NORTH CAROLINA LAW REVIEW

Volume 44 | Number 3 Article 1

4-1-1966

A Bowing Acquaintance with the Uniform Commercial Code

William D. Hawkland

A BOWING ACQUAINTANCE WITH THE UNIFORM COMMERCIAL CODE

WILLIAM D. HAWKLAND*

The Uniform Commercial Code has been described as "the most ambitious codification ever undertaken in the Anglo-American legal world."[1] This description is not extravagant. The Code replaces seven uniform acts,[2] the model collection code of the American Bankers' Association, a legion of individual state statutes dealing with banking, selling and security, and a mass of common law concerned with personal property. The author of this paper once estimated that the enactment of the Code in New Jersey in some way affected about one-third of the private law of that state,[3] and there is every reason to believe that a similar impact obtains in North Carolina. The drastic displacement of this large body of law is of considerable concern to practicing attorneys, particularly to most general practitioners who, unlike the commercial-law specialists, have not followed the development of the Code and its enactment in the other states. These general practitioners will be heartened by the following words of assurance given to them by Mr. Walter D. Malcolm, prominent Boston attorney and expert on the Code:

> Lawyers of this type in the state enacting the Code will need to have a bowing acquaintance with the Code. They will have to know the Code has been passed, they will have to have copies of the Code in their office, they should know when a subject is likely to be covered by the Code and where to look for coverage in the Code. In most cases, however, the general practitioner, having this bowing acquaintance with the Code, can then wait until a case arises which is covered by the Code and then look to the Code to see if there is an answer. When he does so he will find in a very substantial portion of cases that he will find

---

* Dean, State University of New York School of Law.

[1] Mentschikoff, *Highlights of the Uniform Commercial Code*, 27 MOD. L. REV. 167 (1964).

[2] UNIFORM SALES ACT (1907); NEGOTIABLE INSTRUMENTS LAW (1897); UNIFORM WAREHOUSE RECEIPTS ACT (1907); BILLS OF LADING ACT (1919); UNIFORM TRUST RECEIPT ACT (1933); UNIFORM CONDITIONAL SALES ACT (1917); and UNIFORM STOCK TRANSFER ACT (1907).

[3] FIRST REPORT TO THE GOVERNOR, THE SENATE AND THE ASSEMBLY OF THE STATE OF NEW JERSEY, COMMISSION TO STUDY AND REPORT UPON THE UNIFORM COMMERCIAL CODE FOR NEW JERSEY (1959).

more answers than he did prior to the enactment of the Code and he will find answers much more rapidly.[4]

This short article has been written in the hope that it will give the general practitioner in North Carolina this "bowing acquaintance" with the Code.

The Commercial Code is divided into ten parts called articles. The articles, in turn, are divided into sections. Altogether there are about four hundred sections in the Code. Each article handles one major subdivision of the entire subject of commercial law. The first and last articles, however, do not cover any traditional field of law. Article 1, instead, sets forth principles and definitions of general application, and Article 10 provides rules relating to uniform construction, savings clauses, repealers, and the effective date. Subject to these general provisions, all the rules on sales are collected in Article 2, commercial paper in Article 3, bank deposits and collections in Article 4, letters of credit in Article 5, bulk transfers in Article 6, documents of title in Article 7, investment securities in Article 8, and secured transactions in Article 9.

A chosen and consistent terminology runs through the Code, a matter made possible by the forty-six generally applicable definitions presented in Article 1. In addition, there are a number of "nominal" definitions, ones chosen for use only in particular areas. For example, Article 2 on sales draws in a number of its sections a distinction that turns on whether the party involved is a merchant. This distinction is not made in the other articles. For this reason Article 2, rather than Article 1, defines the term "merchant."

Within each article the various sections are arranged so as to group together related rules and topics. Thus each article becomes a microcosm of the Code itself. Article 2, for example, is subdivided into seven parts; Part 1 concerns itself with definitions and general principles; Part 2 with form, formation and readjustment of contract; Part 3 with general obligation and construction; Part 4 with title, creditors and good faith purchasers; Part 5 with performance; Part 6 with breach, repudiation and excuse; and Part 7 with remedies. The other articles are similarly subdivided.

Logical arrangement is also found in the sections of the Code.

[4] THE EXPERIENCE OF MASSACHUSETTS AND OTHER STATES UNDER THE CODE, REPORT OF THE NEW YORK JOINT LEGISLATIVE COMMITTEE ON INTERSTATE COOPERATION 261 (1962).

This fact is indicated by the great number of sections which begin by stating a general rule and end by listing all the exceptions to it. This systematic approach has promoted a consolidation not usually found in commercial statutes. For example, consider section 3-511, which gathers together in one convenient place all the various commercial-paper rules and exceptions relating to dispensation of presentment and notice. Formerly, in the Uniform Negotiable Instruments Law, these rules were haphazardly stated in seventeen different sections.[5]

The various provisions of the Code are well coordinated with one another. This is accomplished by the liberal use of cross references and definitional cross references which are set out in the comments to nearly all the sections. The Code also contains a number of subordination provisions which resolve conflicts that might otherwise arise because of the apparent overlapping of the various articles. For example, a promissory note, usually governed by Article 3, may constitute the collateral for a security transaction. Questions of collateral are usually governed by Article 9. The note may be collected through banking channels. Bank collections are governed by Article 4. Which article governs our note? The Code, through a carefully designed hierarchy, provides various subordination rules which resolve this kind of problem. In the matter at hand, section 3-103(2) gives part of the answer: "The provisions of this Article are subject to the provisions of the Article on Bank Deposits and Collections (Article 4) and Secured Transactions (Article 9)." Section 4-208 completes the answer by subordinating most of the rules of Article 4 to those of Article 9.

Having generally considered the systematic construction of the Code, let us now examine each of its ten articles.

I. General Provisions (Article 1)

This article sets forth general rules to be applied throughout the Code, deals with principles of interpretation, contains definitions of general application, imposes the general obligation of good faith in the performance of all transactions, and states the purposes of the Code: to "simplify, clarify and modernize" commercial law and to "permit the continued expansion of commercial practices

[5] Uniform Negotiable Instruments Law §§ 79-82, 109, 111-16, 130, 147, 148, 150, 151, 159.

through custom, usage and agreement." The general principle of freedom of contract is reaffirmed by section 1-102, but the same section prevents the parties from contracting away the obligation of good faith, diligence and reasonableness. The section also makes it clear that other sections of the Code may effectively provide that their terms cannot be varied or avoided by agreement.

Article 1 also contains a general rule on territorial applicability (choice of law) and a general statute of frauds. Both of these rules are subject to displacement by the more specific rules of other Articles. In other words, these general rules of Article 1 are gap-fillers. They are applicable only to situations not covered by the more specific rules found in other articles. For example, the sales statute of frauds does not cover choses in action. The sale of a chose in action, therefore, is left to the general statute of frauds of Article 1. By the same token, because Article 2 does not provide a choice-of-law rule for sales transactions, the conflict of laws involving sales are handled under the general rule of Article 1.

Obviously, the lawyer who plans to read the entire Commercial Code should not start this project with Article 1. This article, standing alone, seems almost banal. Read in isolation, it is practically meaningless. It takes on its bite and meaning only as it is related to other articles. *But Article 1 is an extremely important article and research under the Commercial Code is not complete until reference is made to its provisions to determine whether or not a definition or a general principle is applicable to the problem at hand.*

II. Sales (Article 2)

Article 2 is the longest article of the Code. Its one hundred and four sections comprise about twenty-five per cent of the entire Code. Its size has made Article 2 a favorite target of critics who are quick to applaud the shorter, and, inferentially, better drafted, provisions of the Uniform Sales Act. This criticism, however, fails to take into account the fact that something like forty per cent of the sales cases decided in states having the Uniform Sales Act employed rules of law which were not included in that statute.[6] Article 2 is longer than the Uniform Sales Act because it is more complete.

[6] Hawkland, Sales and Bulk Sales Under the Uniform Commercial Code *v* (1958).

Thus, thirty-seven of the one hundred and four sections of Article 2 have no statutory counterparts in the Uniform Sales Act, their origin being the common law and commercial practice. The completeness of Article 2 will make research into sales problems easier than it has been in the past, for answers can be found in this article to practically every conceivable sales question, and the heavy burden of research outside the article usually will be unnecessary. The size of Article 2 is one of its chief merits.

Article 2 does more than complete the fragmentary body of law found in the Uniform Sales Act. It substantially overhauls this body of law in an effort to bring it into line with the best and most modern commercial practices.

In studying Article 2, one would be well advised to keep in mind the four basic questions which any complete law of sales must answer: (1) How do you form a sales contract? (2) After the contract is formed, what are its terms? (3) How are these terms performed? (4) What are the consequences of non-performance?

The Uniform Sales Act answered the first of these questions by providing, in effect, that a sales contract is formed in the same way that any other contract is formed. The draftsmen of Article 2 thought this approach might involve "painting with too broad a brush." They wondered if a formation rule which worked well in one contractual situation, say, an employer-employee contract, would necessarily work well in a vendor-vendee contract. Investigation proved that the simple contract rules of formation were generally satisfactory but were not working well in a few special sales situations. Special formation rules were developed to take care of these special cases. These rules appear in sections 2-201 through 2-210 of the Code. Except for these ten special rules, the law of simple contracts continues as the operative set of rules governing formation. The most important new special rule is found in section 2-207, which deals with the "battle of conflicting forms." *Anyone representing businessmen who use purchase order or order acknowledgment forms should immediately familiarize himself with section 2-207.*

The second question, namely—what are the terms of the sales contract?—gives way to several interesting answers in Article 2. We have seen that Article 1 announces a policy of freedom of contract. Consistently, Article 2 gives the parties substantially full control of the sales contract terms. There are a few limitations, the most important of which is the doctrine of unconscionability found in section 2-302.[7] In drafting a sales contract, each of its provisions must be screened for "unconscionability." It is important also to check each provision against the limitations of good faith, commercial reasonableness and due diligence imposed by Article 1. In the absence of these limitations, a conscionable agreement will be sustained, unless it attempts to change a rule of law set out in Article 2, which, by its own terms, is invariable. There are relatively few sections in Article 2 whose rules are not subject to variation by the agreement of the parties. All sections of Article 2 are deemed to be modified by the phrase "unless otherwise agreed," unless there is a provision to the contrary in the section.[8]

The doctrine of freedom of contract does not necessarily mean that the terms of the sales contract can be found within the four corners of the instrument. Parties, for one reason or another, frequently omit certain terms. Perhaps the omission can be explained by the fact that the term is so well understood by the parties because of past practices or trade customs that it seems unnecessary to write it down. Perhaps it is omitted because it was forgotten or did not seem important at the time the agreement was drafted. Subsequently, if the omitted term becomes important, the court is put in a position where it must take one of two basic actions. It can rule that it is improper for the court "to make a contract for the parties"; that, therefore, it will not supply the missing term for the parties; and that the contract is too indefinite to be enforced without the missing term. On the other hand, it can rule that it is better to make a contract for the parties than to throw the entire agreement out; that, therefore, it will look to trade customs, past practices and the like in an effort to construct a reasonably good "missing term"; that the parties cannot complain about this approach, because they have only themselves to blame for not providing the term in the first place; and that the contract is sufficiently complete with the added term to permit it to be enforced. One hundred years ago the first approach dominated the law of sales, but its vigor has been in decline since that time. Article 2 almost completely abandons this approach in favor of its alternative, con-

[7] This clause was not adopted in North Carolina. See Clifford, *Article Two: Sales,* 44 N.C.L. Rev. 539, 591-94 (1966).
[8] G.S. §§ 25-1-102(3), (4).

structing the missing terms. But the construction does not employ an open-ended method in which the court is free to set any term it wishes. The court is directed to consult "course of dealing" (*i.e.*, previous deals of the parties) and "usage of trade" in ascertaining the missing term.[9] If there is no course of dealing or usage of trade, the court then is directed to the provisions of Part 3 of Article 2, that is to say, sections 2-301 through 2-325. In this part of Article 2 are a series of sales terms which are to be included in the sales contract in the absence of express terms, course of dealing or usage of trade to the contrary. For example, suppose the sales contract is silent as to time of delivery. Suppose also that the parties have not had past dealings and there is no industry practice with regard to this matter. Rather than throw the contract out because it is missing a term which has proved to be important, the court would fill the gap by reference to section 2-309.[10]

Only if the missing term cannot be supplied by reference to course of dealing, usage of trade or the provisions of Part 3 of Article 2 shall the court decline to fill it. This declination may or may not result in the contract's being thrown out, depending on the nature of the missing term.

Part 3 of Article 2 also contains detailed definitions which make it easy and safe to employ mercantile symbols in the sales contract. For example, an extensive definition of the symbol *"F.O.B."* is set out in section 2-319. This definition makes it possible to use this term in the contract without further elaboration, unless the parties want to give the term a meaning that differs from that found in section 2-319. In that case they are competent to give the term any meaning they wish, but they should set out their own definition in the contract itself, remembering that, according to section 2-319, "Unless otherwise agreed, the term F.O.B. [means as follows]. . . ."

Performance of the sales contract is governed by rules found in Part 5 of Article 2, that is to say, in sections 2-501 through 2-515. Strict performance is required. The seller performs his contract by tendering delivery of conforming goods to the buyer. The buyer performs his contract by accepting the goods and paying for them in accordance with the agreement upon a proper tender by the seller.

---

[9] G.S. §§ 25-1-205, -2-208.

[10] G.S. § 25-2-309(1) provides that "the time for shipment or delivery or any other action under a contract if not provided in this Article or agreed upon shall be a reasonable time."

Failure by either party to perform is a breach, unless some mitigating circumstance excuses the infraction or permits substitute performance to be made. Article 2 contains several mitigating provisions formulated in terms of the concepts of "cure"[11] and "failure of presupposed conditions."[12] Its special treatment of anticipatory repudiation[13] and breach of installment contracts[14] also might be regarded as employing mitigating provisions.

In setting out its remedies for breach, Article 2, following to some extent the rules of the common law and the Uniform Sales Act, draws an important distinction that turns on whether or not the buyer had accepted the goods. The remedies aim at putting the aggrieved party in as good a position as if the other party had fully performed the contract.

III. Commercial Paper (Article 3)

Unlike Article 2 which is much longer than the Uniform Sales Act, Article 3, dealing with the subject of commercial paper, is much shorter than its counterpart, the Uniform Negotiable Instruments Law. It completely repeals the NIL and replaces its one hundred and ninety-eight sections with a short and precise article that is seventy-nine sections in length.

Article 3 is a conservative statute and lawyers familiar with the NIL will not have difficulty understanding and using it. The conservative nature of the article has promoted a common tendency to characterize it as one that does little more than resolve the conflicts of authority which developed under the NIL. This characterization is too modest. Article 3 makes at least three major contributions to the law of negotiable instruments: (1) it limits its own scope to short-term money instruments (*i.e.,* to checks, notes and drafts), thus freeing long-term investment paper for the separate coverage of special rules provided by Article 8; (2) it coordinates its rules with the law of bank deposits and collections, set out in Article 4, thus facilitating the banking system; and (3) it makes certain basic and sometimes novel changes in the law of commercial paper, thus providing demonstrably better solutions to problems, some of which are age old. Some of these changes are: While not

[11] G.S. §§ 25-2-508, -511.
[12] G.S. §§ 25-2-613, -614, -615, -616.
[13] G.S. §§ 25-2-610, -611. See also G.S. § 25-2-609.
[14] G.S. § 25-2-612.

requiring the instrument to be complete and regular on its face as under the NIL in order for a holder to be a holder in due course, it makes this an element of adverse notice; nondelivery of an incomplete instrument is no longer a real defense, good as against a holder in due course; restrictive indorsements do not terminate negotiability or preclude a holder from being a holder in due course; protest is not required unless the instrument is drawn or payable outside the United States; a reasonable time for presentment of an uncertified check is presumed to be within thirty days after date or issue in order to charge a drawer and within seven days after indorsement in order to charge an indorser; the drawee's right to recover from the presenter will now depend on presentment warranties rather than on restitutionary remedies, as was the case under the doctrine of *Price v. Neal*,[15] and the "fictitious payee" rule has been expanded so that the drawee bank is less apt to be liable in the fraudulent situations of the padded payroll or the imposter.

IV. Bank Deposits and Collections (Article 4)

The bank collection process is a massive and complex affair. American banks handle over fifteen billion items a year of which eighty-five per cent are checks. Approximately fifty million checks are cleared every day. In the past this important business has been done under fragmentary laws which were completely incomprehensible to most lawyers who were not specialists. Some improvement in the law was made by the enactment in some twenty states of the American Banker Association's "Bank Collection Code," but there long has been a need for a simple, clean-cut statute meeting the requirements of a high-speed, high-volume check collection system. Article 4 fills this need.

In addition, Article 4 provides rules governing the bank-customer relationship. These rules, found in Part 4 of Article 4, that is to say, in sections 4-401 through 4-407, will be of particular interest to many general practitioners whose interest in the banking process is limited to representing customers who feel aggrieved by particular banking practices.

Section 4-401 codifies the rule permitting banks to charge customer's accounts for overdrafts. Section 4-402 deals with the matter of wrongful dishonor of checks. The section makes three points:

---

[15] 3 Burr. 1354, 97 Eng. Rep. 871 (K.B. 1762).

(1) the "trader rule," under which a merchant is entitled to special damages without proof of loss in cases where his checks have been wrongfully dishonored, is abandoned; (2) the rule permitting nominal damages for wrongful dishonor is abandoned; and (3) the rule of damages is limited to those which are actually proved, but they may include recovery for loss due to arrest or prosecution resulting from wrongful dishonor.

Section 4-403 deals with stop orders. Oral stop orders are good for fourteen days. Written stop orders are good for six months. Under a rule based on provisions of section 4-103, the banks can no longer protect themselves with exculpation clauses for liability arising from negligent or inadvertent payment over a stop order.

Stale checks are dealt with in section 4-404. This section provides that a bank may refuse to pay a check which is more than six months old, but it is protected in charging the customer's account for a check more than six months old when it pays it in good faith.

Section 4-405 permits a bank to pay checks written by a customer who has died prior to presentment. In all cases the bank may pay such checks until it learns of the customer's death. Even after it learns of the death the bank may pay checks for a ten-day period measured from the day of the customer's death.

Section 4-406 deals with the duty of the customer to discover and report unauthorized signatures and alterations. Section 4-407 has a novel provision allowing the bank to subrogate in cases in which it has paid a check over a proper stop order.

V. Letters of Credit (Article 5)

Article 5 represents the first effort to codify the law of letters of credit. Before the Code was enacted only a few banks wrote letters of credit, largely because the law of their states did not provide clear-cut answers to problems which might arise in this field. Of fourteen thousand commercial banks in the United States, only about one hundred had ever written a letter of credit before the Code was enacted, and of this group twenty-five banks had more than seventy-five per cent of the business.[16] Now that Article 5 presents in seven-

[16] Second Report to the Governor, the Senate and the Assembly of the State of New Jersey, Commission to Study and Report Upon the Uniform Commercial Code 441-42 (1960). See also Chadsey, *Practical Effect of the Uniform Commercial Code on Documentary Letters of Credit,* 102 U. Pa. L. Rev. 618, 620 (1954).

teen sections the law of letters of credit, it is expected that many banks will engage in this important and lucrative business.

Article 5 deals with many, but not all, of the rights and obligation of the parties to a letter of credit, such as establishment of the credit, issuer's duties and obligations to honor, and the responsibility to examine documents. The Article makes it clear that the issuer of a letter of credit remains responsible only for the contract represented by the letter of credit and not for the underlying sales transaction.

VI. Bulk Transfers (Article 6)

Article 6 is the first effort in the United States to make uniform the law of bulk transfers. Pre-Code bulk transfer laws varied substantially from state to state, but, basically, all these laws provided that a transfer in bulk was void or voidable as against creditors of the transferor unless the creditors were notified of the details of the transfer a specific number of days before it occurred. Usually the transferor was required to deliver a list of his creditors to the transferee, and it was then the duty of the transferee to notify them of the proposed bulk transfer. In some states the transferee also was obligated to distribute the new consideration of the transfer pro rata to the creditors of the transferor.

Article 6 makes some changes in the details of these laws, but, by and large, it follows closely the scheme described above.

Most bulk transfer litigation has involved the question whether or not a particular transaction falls within the reach of the bulk transfer law. One may predict that this situation will continue under Article 6. Therefore, sections 6-102, which defines "bulk transfer," and 6-103, which excepts certain transfers from the scope of the article, probably are the most important sections.

VII. Documents of Title (Article 7)

Documents of title have been the subject of comprehensive uniform laws. These laws, namely the Uniform Warehouse Receipts Act, the Uniform Bills of Lading Act, and portions of the Uniform Sales Act now have been replaced by Article 7 of the Code. Article 7 does not control bills of lading issued for interstate commerce because the federal government has pre-empted this field. Additionally, Article 7 does not displace regulatory statutes such as those prescribing tariffs or classifications. Because of these limitations, the scope of Article 7 is sharply proscribed. This is just one reason why many experts consider Article 7 the least important article of the Code. Another reason is that it makes fewer changes in prior law than any other article. Nevertheless, storage and shipment are important parts of many commercial transactions, and no commercial code could be considered complete without making provisions for bills of lading and warehouse receipts.

Article 7 contains some interesting new provisions on delivery orders, freight forwarders, destination bills, and the right to divert and reconsign goods.

VIII. Investment Securities (Article 8)

This article replaces the Uniform Stock Transfer Act and provisions of the Uniform Negotiable Instruments Law which covered bearer bonds. The purpose of the article is to provide a negotiable instruments law for investment securities which include not only stocks and bearer bonds, but corporate long-term capital and debt obligations and all other types of investment paper commonly dealt in upon securities exchanges or markets, or commonly recognized as a medium of investment. It is not a corporation code or a blue sky law.

Article 8 deals comprehensively with the rights and liabilities of the parties involved in transfer of investment securities. It relates to problems which arise between the issuer and the first holder, the problems of transfers between holders, and the problems of registering the transfer.

The article gives intensive treatment to questions concerning the rights of bona fide purchasers, making a sharp distinction between the rights of the purchaser against the issuer, as contrasted with the rights of a purchaser against other adverse claimants to the security. A bona fide purchaser for value who takes without notice of a "particular" defect takes free of most of the issuer's defenses based on that particular defect. A bona fide purchaser for value without notice of any adverse claims takes free of all adverse claims or equities of ownership. Banks lending on investment securities may qualify as bona fide purchasers irrespective of technical wording of the security and whether the security is bearer or registered.

Finally, Article 8 provides a series of rules which are designed to speed up and simplify the registration process. These rules should prove particularly helpful in cases which involve getting shares of stock transferred out of the names of deceased or incompetent persons or of fiduciaries.

IX. Secured Transactions (Article 9)

Article 9 should be studied carefully by all general practitioners, and a survey treatment here of this extremely important subject is not appropriate. Suffice it to say that Article 9 replaces the many existing devices used to encumber personal property as the collateral for an obligation, such as the chattel mortgage, conditional sale, "trust receipt," lease or bailment with an option to buy, field warehousing, and the like. It replaces these forms of security with a new "single lien." The article provides some new terminology. The transaction is called a "secured transaction," instead of a "mortgage" or a "conditional sale" or a "trust receipt" or whatever. It is created by a "security agreement" made by the "debtor," on the one hand, and the "secured party" on the other. The interest created by a security agreement is called a "security interest." The property to which the security interest attaches is called the "collateral." Collateral is divided into various classes depending on the nature of its use and the status of the parties. Thus collateral may consist of "inventory," "equipment," "consumer goods," "farm products," "farm equipment," "contract rights," "accounts," "general intangibles," "chattel paper," "instruments" or "proceeds." Different rules may be triggered into operation by different kinds of collateral. For example, a "financing statement" (the instrument which is filed to perfect a security interest) must be filed locally to perfect security interests in certain kinds of collateral and centrally to perfect others.

Article 9 answers three basic questions: (1) How do you create a security interest? (2) How do you perfect this interest so as to have priority over third parties? (3) How do you foreclose this interest?

X. Effective Date and Repealer (Article 10)

Article 10 contains a provision to the effect that the Commercial Code will be effective in North Carolina as of July 1, 1967. Transactions validly entered into before the effective date and the rights, duties and interests flowing from them will remain valid thereafter.

XI. Conclusion

This brief treatment of the Uniform Commercial Code should be sufficient to drive home two points. (1) The Code has a significant impact on the private law of North Carolina. *It is good advice to consult its terms in every situation involving personal property.* (2) Nevertheless, the changes of the Code are not of a radical nature requiring major adjustments in current ways of doing business.

If lawyers in North Carolina are like lawyers in other states, they will initially argue whether the legislature was wise in adopting the Code. After a few years of experience with it, they will be convinced that the Code represents a substantial improvement in the commercial law of the state. They will also remember that the transition period was not as rough as they had feared.