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Article 6

U.C.C. Article 2A: The New Face of Leasing?

Raymond T. Nimmer

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MARGIT LIVINGSTON: It's my pleasure to introduce Mark Leipold. He was a clerk for Judge Robert Ginsberg of the Bankruptcy Court for the Northern District of Illinois. Mark is also a member of the Turnaround Management Association, American Bar Association and the American Bankruptcy Institute. He's a DePaul Law grad and received his bachelor's degree from Northwestern University.

It's my pleasure to present Mark Leipold.

MARK LEIPOLD: Thank you, Professor Livingston. It is an honor and pleasure to be here today.

We have a great line-up of speakers addressing some of the top issues in commercial law. I, personally, have been looking forward to our first speaker's presentation.

Professor Ray Nimmer is, by far, one of the most engaging speakers that I have had the opportunity to listen to.

Professor Nimmer is the Leonard H. Childs Professor of Law at the University of Houston Law Center and co-director of the Houston Intellectual Property and Information Law Institute. He is a prolific author.

He is an author of over twenty books and numerous articles, having received a National Book Award from the Association of American Publishers in 1985.

Professor Nimmer has published the books *Information Law*[1] and *The Law of Electronic Commercial Transactions*[2], which address issues that all commercial lawyers are going to be involved with, on a regular basis, in the coming years. He has been a frequent speaker and it is a pleasure to have him join us today to talk about U.C.C. Article 2A.

Please welcome Professor Ray Nimmer. Thanks.

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* This is an edited version of the transcript from the third panel at the DEPAUL BUSINESS AND COMMERCIAL LAW JOURNAL SYMPOSIUM, *Out with the Old, In with the New? Articles 2 and 2A of the Uniform Commercial Code*, held on April 7, 2005.

1. RAYMOND T. NIMMER, INFORMATION LAW (1996).

2. RAYMOND T. NIMMER & HOLLY K. TOWLE, THE LAW OF ELECTRONIC COMMERCIAL TRANSACTIONS (2003).

RAYMOND T. NIMMER: It is impossible to follow that lunch speaker and sound interesting at all. That was a great speech. Unfortunately, I tend to be on the republican side of the economic center, so I was gritting my teeth a little bit, but it was fun.

This talk is not going to be quite as exciting. We are going to be talking about Article 2A. What I am going to try to do is to blend a discussion of the existing law and a discussion of some of the revisions.

As Jim White commented several times during his presentation, it has been an unbelievably long and contentious process attempting to create the revisions for Article 2 and 2A, and to draft UCITA, UETA and a variety of other things that are coming out of the uniform law process. Unfortunately, I think we are experiencing the output or the end product of that contention. There is a strong question about whether any additional uniform laws in the commercial area are ever going to be enacted by the states and very strong questions as to whether the uniform law conference is going to ever try it again. In fact, I suspect they will not.

We are going to focus on the next to the last broadly successful uniform U.C.C. provision, Article 9 being the most recent. Article 2A has been enacted in forty-nine states. Article 2A deals with, as everybody in the industry points out, a multibillion dollar industry. In fact, in areas of commerce that many in the lay public often think of as primarily involving sales of goods, more transactions are done using leasing rather than actual sales. That is true, for example, in the automobile industry. New car sales are actually more often than not leases.

Article 2A and its presence in the UCC also illustrates the fact that the economy has become more complex. There are many different kinds of transactional frameworks, and Article 2A deals with one of those frameworks. As I have said, it has been enacted in forty-nine states. It is supplemented by common law and by Article 2, depending on what particular issue you are talking about.

One of the unique things about Article 2A, and one that also applies to the uniform law that I helped coauthor, UCITA, is that Article 2A has been successful as measured by the fact that it has not been litigated very much. It has been law for a number of years in a variety of states, but most of its provisions remain untested in court. Prior to its enactment, there was extensive litigation about several major issues in leasing. Since its enactment, this litigation largely disappeared, at least in terms of reported cases.

Both because of that drop in litigation and because of the nature in the statute and leasing practice, leasing law really is, in fact, a contract

choice framework; that is, contract terms, which are typically fairly elaborate, rather than the simple terms you often run into in sales of goods, dominate except in the limited situations where there is a provision in 2A or other law that limits or restricts contract freedom.

Article 2A itself contains an official comment which is lacking in current Article 2 and in revised Article 2. That comment directly says that Article 2A is informed strongly by the common law tradition of freedom of contract. And so it is fair to say that in Article 2A most of what is in the statute is, in fact, a default rule system in the sense that the law stands behind rather than controls the terms of the leases.

We are going to focus today on some things that are new and some things that aren't new, but there are four major issues.

The first concerns the scope of Article 2A. Some of the issues in the scope area are affected by issues that came out in revised Article 2, specifically the question as to what extent does Article 2A apply to software transactions. But the broader focus is on the definition of what is a true lease.

The second issue concerns warranty and disclaimer treatments in both existing Article 2A and in the revisions in Article 2A.

The third issue relates to consumer provisions. By way of preface, Article 2A, as currently enacted, has by far the largest number of specific rules for consumers of any of the other uniform laws.

In UETA, which we talked about this morning, for example, the drafters prided themselves in never once mentioning the word "consumer" in the substantive provisions. Well, that is not true in 2A. And, in fact, one of the ways of understanding leasing law under Article 2A is recognizing that there are at least two very distinct worlds involved - one world being commercial and the other one being consumer. The rules of the road for each are very different in the statute.

The fourth issue relates to remedies if we have the time to get there.

But what I am going to try to do is make sure I do not put us any further behind than we've already fallen and try to get through my materials a little faster than my one hour.

So, all of this discussion occurs in context of the provisions of revised Article 2 and 2A. I understand that we will have a speaker this afternoon on the legislative process, and I certainly have not been involved in it. I assume this point has already been mentioned, but since it's on my overheard, I will say it: Article 2, and I believe 2A, were introduced or at least potentially introduced in two states. In both states the process either stopped or the bills have been withdrawn, in large part because of opposition from industry. I believe there was a

hearing in Nevada and no supportive testimony was offered by any group at that hearing. The testimony was only negative.

The question of whether the revisions will ever actually become law is something that other people can deal with. But when you look at Article 2A, I think there are two things you have to understand in dealing with the potential revision process. One is that Article 2A probably was not and is not broke. As I have said, it is a statute that has not generated a lot of litigation, and in commercial law, I think that's a positive. I am not a leasing specialist, but I am not aware of any specific things that might be going on in leasing practice that provide a reason for change and I have not seen any articulated in print. But I can say that, in looking at the revisions themselves, there do not appear to be any provisions aimed at serious problems unique to leasing.

Secondly — and here you will find me being a bit redundant of some earlier speakers — a number of the Article 2A revisions are essentially mirror images of Article 2 revisions, at least the revisions proposed there. I think — and, Jim, if I am wrong, tell me — I think the concept was that 2A was to be revised solely as an adjunct to the revisions of Article 2, and for the purpose of keeping correspondence between Article 2A and revised 2.

Now, what happened in Article 2A is that a number of changes that were proposed and put into the revisions of Article 2 did not get into the revisions of Article 2A. The most important are the two new warranty sections that Jim was talking about this morning. Neither is present in the Article 2A revisions. There are political reasons (leasing specialists opposed these changes) and at least arguably practical reasons for this; that is, the lease business is a slightly different animal than is the sale of goods business.

With that background, let me start with the scope of Article 2A. It is straightforward stuff, but it is important. Article 2A only applies to "true leases," so the fundamental scope definition is involved with whether a particular transaction qualifies as a lease or not, and, secondly, whether the transaction involves goods. Those are the two operative definitional points for the scope.

Leases are a form of financing, at least in my book, because they provide somebody with control and beneficial use of goods without having paid the full purchase price. They achieve that "financing" not by extending credit. In fact, those who practice in this area would hate even calling it a finance arrangement because what they often want to be is something other than an Article 9 financing transaction. But leases achieve financing by dealing with rights of possession.

So the key here is that when we are talking about lease transactions that go into Article 2A, we are talking about transactions in which, at least nominally, the purpose of the deal is to put somebody, that is, the lessee, in physical possession of the goods with the right to use them.

The distinction that drove the creation of Article 2A initially was the distinction between a sale and a security interest on one hand and a true lease on the other. Because what happens in most financing areas is that people push the envelope, in this field an important pattern involves attempting to characterize as leases transactions that were more like sales and security interests, rather than leases.

The distinction between these two determines whether you are within Article 2A or not. It also affects other laws: tax, accounting, bankruptcy, contract law generally, questions about filing and the like. This is a distinction that has a significant bite, and, therefore, it's a distinction that has been litigated and discussed quite extensively.

The second distinction defining the scope of Article 2A — and this parallels something mentioned in the earlier discussions of Article 2 — is the distinction between goods on the one side and information and intangibles on the other. We are going to see a bit of overlap between what I need to discuss and what speakers this morning talked about because the issue was raised explicitly in both Article 2 and 2A. Essentially, the issue is: how should we treat software and other types of intangibles when we are dealing with contract laws whose literal scope description says they only deal with transactions in goods, either leases or sales. Should we allow courts or practitioners to lump goods and intangibles together, and, if not, how should we make the proper distinction? As was pointed out this morning, that turned out to be not only one of, I think it was the most controversial issue towards the end of the Article 2 revision process and, by extrapolation, towards the end of the Article 2A process.

The overhead provides the definition of a lease. It's straightforward. That is, a lease is a transfer of the right to possession and use of goods for a term in return for consideration.[3] But a sale, et cetera, is not a lease. This particular definition comes from the revisions of Article 2A and contains language that is not present in current law. I will flag it for you so that you know it before we get back to this issue later on.

The very bottom line of the definition says that a sale, including a sale on approval, et cetera, et cetera, license or license of information

3. U.C.C. § 2A-103(j) (2005).

is not a lease.[4] And so we have the issue here, just as in revised Article 2, of what does the word "information" cover?

What this language flags for anybody who practices in this area is: are transactions involving information (leasing of computers, for example), covered by Article 2A entirely, or bifurcated into a transaction covered by Article 2A with reference to the computer and some other law with reference to the software? I have a client on the West Coast who I have done expert testimony for at least four different times on that issue, that is, what is the treatment of the software? And that issue will be solved by this definition by clarifying that the software license is not covered by Article 2A.

The basic Article 2A definition makes scope straightforward. That is, a transaction is a true lease and, therefore, within Article 2A, if and only if it transfers the right of possession and use of the goods for a term in return for some form of consideration typically runs. The actual substance of that definition, however, is elsewhere in the U.C.C., and lies in the distinction between a security interest and a lease.

The current enacted version of Article 1, in all of the states who have not adopted the revisions of that Article, provides the meat of this distinction in the definition of "security interest". The revised versions of Article 1, and I do not know if Jim or anybody else talked about this, but one of the things you run into when you are drafting these uniform laws, is that there is this group of people who are tyrannical in their adherence to rules. They're called the style committee. They just do not let drafters use normal language. They do not let you break from their traditions, even new ones. They concluded that the definition of lease, as compared to a security interest, could not be a definition. It must be in a separate substantive section. So it's currently a substantive rule in the revisions of Article 1.

But what I need you to understand is that this definition, which came in the enactment of original Article 2A, basically — came close to ending — it substantially reduced litigation. It is one of the cases in which a statute was drafted literally to provide guidance to draft a contract to get the desired answer. It is very explicit, and, frankly, it's very hard not to get it right if you're paying attention

Original Article 2A took the law away from worrying about what the parties "intended" to do, which is what the old law used to be, that is, you decide whether something was a security interest or a lease based on the intend of parties. That intention test produced tons of litigation.

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4. *Id.*

Under the current definition, you don't care about intent. What you care about is the economic structure of the relationship.

In a true lease, the economics are that the lessor has a realistic expectation of having the goods returned to it and having a residual value that it can realize on in those goods. So the key is whether or not the transaction in and of itself contemplates almost inevitably giving ultimate control and ownership for the life of the product to the lessee or giving an economically viable product back to the lessor at the end of the lease.

If the transaction gives this end of lease value to the lessee, it's not a lease. It's a sale. If the transaction, essentially, returns that value to the lessor or contemplates returning it to the lessor or paying him for it, then it's a lease.

This is the current version and the revisions of Article 2A. It says, essentially, that a lease is a security interest if the consideration that the lessee is to pay is not subject to termination by the lessee and the term or mandated renewal term, the original term of the lease and/or the mandated renewal term is equal to or greater than the economic life of the goods. The basic concept is, for example, if you have a laptop computer like mine, and you lease it to somebody and run the term of the lease for ten years, the transaction will not be treated as a lease. It will be treated as a security interest because laptops, at least in my experience, last all of five or six years of use, and then they're gone. Most of mine don't even last that long. That's quite amazing.

Additionally, if the consideration for the lease is not subject to termination by the lessee and the lease has a renewal or purchase option for no or nominal consideration, it is not a lease. Those of you who took secured financing in law school will have seen the phrase, nominal consideration. It basically means that if I lease this laptop to you for one year and if we can prove that the economic life is longer than one year but the lease says at the end of one year you have the right to buy it for $0.05, then it's not a lease. It is a security interest. Again, the concept is that it's a question of, in terms of economic reality, does the lessor have an expectation of something coming back to it? And this is the basic key.

The distinction is not a question of what the parties intended, but, for example, consideration is nominal if the option is less than the lessee's reasonably predictable cost of performing, that is, if you essentially almost have to exercise it in terms of being economically rational.

There are several other ways in which the statute sets out how one goes about applying this distinction. But the definition also has a set

of safe harbors. And this is what I mean about there being a structure designed to aid in drafting. I'm not going to go through each of these because, frankly, they're a bit more specialized or focused than we need to be here. But to get a sense of them, I'll just read you one or two.

Section 203 says that a transaction is not a security interest merely because the present value of the consideration is substantially equal to or greater than the fair market value of the goods at the time of the lease. This computer costs, let's assume, $5,000. It didn't, but let's assume that. What this rule says is that my transaction does not become a security interest simply because the full payment of the lease is more than $5,000 in present value. The theory is that you, frankly, may make a bad deal and due to the full payout lease, but that doesn't necessarily turn the lease into a sale. The key being what happens with the economic value at the end of the lease, and does it go back to the lessor or stay with the lessee.

Risk of loss, if you look at this part of the statute, this is actually a list of what goes into commercial leases. Lessee assumes the risk of loss. Lessee agrees to pay taxes, insurance, et cetera, and lessee has an option to review or to become the owner. You can include all of those things, and under Section 203(c) it doesn't transform the transaction into a sale.

The second way in which the statute approaches this is to say that a transaction is not a security interest merely because there is an option to renew for a fixed rent equal to or greater than the reasonably predictable fair market rent at the time the option is to be performed. That is, if you are writing an option, and you write it to be in reference to the predicted fair market value and can establish that, then you would have not created a security interest.

What happens in practice, as I understand it, and my colleagues up here know a lot more than me on this issue, is that one of the steps that should be taken is to make that estimate explicitly at the outset of the lease.

You can't read that overhead because I can't read it, even standing here. I think what it says is that you measure reasonably predictable value, fair market value and all those other items not after the fact, but as of the time of the transaction. It's a forward-looking framework that is, what did you think it was going to be when you did the deal? And, again, if what happens at the end of the lease with the renewal or the option is that the only way the lessee gets to keep it is by paying the lessor a fair equivalent market value or fair equivalent

price, then that's essentially giving the residual value to the lessor and, therefore, it is a true lease.

Let me get to a new issue because all that we just discussed is current law. And if Article 2A revisions fail, that will all stay the law.

The second scope issue is more critical in terms of revisions of Article 2A. It deals with software leases. Here I'm going to sound like the presentation on Article 2 because the concepts here in the revisions are similar, but there are two issues of importance.

The first is that in some aspects of the software industry, software providers and finance companies have experimented with applying the technique of finance leasing from the goods industry to financing software. A finance lease is a transaction involving three parties: I'm the one who wants to wind up with the goods. You're the lender, and somebody out there is the supplier. Instead of purchasing the goods from the supplier with credit from you, we finance it by having you purchasing the goods and then lease them to me. You become a lessor in the transaction, but you're only doing it to accommodate a financial transaction.

Well, in some parts of the software industry, there are lenders that use this model for software. That is, I have a high-end piece of software, and I'm willing to license it, but the upfront cost is more than the licensee wants to provide. I'm not willing to sell the copy to anybody. So we can't set up a deal in which there is a financed sale. One way of setting up the transaction is that the financier obtains a license from me and licenses the software down to the transacting party.

Also, as I mentioned earlier, you see software leasing in situations where software has become a part of equipment leasing because, obviously, computers and many other types of equipment basically run only because of the software. Software is not sold in the industries. It is licensed. And so the financing has to accommodate that.

A question in all of these transactions is what body of law applies. There is a strong argument that current Article 2A does not apply to the software. Unlike in Article 2 where there is litigation on the question of the extended scope as was talked about this morning, there has not been any reported litigation on that issue in Article 2A, and there are other provisions of 2A that indicate software is not within it.

The second issue is one that my friends in the software industry worry about or at least think about: is software going to be treated as goods in some cases. If so, shouldn't the software license be treated like a lease because the person who uses the software doesn't become

the owner of it? The licensor, in fact, keeps ownership; all the attributes of the lease, except for the physical stuff, are present.

Well, the problem is that licensing is a different arrangement than sales of goods, and the subject matter is different. UCITA, which is the statute I was involved in and it's enacted in Virginia and Maryland, has tailored rules for software leasing. So if any of you run into it in one of those states, you need to use UCITA, not Article 2A. UCITA, as with Article 2A has generated, literally, no litigation since it was enacted several years ago.

Here's the Article 2A solution or approach. Under existing Article 2A the statute has a separate definition of goods, and it defines goods as all things that are movable at the time of the transaction.[5] But it specifically excludes general intangibles.[6] The Article 9 people in this room or people who have had contact with Article 9 will know immediately that that phrase "general intangibles" is an Article 9 concept. And under current Article 9, at least, general intangibles include software.[7] There's a carve out for particular types of computer programs, but getting away from detail about Article 9, the basic theme is that general intangibles includes things like copyrights, patents, all those things that the software industry worries about and software.

And so one way of reading this is to say that as for Article 2A as it stands in the states today, software is excluded, at least excluded to the extent that it's treated as general intangibles under Article 9.

On the other hand, somebody this morning mentioned the wonderful stuff about legislating in comments. Well, they did that in Article 2A also, and one of the existing Article 2A comments says that nothing should prevent the courts from applying the statute by analogy to other transactions and personal property that result in somebody obtaining possession and a right to use. I have thought about that for years, and I've never figured out commercially valuable transaction other than license of intellectual property that would fit that category.

I should really add a side note here. In my experience, this tactic of legislation by commentary is very interesting since at least in the states I have seen, the legislators never even see the comments, and that is true whether or not they are enacted as part of it or treated as official or not. They just don't even see them. And in none of the hearings I was at did anybody successfully argue that the comments solve this problem, so you don't have to do anything.

5. U.C.C. § 2A-103(n) (2005).
6. *Id.*
7. U.C.C. § 9-102(a)(42) (2005).

The revisions, as I've said before, deal with this issue, and they deal with it in the same kind of sloppy, I think, leave-the-issue-open way that Article 2, at least, tries. The revisions take out the reference to general intangibles and, instead, they exclude information from the definition of goods.

Well, the problem is that there is not a definition of information in the statute; although, there are definitions which I'll put up here in a second, which would include software. But this raises questions about other types of licensing, patents, for example. Would you call a patent license a license of information? I know you would call it a license of a general intangible.

The revisions also exclude from the word "lease" any license of information.[8] So once you know what "information" is, a license of that information is excluded. Of course, then you have to figure out what the word "license" means, and the only statute I know that has a definition of that is UCITA, and that is not Article 2A.

A license is, essentially, conditional permission to use intellectual property or of a similar context.

Information is defined in UCITA and in federal E-Sign. And both of those laws, as well as UETA, define information to include data and computer programs.

There's a comment — and this was mentioned earlier — a comment in Article 2 that hedges the bet a little and makes it sound that in some cases, software will be so closely connected to goods that it should be treated as part of the goods themselves.

Again, a side note. You can't avoid it in talking about this issue. This is another sort of official comment common in the revisions, trying to open an issue and let the courts decide a significant question. Whatever happens with revised Article 2 will be what happens with revised Article 2A on this issue. There are no separate comments in 2A.

Okay. Let me go on to the second topic: warranties. Here again, if we hadn't had the fine presentations we had earlier on sales of goods, the revisions, I think, are interesting. But having heard about them before, frankly what you really need to know, before I get into details, is that Article 2A in its revised form does not adopt the aggressive warranty changes that Jim was talking about, the warranty-in-a-box concept or the advertising concept. It does adopt, on the other hand, the same or similar language for warranty disclaimers.

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8. U.C.C. § 2A-103(j) (2005).

Let me just go through and show you what that's about. Existing 2A makes two different distinctions. One is between quality warranties and infringement warranties or use warranties. The second is the distinction between an ordinary lease and a finance lease. A finance lease, as I have said, is a three party arrangement. The way in which the warranties are generally handled is that the lessee, the debtor if this were a credit transaction, gets the benefit of the supplier's warranties, but the finance person, the one in the middle, doesn't make any separate warranties unless it undertakes them expressly, which finance lessor never do, so the transaction looks like a triangle, but the warranties go straight from the supplier to the end user.

For the quality and the infringement warranties, I am not going to spend much time. One of the decisions that was made when they promulgated Article 2A originally, was that although leasing practices differ from sales, there are many ways in which they are the same, and so Article 2A has always been modeled after Article 2, with tweaking changes in it.

The big difference here is that an Article 2A transaction carries with it a warranty of noninterference. That warranty is not present in Article 2. It was put back into 2A. When I say "back into," what I am referring to is the fact that it is probably a warranty found at common law - a warranty of quite enjoyment. And, while excluded from Article 2, it is back in original Article 2A.

Let me mention just two things about these warranties. One relates to the warranty of noninfringement. This is basically a warranty that the goods, as delivered under the lease, will be free of any third party claims by way of infringement or the like. Well, I have no idea how many people in this room do intellectual property, but the way that is phrased creates a very important limitation on the lessee's protection. And if you have any leverage as a lessee, it's one that you probably need to think through. The language says "as delivered," that is in their form as delivered and not being used, the goods do not infringe any other third party intellectual property right.

The problem is that many patents, trade secrets and other intellectual property rights relate to use rather than as delivered. A patent, for example, might apply to a process. That process might be one that the goods are used to perform, but as the goods are delivered, they are not performing the process and would not infringe the warranty.

In many cases, goods are used as part of a larger process, and this would exclude consideration of any use by the lessee or the buyer in determining breach of this warranty. Indeed, many intellectual property people do not even understand this concept of "as delivered," but

the applicable laws refer to terms such as "make", "sell" "use", "reproduce", and "distribute." But "as delivered" is a concept that does not have a good analogy in the intellectual properties fair. That problem, by the way, was not addressed or much discussed in the revisions.

The non-interference warranty is essentially this: for the lease term no person will hold a claim or other interest in the goods that arises from an act or omission of the lessor which will interfere with the lessee's enjoyment of its leasehold. It is essentially a commitment that the lessor will not do anything that is not authorized by the lease that will disturb the use of the goods in the lessee's hands during the term of the lease.

The revisions change that rule, or would change it if they are ever enacted, in significant ways. First, the interference warranty will now apply to finance lessors, which it wasn't clear whether or not it did under the old act.

There is a bigger change. A lessor in a lease contract warrants that except for claims of infringement, et cetera, et cetera, no person holds a colorable claim to or interest in the goods which will unreasonably expose the lessee to litigation.

In other areas of law, this notion of a warranty as to colorable claims has been expressly rejected. For example, in licensing law, most case law says we just don't believe that you can have a breach of implied warranty unless the claim is, in fact, rightful. The difference being that it is not enough to get past the summary judgment and/or motion to dismiss. Presumably, passing summary judgment would make it colorable, as compared to will you lose or will you win, which would affect whether it's a rightful claim or not.

This new language comes from the old official comments in Article 2. It is an illustration of something that happened frequently with the first Article 2 committee. That committee frequently took things from the comments and brought them into the black letter usually with the goal of clarifying the law, but almost invariably creating controversy because people who hadn't practiced or paid attention to the comments saw changes in the law, at least from what they thought the black letter meant.

This particular change is one that came up into the black letter and stayed there. It doesn't affect infringement claims. I think some of the people who are opposed to Article 2 mistakenly read this as saying that this would create warranty to liability for a copyright infringement claim, even if the claim would lose. That is not what this is talk-

ing about. It's talking about noninfringement title claims and things like that.

Then there is a proposed change in the disclaimer language, in the proposed revisions that foreshadows change, bigger change, in disclaimer rules for qualitative warranties. I believe this is parallel to revisions Article 2. New language says that you disclaim these warranties of infringement, noninterference or the like by circumstances that give the lessee reason to know that the lessor purports to transfer only such rights as the lessor or third party may have or that the lease is subject to any claims of infringement or the like. This is basically a quitclaim concept. It expands I think, if I'm reading it properly, to more general concepts than the language that is in current law. It allows the lessor to quitclaim the lease and avoid the warranties I just discussed.

The material in the overhead has been previously talked about, so I'm not going to spend any significant time on it, but I just thought you would like to see it up on the screen, if you can see it given the size of the screen. This is the language in revised Article 2A that changes the language for disclaimer of implied warranties. This is the disclaimer of implied warranty for merchantability that Jim talked about earlier, the toned down version, as compared to the one where you must tell everybody that the product does not work. Jim already quoted it and talked about it, so I'm not going to spend any time on it.

On to our third topic. As I said at the outset, Article 2A has more references to special consumer rules than any other of the uniform laws generally, and certainly any of the other U.C.C. provisions, and I assume that this was part of the political process back when it was being initially designed to get through the consumer lobby and reduce their opposition.

My count, and I may be wrong on this, is that there are at least thirteen separate rules in existing Article 2A and its uniform version that single out consumers for special, as you might guess, preferential treatment. And these thirteen rules, obviously, are over and above or in addition to the law that comes under federal and state consumer leasing and protection laws.

As I think I said earlier, there are two or three separate worlds within Article 2A, even though they're entwined together in the sense that some of their rules overlap. One separate world is the finance lease, that is, protection for the creditor who is financing acquisition of goods through a three party lease arrangement. The second world is the consumer lease. We have thirteen special rules for this world.

And then the third is all the leasing that's left over, which is the commercial leasing world.

One of the good things that happened in original Article 2A occurred because of the drafters' willingness to single out consumers for special protection. Because of this, when you read the commercial lease provisions, they're really quite commercial. Unlike some of the revisions of Article 2, original Article 2A is pretty clearly a pro contract statute set in the commercial world, and I think that's partly because they were able to accommodate consumer and other interests with specific provisions.

I'm not going to go through all thirteen special rules. Frankly, that would be boring and not necessary, since those of you who practice in this area know these already. I will just mention two or three just so that those who do not practice in this area know of them, get a flavor for what 2A does for consumers.

Section 2A-108 contains a concept of unconscionable inducement and the right to attorneys' fees, both limited to consumer leases.[9] In the early Article 2 revision debates and Article 2B, which then morphed into UCITA, one of the strongly pushed proposals from the consumer side was to include this concept in the other two laws. The concept is, essentially, a fraud-like concept. That is, it borders on a claim of fraudulent inducement but allows a remedy for consumers for something called unconscionable inducement. Neither revised Article 2, nor UCITA adopted this concept.

Section 2A-106 contains a limitation on choice of law, limiting the contract to choosing only the law where the consumer resides or the law of the state in which the goods are to be used. The revised comments to Article 2A attempt to ameliorate the restriction by saying that this rule often will mean the state in which the goods are delivered to the consumer.[10] And I suppose that's true in many cases, but not in all. The stated reason for the limit is that the consumer should have a right to be governed by law with which it is familiar, but of course, most consumers do not know the details of consumer law.

Choice of forum in the lease contract is not enforceable against a consumer if the chosen state would otherwise not have jurisdiction.[11] Choice of forum clauses have become important in modern commerce. Companies like AOL and many other online providers, rely heavily on a choice of forum. The idea is that the clause will limit

9. U.C.C. § 2A-108 (2005).
10. U.C.C. § 2A-106 (2005).
11. *Id.*

lawsuits against AOL to Virginia, which is where AOL is based. Microsoft doesn't do it, but other software companies do. And the clauses are routinely enforced. There is a Supreme Court authority that talks about contractual choice of forum as being presumptively enforceable.

But Article 2A validates them unless you choose the jurisdiction in which the consumer could have been brought to court without the choice of forum clause.

The Article 2A revisions, not surprisingly, increase the number of consumer provisions quite significantly.[12] Section 104 would be revised to change the deference to state consumer law language currently as was discussed earlier about Article 2. The statute currently provides that Article 2A defers to consumer protection statutes and case law existing at the time of adoption interpreting those statutes. The revisions would change that to defer to a rule of law that establishes a different rule for consumers.

I had planned to discuss this, but most of the relevant points were made before lunch, I agree with those earlier comments. This is a potentially significant change, if enacted. I do not know if courts will actually read the phrase "rule of law" to be as broad as it seems to be. But if they do, one possibility is that we wind up with a common law statute. That is, this deference to "other rule of law," refers to court decisions applying a different rule than that in the statute. And that effectively means that a court, even after enactment of Article 2A, could invent a new rule, and the statute would defer to it. Now, I do not think that is the way it would actually be read, but I do know that this is one of the issues that people who are very strongly opposed to Article 2 (and 2A) really think of as a major negative, whether it's a fair assessment or not. And, again, I'm just echoing what I said earlier. It increases the nonuniformity if either of these laws are enacted in some but not all states.

Section 2A-104, again, was talked about before. it uses NCCUSL boilerplate to reserve out Article 2A from E-Sign, thus having state law take over from E-Sign, but reserves out the E-Sign notification rules for consumers, rather than superseding them. That either is very significant or meaningless because Article 2A doesn't have any rules to which those provisions of E-Sign apply.

Disclaimer language. As we previously talked about, disclaimer rules are singled out and altered, essentially for consumers. Jim men-

12. U.C.C. § 2A-104 (2005).

tioned briefly the Article 2 rule that prohibits reducing the statute of limitation in a consumer case. That's also present in Article 2A.

And then finally — there is the provision on consequential damages. This is very important from the standpoint of industries that have trade secrets that are embodied in leased products.

Under general trade secret law if I sell you a product and you can rip it apart and discover my secret, you are free to use that secret. That rule has been out there for a long time, in reference to a sale of goods. But the rule with reference to leases has always been that a lessee does not have the right to take apart my property because all you have is the right to use it in your possession. If you do take it apart, you're not authorized to use my secret in any other product or in any other way.

If unauthorized discovery and use of the secret occurs, one way in which I can recover is for breach of contract with the damages often being a form of consequential damages. New Article 2A allows recovery of consequential damages against a lessee, but not against a consumer.

In the area of trade secrets, the question of who's a consumer is, at best, one that I don't think we'll ever know the answer to.

I will try to wrap up on time, so I am going to skip past remedies, except for one that I think, very oddly, is something Article 2A's revisions did not address but might have.

The remedies for Article 2A are very different than the remedies for Article 2. The assumption in 2A is that you do not have to sell or otherwise dispose of the property if you are the lessor. And the reason is you own it. And so you can do anything you want with it. You can keep it; you can re-lease it; or you can sell it. The remedies rules are fairly elaborate in how they treat each of those decisions, but they're based on a totally different model.

What the remedies are trying to do for the lessor in 2A is to compensate for loss of rental value, and any damages to the residual interest, that is, what the lessor expected to get back. This system is different from Article 2 and it is hugely different than Article 9. I will not go into the detail, but Article 9 remedies provisions are incompatible with Article 2A because Article 9 assumes you're selling the collateral to pay off the debt. The difference is important because in many cases an issue may exist about whether the transaction was a true lease or an article 9 security lease.

One further issue is liquidated damages, the obligation to pay all the future rent, reduced to present value. Article 2A limits liquidated damages but uses a formula that is different from Article 2. It essen-

tially says that you can liquidate damages in light of the anticipated harm, not the harm actually caused and not some question about the degree of difficulty of proof, but in terms of anticipated harm.

Article 2A allows the lessor to repossess. And this is the remedy I want to spend a couple minutes on and then I will quit. Article 2A says, just like Article 9, if there is a breach and the lessor cancels the lease, it has a right to take possession. If the contract provides for this, the lessor has the right to insist that the lessee assemble the goods at a place to be designated and without removal can render unusable any goods employed in the trade or business and may dispose of the goods on the lessee's premises.

Let me talk about rendering the leased property unusable. One of the big debates in UCITA involved the question of electronic self-help repossession, a question of whether a licensor could put in codes what would turn off a machine and make it unusable in the event of default. The debates in UCITA focused on the risk of abuse; the enacted versions of UCITA place substantial restrictions on self-help, and the final version of UCITA prohibits electronic self-help in a license. Article 2A, I think, quite clearly authorizes it. And it authorizes it without judicial intervention as long as you avoid breaching the peace.

And if you are wondering about how this works, what is involved is basically remote communications. That is, I will have placed a code in the conveyor belt system that I am leasing to you. When you fail to pay, I punch a button on my computer, and it communicates through a backdoor and shuts off your conveyor. I have "rendered unusable" goods employed, in your business without breach of peace and without notice or judicial intervention.

As I said, one of the interesting things about 2 and 2A's revisions is that there's a lot of business activity out there that none of these revisions really addressed, issues that might have been certainly useful. Self-help is one of those issues.

I do not blame the revisors for not addressing the topic because I do not think either of the projects had the kind of political support to be able to address any more controversial things than they already did. But one wonders whether a more useful commercial statute could have been proposed had true commercial practice been addressed and incorporated into the revision process.

Are there any questions?

AUDIENCE MEMBER: Ray, I have one question.

One of the issues, from a practitioner's standpoint, is: revisions are great until they come up with one controversy. Generally, like the

bankruptcy code, I don't think I'm going to read it, until the president signs it.

Article 2A is somewhat similar to that. I sense there is a lot of competition in the type of statutes that are floating out there. Handicap this race for me. Do I need to worry about 2A?

RAYMOND T. NIMMER: You know, I don't think, and some may have a different take on this, but I don't think there's any separate lobbying for or expression of interest in a 2A revision, independent of an Article 2 revision. And as I read the tea leaves in the process that went on in 2A, what was really going on was that the leasing experts who were represented at the hearings and in the ABA were trying to fight a holding action, to keep as much that they viewed as bad that was going into 2 away from 2A. They succeeded in part. Several things that could have easily been put in were kept out. But they've kept some unfortunate revisions in Article 2A.

So I think the handicapping for a separate enactment of 2A is zero. That is, there is no chance of these revisions occurring unless the Article 2 revisions occur. And this is an audience where I hesitate to say this, but my view is that the Article 2 revisions have very little chance of success as written unless there's a huge change in what they say, and the huge change, I think, is just not something NCCUSL is going to be able to do and get through ALI. So I suspect that the chances of that are low.

With UCITA we got through two states with real heavy fights and were introduced in a few others before lobbyist resistance created a stalemate and we just put it on the shelf for a while. But in that process, there were strong advocates and strong adversaries.

In 2 and 2A, in terms of groups, I don't know of any advocates for revision other than NCCUSL.

AUDIENCE MEMBER: Let me ask you the follow-up question.

The handicap is: this horse may not get to the finish line. Am I going to get a judge out there who is going to read these revisions and who has attended seminars like this one who will say: "maybe it's not the law, but I'm going to find a way to back door it in" or "I'm going to plea bargain that it is breached." Do I have to worry about this type of unwritten amendment?

RAYMOND T. NIMMER: You know, I think I like Jim's response to a similar question at the end of his presentation, and I think I agree with him entirely. I think it depends on which provisions you're talking about. I think, for example, maybe this is wishful thinking, but I think that the consistent treatment of information/computer programming as being separate from goods across four different uniform laws,

three of which wound up being approved by both ALI and NCCUSL. This means that it is a straightforward argument and that the judgment that there's a strong policy to support and to implement that.

The Article 2 concept of remedial promise, I think that's a kind of change that I think could have an effect because it's sensible. You know, how else would you treat a promise to fix the product?

I think, some of these others, I just don't see them being adopted by courts. They're warranties that Jim was talking about 313(a) and (b).

I think the comments will have basically zero value. Unlike comments written by the original Article 2 people, comments in a statute draft that may not get widespread enactment are no more than articles, and articles usually do not have force of law.

Thank you.