agreement. Sections 2A-103(4) and 1-106(1). Note that a special rule has been created regarding the lessee's recovery of rent and security that have been paid in the case of an installment lease -- recovery is limited to that which is just under the circumstances. With the various different types of installment leases, no bright line can be created that would operate fairly in all cases; in addition, this provision should further encourage the parties to establish their own rules by agreement.

Subsection (2), a version of the provisions of Section 2-711(2) revised to reflect leasing terminology, lists two alternative remedies for the recovery of the goods

by the lessee; however, each of these remedies is cumulative with respect to those listed in subsection (1).

Subsection (3) is new and allows the lessee access to the remedy scheme of this Article as well as the lease contract if the lessor is in default for reasons other than those stated in subsection (1). Note that the reference to this Article includes supplemental principles of law and equity. Sections 2A-103(4) and 1-103.

Subsection (4) is new and merely adds to the completeness of the index by including a reference to the lessee's recovery of damages upon the lessor's breach of warranty; such breach may not rise to the level of a default by the lessor (e.g. breach of an express warranty that the goods subject to the lease conform to description where the non-conformity is such that when measured by objective criteria it reflects a minimal deviation from description) unless the breach is material or unless so provided by the lease agreement.

Subsection (5), a revised version of the provisions of Section 2-711(3), recognizes, on rightful rejection or justifiable revocation, the lessee's security interest in goods in its possession and control. Section 9-113, which recognized security interests arising under the Article on Sales (Article 2), was amended with the adoption of this Article to reflect the security interests arising under this Article. Pursuant to Section 2A-511(4), a purchaser who purchases goods from the lessee in good faith takes free of any rights of the lessor, or in the case of a finance lease the supplier. Such goods, however, must have been rightfully rejected and disposed of pursuant to Section 2A-511 or 2A-512. However, Section 2A-517(3) provides that the lessee will have the same rights and duties with respect to goods where acceptance has been revoked as with respect to goods rejected. Thus, Section 2A-511(4) will apply to the lessee's disposition of such goods.

Pursuant to Section 2A-527(5), the lessee must account to the lessor for the excess proceeds of such disposition, after satisfaction of the claim secured by the lessee's security interest.

Subsection (6), a slightly revised version of the provisions of Section 2-717, sanctions a right of set-off by the lessee, subject to the rule of Section 2A-407 with respect to irrevocable promises in a finance lease that is