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PREEMPTION & SUPPLEMENTATION UNDER REVISED 1-103: THE ROLE OF COMMON LAW & EQUITY IN THE NEW U.C.C.

*Sarah Howard Jenkins**

ANALOGIZED as being as central to the U.C.C. as a “hub” is to a wheel, Article 1 is an integral part of the Uniform Commercial Code.¹ Called a “sleeper” article by some and “inconsequential” by others, the provisions of Article 1 should instead be viewed as a “silent stalker” lurking in the shadows of every transaction and as relevant to the transaction as the applicable article.² Although it is an extremely short article, the revision of Article 1 is a significant undertaking; the resulting product will impact all commercial transactions within the scope of one of the specific articles.³ One of the Article’s rules of construction is of paramount significance in understanding the rights and obligations of commercial parties but is often overlooked. This provision, Section 1-103, has been the focus of attention by the Revised Article 1 Drafting Committee. Section 1-103 authorizes the supplementation of the U.C.C. provisions with principles of both common law and equity unless those principles are displaced.

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1. MILLER & CILKE, *THE ABC’S OF THE U.C.C., ARTICLE 1: GENERAL PROVISIONS* xi (1997).

2. Robert S. Summers, *General Equitable Principles Under Section 1-103 of the Uniform Commercial Code*, 72 *Nw. U. L. REV.* 906, 945 (1978). Revised Section 1-102 specifically limits the application of the U.C.C. to transactions within the scope of one of the individual substantive articles. See U.C.C. Revised § 1-102 *Scope of Article* (2000) [hereinafter proposed Revised Article 1 will be cited as § R 1-xxx (2000)]. “This article applies to a transaction that is governed by any other article of the [Uniform Commercial Code].” U.C.C. § 1-102 (2000) (brackets in original).

3. See generally James J. White, *The Effect of Section 1-102(3) and 1-103 on Commercial Agreements Involving U.C.C. Transactions: Should They Be Revised?*, ALI-ABA course of study, “The Emerged and Emerging New Uniform Commercial Code” (December 8-10, 1994) (addressing the impact of Sections 1-102(3) and 1-103 on agreements subject to U.C.C. Article 5).

U.C.C. § 1-103. Supplementary General Principles of Law Applicable.

Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.⁴

Courts have taken diverging positions in construing the purpose and function of Section 1-103 and the resulting applicability of principles of common law and equity to a commercial transaction within the ambit of the U.C.C. Comment 1 to Section 1-103 acknowledges the continued applicability of *all* supplemental bodies of law “except insofar as they are explicitly displaced” by the Act.⁵ When are principles of common law and equity *displaced* by the provisions of the U.C.C.? The courts are *not* in agreement. What doctrinal perspective *have* courts followed for resolving the question of displacement? What doctrinal perspective *should* a court follow for resolving the question of displacement?

In the early drafting stages of the revision, the Drafting Committee revised the comment to Section 1-103 to delete the “explicitly displaced” language.⁶ Removing the “explicitly displaced” language eliminated an apparent contradiction between the goals of Section 1-102(3)⁷ and comment 1 of Section 1-103. The goals of Section 1-102 mandate a construction of the U.C.C. provision so as to modernize commercial law; to permit the continued expansion of the U.C.C. as commercial and industrial custom, usage and agreement expand; and a construction that engenders uniformity among jurisdictions rather than the continued

4. U.C.C. § 1-103 (1999).

5. U.C.C. § 1-103, cmt. 1 (1999).

6. *Id.* Section 1-103 states:

While this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are *explicitly displaced* by this Act, the principle has been stated in more detail and the phrasing enlarged to make it clear that the “validating,” as well as the “invalidating” causes referred to in the prior uniform statutory provisions, are included here. “Validating” as used here in conjunction with “invalidating” is not intended as a narrow word confined to original validation, but extends to cover any factor which at any time or in any manner renders or helps to render valid any right or transaction.

Id. (emphasis added).

7. U.C.C. § 1-102. Purposes; Rules of Construction; Variation by Agreement.

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.

(2) Underlying purposes and policies of this Act are

- (a) to simplify, clarify and modernize the law governing commercial transactions;
- (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;
- (c) to make uniform the law among the various jurisdictions.

(3) The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

U.C.C. § 1-102 (1999).

applicability of particularized local law. On the other hand, comment 1 to Section 1-103 mandates the continued applicability of particularized local law as reflected in the principles of common law and equity as developed by each individual jurisdiction.⁸ Later, the Drafting Committee sought to give direction on the relationship between relevant supplemental law and the provisions of the U.C.C.⁹

What further revision beyond the elimination of the “explicitly displaced” language should the Drafting Committee make in Section 1-103? Moreover, should the Drafting Committee go to the extreme of eliminating the section? Grant Gilmore distinguished a statute from a “true code” or civil law code by the preemptive effect of a code.¹⁰

A ‘statute’. . . is a legislative enactment which goes as far as it goes and no further [W]hen a case arises which is not within the precise statutory language, which reveals a gap in the statutory scheme or a situation not foreseen by the draftsmen (even though the situation is within the general area covered by the statute), then the court should put the statute out of mind and reason its way to decision according to the basic principles of the common law. A ‘code’. . . pre-empts the field and . . . is assumed to carry within *it* the answers to all possible questions. . . . [W]hen a court comes to a gap or an unforeseen situation, its duty is to find, by extrapolation and analogy, a solution consistent with the policy of the codifying law When a ‘statute’. . . has been interpreted in a series of judicial opinions . . . the meaning of the statute must now be sought not merely in the statutory text but in the statute *plus* the cases . . . decided under it. A ‘code,’ on the other hand, remains at all times its own best evidence of what it means: cases decided under it may be interesting, persuasive, cogent, but each new case must be referred for decision to the undefined code text.¹¹

8. U.C.C. § 1-102 (2)(a)-(b) (1999).

9. The Reporter’s Notes, which will become the official comments, state in pertinent part:

The language of subsection (b) is intended to reflect both the concept of supplementation and the concept of preemption. Some courts, however, have had difficulty in applying the identical language of current Section 1-103 to determine when other law appropriately may be applied to supplement the Code, and when that law has been displaced by the Code. Some decisions have applied other law in situations in which that application, while not inconsistent with the text of any particular provision of the Code, clearly was inconsistent with the underlying purposes and policies reflected in the relevant Code provisions. In part, this difficulty arose from Comment 1 to current Section 1-103, which states that “this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act.” The “explicitly displaced” language of that Comment does not accurately reflect the proper scope of Code preemption, which extends to displacement of other law that is inconsistent with its purposes and policies as well as its text.

U.C.C. § R 1-103, Reporter’s Notes (2000).

10. Grant Gilmore, *Legal Realism: Its Cause and Cure*, 70 *YALE L.J.* 1037 (1961).

11. *Id.* at 1043 (emphasis added). *But see* William D. Hawkland, *Uniform Commercial “Code” Methodology*, 1962 *U. ILL. L. REV.* 291, 309 (describing modern civil codes as comprehensive when providing a systematic means to resolve the “unprovided for case” through coordination, subordination, and gap-filling).

Does the mere existence of Section 1-103 negate the viability of the view that the U.C.C. is a “code” rather than a statute? Or is the U.C.C. a hybrid, an attempt to formulate a preemptive regimen of rules and norms for commercial transactions, accommodating our common law tradition and injecting the conscience of the Chancellor into commercial transactions through Section 1-103? Have courts construed the U.C.C. adhering to the Gilmore process for statutory or code analysis? Resolving the issue of Section 1-103’s future *may* rest, in part, in determining the nature or essence of the U.C.C. or what it has *become* in its 50 year history.

This article addresses these issues and recommends a perspective for construing the proposed revision of Section 1-103. To support the recommendations herein, this article reviews the history of Section 1-103 as construed by selected jurisdictions; suggests a methodology to be employed by courts to achieve the stated goal and objectives for construing the U.C.C.; and offers, as an illustration, an analysis for the continued viability of the doctrine of unconscionability as a “validating or invalidating” device under Revised 1-103. Fundamentally, this article supports the proposed revision of Section 1-103 and applauds the philosophical and doctrinal perspective adopted by the Drafting Committee in its revision.¹² Although no change in language occurs, coupling Sections 1-102 and 1-103 by physically combining the contents of both sections “reflect[s] both the concept of supplementation and the concept of preemption.”¹³ No longer will Sections 1-102 and 1-103 stand as separate legislative mandates of equal weight and significance, but rather supplementation of the U.C.C. with common law and equitable principles becomes one of several policy goals that must be balanced by the courts. This is both evolutionary and revolutionary. Evolutionary because the respect, acceptance, and prominence achieved by the U.C.C. in derogation of local, parochial common law authority has been accomplished over time. Revolutionary . . . perhaps the revolution occurred when Karl Llewellyn and his team set into motion the codification of an orderly, authoritative, comprehensive expression of commercial law. Only now is the revolution being proclaimed in the revision of Section 1-103. Such a clear pronouncement of

12. U.C.C. § 1-103:

Construction of Act to Promote Its Purposes And Policies; Applicability of Supplemental Principles of Law.

(a) [The Uniform Commercial Code] must be liberally construed and applied to promote its underlying purposes and policies, which are:

- (1) to simplify, clarify, and modernize the law governing commercial transactions;
- (2) to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and
- (3) to make uniform the law among the various jurisdictions.

(b) Unless displaced by the particular provisions of [the Uniform Commercial Code], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

U.C.C. § R 1-103 (2000) (brackets in original).

13. U.C.C. § R 1-103, Reporter’s Notes (2000).

the preemptive goals of the U.C.C. may have been untenable in the 1950s, but now reflects the deference accorded and pervasive acceptance of the Uniform Commercial Code and its underlying policies and purposes by both the legal and business communities.

I. APPLICABILITY OF COMMON LAW AND EQUITY UNDER THE U.C.C.

The terms of Section 1-103 mandate the application of principles of common law and equity as supplementary law to commercial transactions unless "the particular provisions" of the U.C.C. displace them. Comment 1 goes even further by insisting that all supplemental bodies of law continue to be applicable to transactions within the scope of the U.C.C. unless the supplemental law is "explicitly displaced."

Courts have wrestled with the coordination of supplemental law and U.C.C. provisions in over 600 cases¹⁴ between 1964¹⁵ and 1999.¹⁶ In so doing, they have employed a number of approaches in construing the purpose and function of Section 1-103 and in determining the applicability of principles of common law and equity. Of these 600 cases, the issues most often raised were whether provisions of the Code were supplemented by: (1) the doctrines of waiver and estoppel;¹⁷ (2) common law

14. The ABA Subcommittee on Relation to Other Law and Scope, chaired by Meredith Jackson, produced a chart of the substantive issues addressed and the resolution of the issue under Section 1-103. A copy may be obtained by contacting Ms. Jackson at (310) 203-7953 or mjackson@irell.com.

15. *French Lumber Co. v. Commercial Realty & Fin. Co.*, 195 N.E.2d 507 (Mass. 1964) (supplementing Article 9 with the equitable doctrine of subrogation).

16. *Nat'l Union Fire Ins. Co. v. Allite*, 724 N.E.2d 677 (Mass. 2000).

17. In forty-four cases, the supplemental doctrines of waiver and estoppel (twenty-seven cases raised equitable estoppel and eleven promissory estoppel, one raised both equitable and promissory estoppel) were addressed by courts. For cases raising the issue of supplementation by principles of waiver and estoppel, see *First Bank of OKarche v. Lepak*, 961 P.2d 194 (Okla. 1998). See also *Banco Gen. Runinahui, S.A. v. Citibank Int'l*, 97 F.3d 480 (11th Cir. 1996); *Hurwitz v. Bocian*, 670 N.E.2d 408 (Mass. App. Ct. 1996); *Logan & Kanawha Coal Co. v. Banque Francaise du Commerce Exterieur*, 1996 WL 551718 (S.D.N.Y. 1996); *Wayman v. Amoco Oil Co.*, 923 F. Supp. 1322 (D. Kan. 1996); *In re Mycro-Tek, Inc.*, 191 B.R. 188 (Bankr. D. Kan. 1996); *Suburban Trust & Sav. Bank v. Univ. of Delaware*, 910 F. Supp. 1009 (D. Del. 1995); *Nat'l Metal Finishings Corp. v. LaSalle Nat'l Bank*, 1995 WL 609312 (N.D. Ill. 1995); *First State Bank v. Diamond Plastics Corp.*, 891 P.2d 1262 (Okla. 1995); *Soc'y Nat'l Bank v. Sec. Fed. S. & L.*, 71 Ohio St.3d 321 (Ohio 1994); *Moe v. John Deere Co.*, 516 N.W.2d 332 (S.D. Ill. 1994); *In re Edgerton*, 186 B.R. 143 (Bankr. M.D. Fla. 1995); *Airlines Reporting Corp. v. Norwest Bank, N.A.*, 529 N.W.2d 449 (Minn. Ct. App. 1995); *Fleet Bank, N.A. v. Polites*, 1992 WL 77323 (Conn. Super. Ct. 1992); *Starry Const. Co. v. Murphy Oil USA, Inc.*, 785 F. Supp. 1356 (D. Minn. 1992); *Bank One, Cleveland, N.A. v. Grantham, Inc.*, 1991 WL 206733 (Ohio App. 1991); *Mulberry-Fairplains Water Ass'n v. Town of North Wilkesboro*, 105 N.C. App. 258 (1992); *Thornbury v. Morris Oil Co.* 846 S.W.2d 238 (Mo. App. 1993); *United Nat'l Bank of Parkersburg, W. Va. v. Norton Mach. Co.*, 81 Ohio App. 3d 101 (1991); *Columbus Trade Exch., Inc. v. AMCA Int'l Corp.*, 763 F. Supp. 946 (S.D. Ohio 1991); *Canadian Commercial Bank v. Ascher Findley Co.*, 229 Cal. App. 3d 1139 (1991); *Walker v. Grant County Sav. & Loan Ass'n*, 304 Ark. 571 (1991); *SOS Oil Corp. v. Norstar Bank of Long Island*, 76 N.Y.2d 561 (1990); *Zurn Constructors, Inc. v. B.F. Goodrich Co.*, 746 F. Supp. 1051 (D. Kan. 1990); *First S. Ins. Co. v. Ocean State Bank*, 562 So.2d 798 (Fla. Dist. Ct. App. 1990); *Daniel v. Stevens*, 183 W.Va. 95 (1990); *Chrysler Credit Corp. v. Curley*, 753 F. Supp. 611 (E.D. Va.

conversion for instruments under Article 3, Section 3-419;¹⁸ (3) the remedial right of restitution based on unjust enrichment;¹⁹ and (4) the doctrine of accord and satisfaction upon tender of a check in full satisfaction.²⁰ Of these four major areas, recent revisions of the Code resolve the question of the continued applicability of three of these supplementary principles, thereby substantially reducing potential litigation under Section 1-103 based on this history.²¹

A. MODERN PATTERNS OF CONSTRUCTION

Several patterns of construction emerge from the review of a sampling of cases addressing supplementation since 1990. Some courts require ex-

1990); *Cent. Washington Bank v. Mendelson-Zeller, Inc.*, 113 Wash.2d 346 (1989); *Citizens Nat'l Bank of Madelia v. Mankato Implement, Inc.*, 441 N.W.2d 483 (Minn. 1989); *Third Century Recycling, Inc. v. Bank of Baroda*, 704 F. Supp. 417 (S.D.N.Y. 1989); *Affiliated Foods, Inc. v. McGinley*, 426 N.W.2d 646 (Iowa Ct. App. 1988); *In re State Street Auto Sales, Inc.*, 81 B.R. 215 (Bankr. D. Mass. 1988); *In re Boardwalk Marketplace Sec. Litig.*, 668 F. Supp. 115 (D. Conn. 1987).

18. Twenty of twenty-eight cases addressing the displacement of common law conversion were raised in the context of Article 3. *See Glazer v. First Am. Nat'l Bank*, 930 S.W.2d 546 (Tenn. 1996); *Miller-Rogaska, Inc. v. Bank One, Texas, N.A.*, 931 S.W.2d 655 (Tex. App.—Dallas 1996, no writ); *Hartford Fire Ins. Co. v. Maryland Nat'l Bank, N.A.*, 341 Md. 408 (1996); *In re Ostrom-Martin, Inc.*, 188 B.R. 245 (Bankr. C.D. Ill. 1995); *Hartford Fire Ins. Co. v. Cavallo*, 995 F.2d 1224 (3rd Cir. (Pa.), 1993); *Leaksealers, Inc. v. Conn. Nat'l Bank*, 1995 WL 384611 (Conn. Super. Ct. 1995); *Kenerson v. Morgan Guar. Trust Co.*, 889 F. Supp. 523 (N.H. 1995); *Lassen v. First Bank Eden Prairie*, 514 N.W. 2d 831 (Minn. Ct. App. 1994); *Palmer Mfg. & Supply, Inc. v. BancOhio Nat'l Bank*, 93 Ohio App. 3d 17 (1994); *Menichini v. Grant*, 995 F.2d 1224 (3rd Cir. (Pa.), 1993); *Morrow v. First Interstate Bank of Oregon, N.A.*, 118 Or. App. 164 (1993); *Shearson Lehman Bros., Inc. v. Wasatch Bank*, 778 F. Supp. 1184 (Utah 1992); *Berthot v. Sec. Pac. Bank of Ariz.*, 170 Ariz. 318 (Ariz. Ct. App. 1991); *Hecker v. Ravenna Bank*, 237 Neb. 810 (1991); *Sloempoot v. Regency Bank of Fla.*, 567 So. 2d 923 (Fla. Dist. Ct. App. 1990); *Al Sarena Mines, Inc. v. SouthTrust Bank of Mobile*, 548 So. 2d 1356 (Ala. 1989); *Prudential-Bache Sec., Inc. v. Citibank, N.A.*, 73 N.Y.2d 263 (N.Y. 1989); *P.M.F. Servs., Inc. v. Grady*, 681 F. Supp. 549 (N.D. Ill. 1988); *Robbins v. First Fed. Sav. Bank*, 294 So. 2d 219 (S.C. Ct. App. 1987); *Lund v. Chem. Bank*, 675 F. Supp. 815 (S.D.N.Y. 1987).

19. *In re Calumet Farm, Inc.*, 114 F.3d 1186 (6th Cir. 1997); *Gen. Elec. Capital Corp. v. Cent. Bank*, 49 F.3d 280 (7th Cir. 1995); *N. Am. Lighting, Inc. v. Hopkins Mfg. Corp.*, 37 F.3d 1253 (7th Cir. 1994); *In re Quality Processing, Inc.*, 9 F.3d 1360 (8th Cir. 1993); *Thigpen v. Allstate Indem. Co.*, 757 F. Supp. 757 (S.D. Miss. 1991); *In re Spring Grove Livestock Exch., Inc.*, 205 B.R. 149 (Bankr. Minn. 1997); *Guar. Bank & Trust v. Smith*, 952 S.W.2d 787 (Mo. Ct. App. 1997); *Lombardo v. Mellon Bank, N.A.*, 454 Pa. Super. 403 (1996); *Hanna v. First Nat'l Bank of Rochester*, 207 A.D.2d 181 (N.Y. 1994); *Knox v. Phoenix Leasing Inc.*, 29 Cal. App. 4th 1357 (1994); *True v. Fleet Bank-NH*, 138 N.H. 679 (1994); *Ambassador Fin. Servs., Inc. v. Ind. Nat'l Bank*, 605 N.E.2d 746 (Ind. 1992); *Bank of Am. Nat'l Trust & Sav. Ass'n v. Sanati*, 11 Cal. App. 4th 1079 (1992); *Ninth Dist. Prod. Credit Ass'n v. Ed Duggan, Inc.*, 821 P.2d 788 (Colo. 1991); *Garren v. Smith*, 803 S.W.2d 184 (Mo. Ct. App. 1991); *Azalea City Motels, Inc. v. First Ala. Bank of Mobile*, 551 So.2d 967 (Ala. 1989); *Farmers State Bank v. Prod. Credit Ass'n of St. Cloud*, 243 Kan. 87 (1988); *Producers Cotton Oil Co. v. Amstar Corp.*, 197 Cal. App. 3d 638 (1988).

20. *Occidental Chem. Corp. v. Env'tl. Liners, Inc.*, 859 F. Supp. 791 (E.D. Pa. 1994); *Acierno v. Worth Bros. Pipeline Corp.*, 656 A.2d 1085 (Del. Super. Ct. 1995); *Ditch Witch Tranching Co. of Ky., Inc. v. C & S Carpentry Serv., Inc.*, 812 S.W.2d 171 (Ky. Ct. App. 1991); *Robinson v. Garcia*, 804 S.W.2d 238 (Tex. App.—Corpus Christi 1991, pet. denied); *John Grier Const. Co. v. Jones Welding & Repair, Inc.*, 238 Va. 270 (1989); *Weidensaul v. Greenhouse Restaurant of Lawrence, Inc.*, 13 Kan. App. 2d 95 (1988); *Hearst Corp. v. Lauerer, Markin & Gibbs, Inc.*, 37 Ohio App. 3d 87 (1987).

21. *See U.C.C. §§ R 3-418, 3-420, 3-311, 1-207(b)* (1999).

press language of displacement before limiting the applicability of existing common law or equitable principles.²² Some find the common law or equitable principles displaced by the existence of Code provisions addressing the issue in question, and others find implicit displacement by the structure of relief available under the Code.²³ In contrast, others find displacement only if the elements of the Code remedy are identical to the non-Code relief sought.²⁴ At least one court viewed Code remedies as supplemental to common law remedies,²⁵ requiring explicit displacement before limiting the applicability of existing common law or equitable principles.²⁶

These recent cases establish four basic trends in the construction of Section 1-103. The first is the broad displacement of common law and equitable principles by the existence of a particular provision or provisions within the U.C.C.,²⁷ such as the displacement of a negligence claim including consequential and punitive damages when sought in addition to a claim of conversion under former Article 3, Section 3-419. Section 3-419, a particular provision, was held to have supplanted the payee's negli-

22. Felde v. Chrysler Credit Corp., 580 N.E.2d 191, 198 (Ill. App. Ct. 1991).

23. See, e.g., *Stepfano v. First Union Nat'l Bank of Va.*, 981 F. Supp. 417, 420 (E.D. Va. 1997); *Roy Supply, Inc. v. Wells Fargo Bank*, 46 Cal. Rptr. 2d 309, 312 (Cal. Ct. App. 1995).

24. See *Hecker v. Ravenna Bank*, 468 N.W.2d 88, 95 (Neb. 1991).

25. For dicta reflecting this view, see *First Interstate Bank of Or., N.A. v. Wilkerson*, 876 P.2d 326, 334 (Or. Ct. App. 1994).

26. Felde v. Chrysler Credit Corp., 580 N.E.2d 191, 198 (Ill. App. Ct. 1991).

27. *Stepfano*, 981 F. Supp. at 421 (Co-payee brought action against bank for conversion of checks under Revised Section 3-420 and common law negligence). If a Code provision applies to the facts of the case, the common law is displaced. The court construed the broad statement of the general applicability of common law conversion in Section 3-420 as limited to those claims of conversion of a negotiable instrument not specifically covered by Section 3-420. See also *Great Lakes Higher Educ. Corp. v. Austin Bank of Chicago*, 837 F. Supp. 892, 896 (N.D. Ill. 1993) (discussing a drawer and drawee who sued a depository bank for negligence, breach of transfer warranties, and conversion for receiving checks for collection without an endorsement). The code provisions need not "expressly" bar negligence claims; the presence of other remedies renders the common law negligence claim unnecessary. See also *Carlisle Corp. v. Uresco Const. Materials, Inc.*, 823 F. Supp. 271, 275 (M.D. Pa. 1993) (featuring a manufacturer who brought a claim for payment of outstanding purchase orders and a distributor that counterclaimed for breach of agreement and sought to set-off its damages against the amount it owed). The court held that the common law rules of set-off was unavailable, because the "Code sections 'occupy the legal field' except insofar as they do not 'particularly' displace preexisting legal principles." Because the Code specifically addresses set-off under Section 2-717, the common law rule of set-off was displaced by that particular provision. See also *Miller-Rogaska, Inc. v. Bank One, Tx., N.A.*, 931 S.W.2d 655, 662 (Tex. App.—Dallas 1996, no writ) (featuring the payee of a misdelivered check who sued depository bank for conversion of the misdelivered instrument). In *Miller-Rogaska*, Texas common law would permit one entitled to possession of property to prevail on a claim for conversion. Because this right of recovery conflicted with the ownership requirement of former Section 3-419, the Code provision displaced common law conversion under these facts. "[C]ommon-law claims may only exist to the extent they do not conflict with code provisions." *Id.* See also *Roy Supply, Inc. v. Wells Fargo Bank*, 46 Cal. Rptr. 2d 309, 318 (Cal. Ct. App. 1995). In *Roy Supply*, a corporate customer sued the Wells Fargo Bank alleging negligent payment of forged checks. The customer's negligence claim was displaced by the particular provisions of the Code (4-406) that "expressly cover the allegations of plaintiffs' complaint." *Id.* See also *Flavor-Inn, Inc. v. NCNB Nat. Bank of S.C.*, 424 S.E.2d 534 (S.C. Ct. App. 1992).

gence action and foreclosed recovery of consequential damages. Because recovery under Section 3-419 was limited to the face amount of the instrument, consequential damages were not recoverable. However, no particular provision displaced the common law rule permitting recovery of punitive damages if the standards were met. Thus, if a Code provision applied to the facts or granted remedial relief, the common law was deemed displaced, even in the absence of express language of displacement.

The second trend arises in a finding of implied displacement resulting from the structure, purposes, and policies of the U.C.C.²⁸ Here, the legislature's intent to displace the common law rested not only upon the existence of a particular provision, but also from the entire code scheme—its policy goals as reflected in Section 1-102 or the relevant provision, the drafting history of the pertinent provisions, and the structure of remedial relief available.²⁹ *United States National Bank of Oregon v. Boge*³⁰ identified four factors as indicators of legislative intent to displace the common law: the subject matter and completeness of the relevant Code terms; the structure of the Code; whether the purposes of the Code delineated in Section 1-102 were furthered by displacement; and the drafting history of the pertinent provisions of the U.C.C. Unless this analysis established a *logical gap* in the U.C.C., the asserted relevant supplemental law was deemed displaced. Concomitantly, if the analysis revealed a logi-

28. *First Interstate Bank of Or., N.A. v. Wilkerson*, 876 P.2d 326, 329 (Or. Ct. App. 1994) (featuring a customer who appealed the court's application of the subjective standard of good faith to the bank's creation of an overdraft by paying a check drawn by joint account holder). Following *U.S. Nat. Bank of Or. v. Boge*, 814 P.2d 1082 (Or. 1991), the court held the common law duty of good faith was displaced by Section 1-201(19). See *Berthot v. Sec. Pac. Bank of Az.*, 823 P.2d 1326, 1330-31 (Ariz. Ct. App. 1992) (discussing a payee of two checks who brought an action alleging negligence and breach of contract against payor bank for wrongfully paying proceeds of checks to payee's father based upon forged endorsements). The overlapping nature of the common law and U.C.C. theory and the overlapping nature of the claims and conflicting burdens of proving elements of "due care" justify finding of displacement. (Note: The court defined reasonable commercial standard as equivalent with due care. If the issue of displacement were litigated under Revised Article 3, the clear distinction between reasonable commercial standard of fair dealing and ordinary care would obviate one basis for the courts conclusion and the question of displacement might have been resolved differently, given this court's analysis.) See also *Trinidad Bean & Elevator Co. v. Frosh*, 494 N.W.2d 347, 353 (Neb. Ct. App. 1992). In *Trinidad Bean*, the buyer brought an action against the seller for breach of contract and appealed the court's instructing the jury on mitigation of damages under Section 2-713. After construing "learned of the breach," in the context of anticipatory repudiation, to mean "learned of the repudiation," the court found that the policies of Section 2-713 were inconsistent with the defense of mitigation of damages. Buyer's damages were to be measured on the date of repudiation and if covering on that date was commercially unreasonable, buyer had, under Code policy, a reasonable time to cover thereafter. See also *U.S. Nat. Bank of Or. v. Boge*, 814 P.2d 1082, 1087-9 (Or. 1991). In *Boge*, the bank sued to recover on promissory notes. Borrower counterclaimed that bank breached its duty to act in good faith. Jury awarded damages to both. Bank appealed and argued that the common law duty of good faith as the trial court instructed the jury did not apply to transactions governed by Article 9.

29. See, e.g., *Boge*, 814 P.2d 1082 (Or. 1991) (identifying four indicators of legislative intent to displace the common law under Section 1-103).

30. *Id.*

cal gap in the U.C.C., then supplementation was warranted, as the common law or equitable principle had not been displaced.³¹ Likewise, the circumstances, competing policies, or the nature of the relief sought also justified supplementation in other cases.³²

At the other end of the spectrum, several courts required express language in the Code displacing the common law rule or equitable principle³³ before prohibiting supplementation. Finally, at least one court

31. In re Advance Insulation & Supply, Inc., 176 B.R. 390, 399 (D. Md. 1994). Secured creditor sued Chapter 7 trustee for turnover of funds held by trustee and for declaratory judgment that creditor held perfected, first priority security interest in funds generated from pre-petition bulk sales. The court held that enactment of Article 9 of Uniform Commercial Code has not displaced common law doctrine of subrogation. Citing *Finance Co. of America v. United States Fidelity and Guar. Co.*, 353 A.2d 249 (Md. 1976), the court stated: "Nothing in the provisions of Title 9 regarding secured transactions expressly or implicitly refutes the application of subrogation; in fact, Section 9-102 implicitly recognizes the continued vitality of the doctrine." See also *First Interstate Bank of Or., N.A. v. Wilkerson*, 876 P.2d 326 (Or. Ct. App. 1994). In *Wilkerson*, buyer sued seller's bank for tortious interference with seller's obligation to deliver goods that had not been identified to the contract. The terms of Section 2-722, the scope of the section, and the purpose and goals of the provision indicate that "common law tort of interference with contract was not entirely preempted by U.C.C. § 2-722." The court also stated, "In the absence of a clear legislative intent to preempt, U.C.C. remedies merely supplement common" law remedies.

32. *Ed Peters Jewelry Co., Inc. v. C & J Jewelry Co., Inc.*, 124 F.3d 252, 267 (1st Cir. 1997). In *Ed Peters*, a sales agent appealed dismissal of his successor liability claim after a foreclosure sale of debtor's assets. Distinguishing the discharge of a lien from the discharge of the underlying obligation, the court of appeals determined that the nature of the foreclosure process could not preempt the successor liability. Further, Section 9-504 of Rhode Island's Article 9 neither explicitly nor impliedly preempted the doctrine. In *G.P. Publications, Inc. v. Quebecor Printing-St. Paul, Inc.*, 481 S.E.2d 674, 679 (N.C. App. 1997), an unsecured creditor sued the foreclosure sale purchaser of debtor's assets asserting successor liability. Although recognizing the strong public policy favoring discharge of subordinate claims after a U.C.C. foreclosure sale, the court held that "nothing in" Section 9-504 absolutely precluded the equitable doctrine. However, given the strong public policy favoring discharge of subordinate claims, the court limited the standard to be applied in determining successor liability on the theory of "mere continuation" to the traditional test. See also *First Valley Leasing, Inc. v. Goushy*, 795 F. Supp. 693, 700 (N.J. 1992). Here, equipment buyer brought an action against seller for common law fraud, breach of contract, and breach of the New Jersey consumer fraud statute. Buyer was not barred from recovering fraud damages for purely economic loss, where seller and buyer's lessee allegedly conspired to defraud buyer by having seller submit an invoice for goods that it did not own. Determining that the dispute was not "essentially contractual in nature," the district court opined that the New Jersey Supreme Court would permit buyer to pursue its claims for tort damage. (The court did not address Section 2-721 in its analysis.) Similarly, in *D'Angelo v. Miller Yacht Sales*, 619 A.2d 689, 691 (N.J. Super. Ct. 1993), the court held the buyer's recovery for economic loss was limited to Code remedies, but Section 1-103 saved common law fraud and Consumer Fraud Act claims arising from the transaction.

33. *Occidental Chem. Corp. v. Env'tl. Liners, Inc.*, 859 F. Supp. 791, 796-97 (E.D. Pa. 1994). Debtor tendered a check in full satisfaction of a disputed claim; creditor negotiated the check and sued for the difference asserting Section 1-207 displaced the common law principles of accord and satisfaction. First, the court concluded that the scope of the terms of Section 1-207 were inapplicable to accord and satisfaction and that the purpose of Section 1-207 would not be furthered by its application. Second, the court predicted that the Pennsylvania Supreme Court would conclude under Section 1-103 that the common law doctrine was retained "where not expressly superseded" with language in the statute or comments. See also *Acierno v. Worthy Bros. Pipeline Corp.*, 656 A.2d 1085, 1092 (Del. Super. Ct. 1995) (discussing the effect of full satisfaction check under Section 1-207). The court relied on commentary which stated that Section 1-207 could not be read to displace common law accord and satisfaction given the express language of the text. See also Felde

adopted a narrow approach to displacement. Here, unless the relevant Code provision occupies the field by its terms, all relevant common law and equity supplements.³⁴ Construing the relevant Code provision that expressly addressed the remedial right sought by the litigant and reviewing examples of ways an instrument might be converted, the court adopting the narrow view of displacement held that the elements of tortious conversion of a negotiable instrument were not included, and the relevant provision did not displace the common law principle.³⁵

B. ORIGINAL DRAFTERS' INTENT

Despite the varying approaches taken by the courts, drafting history strongly suggests that Section 1-103 was included for a purpose broader than mere deference to our common law tradition. Rather, the inclusion of the general non-statutory law available under Section 1-103 operates similarly to the general principles of common law,³⁶ such as reasonable time and reasonable manner which are also a part of Article 1.³⁷ Like these general principles, the supplementary principles provide a mechanism for avoiding obsolescence and for continuing the viability of the U.C.C. More importantly, these principles prevent the statutory provisions from "operating mechanically"³⁸ without considerations of justice, fairness, or the general public order. Through the supplementary principles, norms such as unconscionability, which represent a general policy and "permit adaptation to new conditions and judicial interpretation expressing the moral value of the community,"³⁹ are included in the U.C.C.

v. Chrysler Credit Corp., 580 N.E.2d 191, 198 (Ill. Ct. App. 1991) (holding that rescission was a proper remedy for breach of warranty, and that Section 2-714 did not contain language precluding buyers from seeking the remedy of rescission).

34. For dicta taking a similar view that Code remedies supplement common law remedies in the absence of clear legislative intent, see *First Interstate Bank of Or., N.A. v. Wilkerson*, 876 P.2d 326 (Or. Ct. App. 1994).

35. *Hecker v. Ravenna Bank*, 468 N.W.2d 88 (Neb. 1991).

36. Homer Kripke, *The Principles Underlying the Drafting of the Uniform Commercial Code*, 1962 ILL. L. FORUM 321, 330 (1962); Peter A. Alces & David Frisch, *Commercial Codification as Negotiation*, 32 U.C. DAVIS L. REV. 17, 45 (1998) (finding that conceptions of privity, fraud, and agreement, for example, are too fundamental to the fabric of the law generally to imagine that they could remain static as transactional patterns evolve).

37. See, e.g., U.C.C. §§ 1-203, 1-204, 9-504(3) (1998).

38. Kripke, *supra* note 36; Gregory E. Maggs, *Karl Llewellyn's Fading Imprint on the Jurisprudence of the Uniform Commercial Code*, 71 U. COLO. L. REV. 541, 573-4 (2000). Professor Maggs suggests the following several reasons for the nonexclusive principle as follows: (1) Llewellyn and the other drafters perceived a tension between having general legal rules and considering the equities of particular cases—Section 1-103 provided a solution by requiring judges to use all available law to reach just and equitable results unless the U.C.C. specifically displaced the pre-existing background law; (2) the drafters saw theoretical difficulties with attempting to make the U.C.C. an exclusive body of law; and (3) Llewellyn did not want to "corral" judges. With the existence of Section 1-103, judges remained in a position to exercise discretion to achieve justice with the availability of common law and equitable principles. Maggs, *supra* at 572-77.

39. Hawkland, *supra* note 11, at 305. In his critique of the Code, Mitchell Franklin asserted that the potential for analogical development of the text through purposive reading—applying the purposes and policies to gaps within the Code—mandated that all constituencies should have been involved in the formulation of the text and that the text

Unlike the experience at common law, legal concepts and rules need not be manipulated to achieve a just result. As business ethics and values evolve and community mores change, the principles of common law and equity generally evolve to accommodate and control the innovative business practices, the novel modes of ordering and modifying commercial relationships, variations in financing mechanisms, and commercial behavior that deviates from established social norms. Ideally, as the principles of common law and equity evolve, supplementation with these evolving principles would also insure the continued expansion of the U.C.C. as commercial practices expand through custom, usage, and the agreement of the parties.⁴⁰ Evolution of the concept of promissory estoppel as a validating device for the enforcement of promises, which arises from its roots in Judge Cardozo's opinions in *De Cicco v. Schweizer*⁴¹ and *Allegheny College v. National Chautauqua County Bank*,⁴² is an example of this phenomenon.

Through Section 1-103, the drafters sought to institute the non-exclusive principle.⁴³ The original drafters nestled or superimposed provisions of the U.C.C. over existing principles of common law and equity.⁴⁴ The design of the U.C.C. was not as an exhaustive statement of all commercial law with the concomitant task of addressing every potential occurrence and every foreseeable transaction or issue and plugging every foreseeable gap with rules.⁴⁵ Courts were expected to develop the U.C.C. through analogical development of the text—the application of the delineated purposes and policies—as unforeseen and new circumstances and practices were confronted.⁴⁶ As originally drafted and now as substantially revised, the U.C.C. rejected a “true code” approach, as defined by Professor Gilmore in the continental sense such as the French Commercial

should have been “qualified by ideas designed to defend the [general public order] of the [various constituencies of the U.C.C.]” Mitchell Franklin, *On the Legal Method of the Uniform Commercial Code*, 16 LAW & CONTEMP. PROBS. 330, 340 (1951).

40. U.C.C. § 1-102(2)(b) (1999).

41. 117 N.E. 807 (N.Y. 1917).

42. 159 N.E. 173 (N.Y. 1927).

43. See Maggs, *supra* note 38; see also Kripke, *supra* note 36; State of New York, Law Revision Commission, Study of Uniform Commercial Code Article 1—General Provisions 41 (discussing an analysis of Section 1-103 by Professor Carl H. Fulda).

44. State of New York, Law Revision Commission, Study of Uniform Commercial Code—Article 1 at 41 (discussing an analysis of Section 1-103 by Professor Carl H. Fulda).

45. Summers, *supra* note 2, at 907. See also Hawkland, *supra* note 11 (discussing the Prussian code of 28,000 sections to address every foreseeable problem).

46. Franklin, *supra* note 39, at 333, 340. Accord U.C.C. § 1-102 cmt. 1 (1999): “This Act is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices.” See, e.g., *Oliver v. Bledsoe*, 5 Cal. App. 4th 998 (1992) (addressing the effect of the strict foreclosure on lienholder's interest in note given as collateral for a line of credit by bank, the court determined that a deliberate gap in the Code was to be resolved by judicial rulemaking in light of applicable statutes, precedents, principles—here, commercial reasonableness, and the overarching policies and purposes of the Code).

Code.⁴⁷ That is, as a self-explanatory code, where courts are obligated to look no further than the code itself—its express terms, its purposes and policies—for solutions to disputes.⁴⁸ Although contrary authority exists, the very existence of Section 1-103 negates this “true code” approach, as defined by Professor Gilmore.⁴⁹ Unless the application of the displacement proviso preempts, common law and equitable principles supplement. Each revised Article⁵⁰ and new addition⁵¹ to the U.C.C. were drafted subject to, and remain subject to, not only the purposes and policies articulated in Section 1-102, but also the continued viability of supplementary principles of common law and equity that are not displaced.⁵²

Early judicial hostility to derogating the common law,⁵³ such as the courts’ continued reliance on common law devices or analysis that implemented common law policy or values,⁵⁴ as well as the absence of explicit guidance on coordinating the mandates of Section 1-102 and Section 1-103, led to non-uniform construction of the displacement proviso. Some commentators suggest “that the objectives articulated in Section 1-102 tend toward vacuity and self-contradiction.”⁵⁵ Rather than being vacuous, these objectives or goals are pregnant with significance, adding complexity to any construction of the U.C.C. or its provisions. Implementing the goals of Section 1-102 has been a driving concern of some jurisdictions. To achieve uniformity with sister jurisdictions, some have deviated from their own precedent.⁵⁶ The guidance lacking will now be available in Revised Section 1-103 and its Reporter’s Notes.⁵⁷

47. Kripke, *supra* note 36; WILLIAM TWINING, KARL LLEWELLYN AND THE REALIST MOVEMENT 311 (1985) (distinguishing the French Commercial Code and the U.C.C.).

48. Robert A. Hillman, *Construction of the Uniform Commercial Code: U.C.C. Section 1-103 and “Code” Methodology*, 18 B.C. INDUS. & COM. L. REV. 655, 657 (1977).

49. *But see* Hawkland, *supra* note 11, at 299-300 (postulating that the U.C.C. satisfies the systematic considerations of a true code).

50. Between 1990 and 1999, Articles 3, 4, 5, 8, and 9 were revised.

51. Articles 2A and 4A were promulgated in 1987 and 1989, respectively. “The *Act* should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the *Act* as a whole.” U.C.C. § 1-102, cmt. 1 (1999) (emphasis added).

52. *See generally* Summers, *supra* note 2 at 908. Professor Summers comments that Section 1-103 imposes a *duty* on judges to interpret and construe the Code to take account of equities in the particular case unless the principles are displaced.

53. John L. Gedid, *U.C.C. Methodology: Taking A Realistic Look at the Code*, 29 WM. & MARY L. REV. 341, 347 (1988).

54. *Id.*

55. Alces & Frisch, *supra* note 36, at 24.

56. *See, e.g.*, Oswald Mach. & Equip., Inc. v. Yip, 13 Cal. Rptr. 2d 193 (Cal. Ct. App. 1992); Allied Grape Growers v. Bronco Wine Co., 249 Cal. Rptr. 872 (Cal. Ct. App. 1988); Producers Cotton Oil Co. v. Amstar Corp., 242 Cal. Rptr. 914 (Cal. Ct. App. 1988); First State Bank v. Diamond Plastics Corp., 891 P.2d 1262 (Okla. 1995); Robinson v. Garcia, 804 S.W.2d 238 (Tex. App.—Corpus Christi 1991, writ denied).

57. The Reporter’s Notes will become the Official Comments to the revised section. November 1999 (ALI Council Draft), Prefatory Note:

This draft contains relatively detailed Reporter’s Notes for those sections that differ in substance from current law. Those Notes will be the basis for Official Comments for those sections. With respect to the sections that have been left substantively unchanged, it is likely that in most cases the Official

II. PREEMPTION & SUPPLEMENTATION: THE RELATIONSHIP BETWEEN THE U.C.C. AND OTHER LAW

Stating the contrary position to that taken in current comment 1 of Section 1-103, the revised comment proclaims, “unless a specific provision of the Code provides otherwise,” other law does not supplant the provisions of the Code, “including the purposes and policies [that the] provisions reflect.”⁵⁸ Thus, Revised Article 1, as drafted November 2000, delineates and redefines for some the interrelationship between the U.C.C. and the supplemental principles of common law and equity. Primacy is given to purposive interpretation—the liberal construction of the Code’s provisions to promote its underlying purposes and policies.⁵⁹ The U.C.C. is declared to be the “primary source of commercial law.”⁶⁰ The paramount rule of construction is that of preemption. This preemptive role extends to the displacement of any law that is inconsistent not only with its express terms but also its purposes and policies. Going beyond a statement of the preemptive role of the Code, the Drafting Committee addresses a recurring concern of commentators—the absence of a “standard or uniform methodology for both interpreting and applying the Code.”⁶¹ No longer must courts struggle with the tension between supplementary principles and the U.C.C. provisions.⁶² Placement of current Section 1-103 within current Section 1-102 supports a conclusion that supplementation by other law no longer stands on an equal footing with the purposes and policies delineated in Section 1-102, but rather, continued viability of supplemental law is now one of several policy goals that must be balanced rather than separately accommodated. The current Reporter’s Notes delineate the methodology for construing the comprehensive, integrated Code that is superimposed upon the supplementary principles of common law and equity of the jurisdiction. These supplementary principles are considered secondarily.⁶³

A. EXPRESS LANGUAGE OF THE U.C.C. ADDRESSES THE ISSUE

Adhering to the guidance provided, a court confronted with an asserted unforeseen issue or context must ascertain, by reviewing the rele-

Comments ultimately will consist of an updated version of the current Official Comments.

58. U.C.C. § 1-103, Changes from Current Law, cmt. (b) (ALI Council Draft 1999).

59. U.C.C. § R 1-103(a) (2000).

60. *Id.*, Reporter’s Notes, cmt. b.

61. Gedid, *supra* note 54, at 341.

62. In *Producers Cotton Oil Co. v. Amstar Corp.*, 242 Cal. Rptr. 914 (Cal. Ct. App. 1988), the court was confronted with a conflict between Section 1-102(1) and (2) and Section 1-103 supplementation by equitable principles. Without resolving the conflict directly, supplementation was permitted.

63. Although not consistent with strict construction under current Sections 1-102 and 1-103, this method of construction was recommended by Professor Hillman in his article *Construction of the Uniform Commercial Code: U.C.C. Section 1-103 and “Code” Methodology*, *supra* note 48.

vant article, whether the express language addresses the issue raised for resolution. If so, the express language is not supplanted by consistent or inconsistent supplementary law. The text governs; supplementation is unwarranted. Resorting to supplementary principles would be impermissible unless some broader, general public policy or fundamental value necessitates policing the transaction or adjusting the equities between the parties. For example, in *In re Hoover*,⁶⁴ lessor sought to recover a portion of the proceeds from the sale of crops planted by the debtor on the leased land. The debtor vacated the premises after planting the crop and without paying the final installment due for the rent. Thereafter, the debtor granted a security interest in the growing crop to two separate creditors. Each creditor perfected its security interest in the growing crops. Applying the provisions of Article 9 to the lessor's application for compensation for use of her land, the court found that the U.C.C. applied to the facts and governed the rights in the proceeds of the personalty, the crops. However, the court held that the general equitable principles of restitution supplemented Article 9 and ordered compensation of the lessor for the rental value of her land for the seven months the crop matured on her land after the expiration of the debtor's lease. Here, the broader community value, one of the external policies upon which the U.C.C. is superimposed, of preventing unjust enrichment supplemented the U.C.C. provision, preventing injustice that would have resulted from the mechanical operation of the rules of Article 9. Lessor had subsidized the growth of the collateral to maturity. The court ordered the compensation of the lessor first from the proceeds then the secured parties in the order of their priority.⁶⁵

64. 35 B.R. 432 (S.D. Ohio 1983).

65. *Id.* at 438. See also *City Bank & Trust Co. v. White*, 4343 So.2d 1299 (La. Ct. App. 1983). In *City Bank & Trust Co. v. White*, the corporation's president signed a note on behalf of the corporation without showing representative capacity and indorsed the reverse side of the note in blank. When sued in his personal capacity as maker of the note, the court held that as between immediate parties, the president should not be held liable on the maker contract. This holding is consistent with the express language of the text. As to his liability as an accommodation indorser or surety, the president raised the corporation's defense of lack of consideration for the corporation's promise to pay. The corporation did not receive the proceeds of the note. As a surety, the president was entitled to assert this defense. Again, the express language of the provisions of the U.C.C. governed the issues before the court. However, after holding that neither maker nor indorser liability existed for the president, the court applied the supplemental principles of restitution to prevent unjust enrichment and required the president to disgorge the benefit received. Why? After receiving the corporation's note, the bank mistakenly applied the proceeds of the loan to the president's personal notes. The president had received the funds personally. Under Revised Article 3, the president would not have been qualified to assert the accommodation-party status because he received a direct benefit from the proceeds and liability would be imposed on the basis of the indorser contract. Assuming some reasoned justification for the court's finding of accommodation party status, applying the supplemental principles of restitution is a proper outcome.

B. A GAP IN THE U.C.C.—THE UNFORESEEN ISSUE OR CONTEXT

If the text does not address the issue or context raised—if the U.C.C. is silent on the issue or if the transaction in which the issue is raised is a new type of transaction—then, because the text does not address the issue or the type of transaction, the court must determine whether an analogy exists within the U.C.C. *Barco Auto Leasing Corp. v. PSI Cosmetics*⁶⁶ and *Advent Systems Ltd. v. Unisys Corp.*⁶⁷ both presented new types of transactions—the long term lease of goods for the useful life of the goods and the licensing of software, respectively. In both instances, Article 2 provided an analogous context for resolving the issues. *Barclays Bank D.C.O. v. Mercantile National Bank*⁶⁸ illustrates the concern where an issue not within the express language of the text was addressed.⁶⁹ Here, Mercantile Bank asserted it was not subject to liability as a confirming bank because the issuer of a letter of credit was not a bank. The express language of former Article 5 defined a confirming bank as “a bank which engages to honor a credit . . . issued by another bank.” The court rejected this argument finding that the underlying policies of the Code and Article 5 justified confirmation of non-bank credits.⁷⁰ In each of these instances, an extension of the U.C.C. to accommodate innovative practices resulted.⁷¹

Before applying an article or rule, the court should ascertain whether the purposes and policies of simplification, clarification, modernization, predictability, and uniformity will be served by applying the U.C.C. by analogy. Does this interpretation give due consideration to the relevant custom and usage or the agreement of the parties even when an expansion of law results, thereby implementing the U.C.C. policy of “permit[ting] the continued expansion of commercial practices”?⁷² Is the construction consistent with that of sister jurisdictions that have resolved the issue? Is the resolution by sister jurisdictions consistent with the underlying purposes and policies of the U.C.C., or mere adoption of their own legal or equitable precedent?⁷³ Resolving these questions will assist

66. 478 N.Y.S.2d 505 (N.Y. Civ. Ct. 1984).

67. 925 F.2d 670 (3d Cir. 1991).

68. 481 F.2d 1224 (5th Cir. 1973).

69. See Julian B. McDonnell, *Purposive Interpretation of the Uniform Commercial Code: Some Implications for Jurisprudence*, 126 U. PA. L. REV. 795, 843-46 (1978) (featuring an in-depth analysis of *Barclay*).

70. *Id.* at 845.

71. U.C.C. § 1-102 (1999).

Purposes; Rules of Construction; Variation by Agreement.

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.

...

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties.

Id. at § 1-102(1)(b).

72. U.C.C. § 1-102(2)(b) (1999).

73. See, e.g., *Oswald Mach. & Equip., Inc. v. Yip*, 13 Cal. Rptr. 2d 193 (Cal. Ct. App. 1992).

the court in fulfilling the goals of construing the U.C.C. in keeping with its purposes and policies.

However, the inquiry must not end here. Consideration must be given to the policies and purposes of the article and the provision that may be applied by analogy. Are these policies and purposes advanced through the resolution of the issue? Is this resolution consistent with the purposes and policies underlying the relevant article? Does the resolution implement the important policy goals of the relevant article,⁷⁴ or does the construction contradict or conflict with the loss allocation or remedial scheme of the article?⁷⁵ Is the construction consistent with the policies and purposes of the relevant provision in question? If so, the gap—the unforeseen issue or context—should be resolved by analogical development or extension of the U.C.C. Supplementation by local law is unnecessary; the asserted relevant common law or equitable principle is displaced by the particular provisions of Section 1-102, the purposes and policies of the U.C.C., and the specific provision applied by analogy.

C. WHEN THE U.C.C. IS UNCLEAR OR AMBIGUOUS

Assume, however, that the U.C.C. is unclear or ambiguous on an issue such as the continued viability of other rules or remedies. *United States National Bank of Oregon v. Boge*⁷⁶ and *Stone & Webster Engineering Corp. v. First National Bank & Trust Co. of Greenfield*⁷⁷ are examples of this conundrum. In the former, the issue was the continued viability of the common law rule of good faith in a secured transaction, and the latter focused on the drawer's right to bring an action in conversion under former Article 3-419.⁷⁸ In both cases, the fundamental issue was the displacement of other law. Had the right to assert conversion beyond that defined in former Article 3 been displaced? Must a party satisfy both the U.C.C. standard of good faith and the common law standard? Again, the beginning point is the particular provision of Section 1-102, such as the purposes and policies of the Code; the purposes and policies of the relevant article; and the purposes and policies of the applicable section.

To resolve the issue a court must ask: will supplementation by a particular local rule adversely affect the simplification, clarification, modernization, predictability, and uniformity of commercial law? Will the scheme of the article—its risk allocation, its notice obligations, its imposed duties, or its remedial rights be impaired by supplementation? Will the policy

74. See, e.g., *Stenseth v. Wells Fargo Bank, N.A.*, 48 Cal. Rptr. 2d 192 (Cal. Ct. App. 1995).

75. *Knox v. Phoenix Leasing Inc.*, 35 Cal. Rptr. 2d 141 (Cal. Ct. App. 1994) (rejecting precedent based on equitable principles after considering scheme of the relevant article, and resolution of the issue by sister jurisdictions).

76. 814 P.2d 1082 (Or. 1991) (holding that the common law duty of good faith was displaced by Section 1-201(19) when confronted with the question of the continued viability of the common law duty of good faith).

77. 184 N.E.2d 358 (Mass. 1962).

78. Under both former Article 3 and Revised Article 3, a payee who has received the instrument is the proper plaintiff in a conversion action.

goals of the specific provision be advanced, nullified, or impaired? Unless the purposes and policies of the U.C.C. are advanced, the scheme of the relevant article implemented, and the policy goals of the specific section are advanced by supplementation, the supplemental principle is displaced. A court must resist any temptation to defer to its local rule or principle rather than undertake the rigor of analysis.

Employing this methodology, the U.C.C. itself becomes the best source for gap-filling, whether the gap is some new transactional context in which the issue arises—lease or license or novel—or the gap is the absence of a substantive legal rule to be applied. Under Revised Article 1, as currently drafted, the appropriation of common law and equity is more restricted.⁷⁹ The overarching effect of the revised section is to explicitly provide for purposive interpretation of the Code, interpretation consistent with its policies and purposes.⁸⁰ Consequently, the rules of construction, including the stated goal of “liberal” rather than “literal” construction of its provisions, statements of purpose in the text or inferred from the choice of language, the official comments including the stated “Purposes of Changes,” the referenced prior uniform statutory provisions, if any, prefatory remarks, and drafting history are valuable sources from which to glean the underlying policies and purposes of each provision and the article as a whole.⁸¹ Because every revised article and each new addition to the U.C.C. were drafted subject to Article 1, this construction methodology should be applicable to the entire U.C.C., despite any inadvertent or deliberate attempt to modify the principle of purposive interpretation in any earlier revision of individual articles or promulgation of new articles.⁸² Furthermore, statements by drafting committees, while a source of purpose and policy, should not, as uncodified, non-statutory unofficial commentary, preempt the overarching construction guidelines of Revised Section 1-103. Otherwise, one of the fundamental construction guidelines in Revised Article 1, Section 1-103 of simplifying and clarifying the law governing commercial transactions becomes meaningless.⁸³

79. In his 1978 article on the supplementary role of equitable principles pursuant to Section 1-103, Professor Summers suggest that the best model for nondisplacement was one in which the text did not address the displacement issues; the text was not comprehensive and exclusive; the comments did not indicate that displacement was intended; the specific objectives of the section were not overriding principles; and nondisplacement would not *significantly* interfere with the general underlying Code objectives of uniformity, modernization, and predictability; and Code analogies and Code history do not dictate displacement. Summers, *supra* note 2, at 939 (emphasis added). The test now becomes would not “interfere” rather than “*significantly* interfere” with the objectives of uniformity, modernization, and predictability.

80. See generally McDonnell, *supra* note 69.

81. See TWINING, *supra* note 47, at 324.

82. See Maggs, *supra* note 38, at 569-70 (suggesting that commentary in Articles 4A and 9 take a hostile view of purposive interpretation, and drafting modifications in Article 3, 4, 5, 6, and 8 eliminate stated goals and purposes of the sections and the verbose drafting style reveal a waning enthusiasm for purposive interpretation).

83. U.C.C. § R 1-103(a)(1) (2000); U.C.C. § 1-102(2)(a) (1999).

D. ANALOGICAL DEVELOPMENT: ITS LIMITS

With the mandate and guidance for analogical development of the U.C.C. in Revised Section 1-103, what constraints corral the burgeoning of the U.C.C. beyond proper boundaries? Is an analogy merely in the eye of the beholder or does the U.C.C. contain sufficient parameters to restrict abuses? The limits and the constraints are found in the underlying purposes and policies of the U.C.C., as delineated in Revised Section 1-103, the policies and purposes of the relevant article, and, when appropriate, the policies and purposes of the specific provision.

Primarily, the U.C.C. should not be extended beyond "its reason."⁸⁴ Hence, a construction or application of the U.C.C. beyond its reason, its fundamental purpose, should not be heeded. Its scope is limited to governing commercial transactions⁸⁵ but not transactions for the conveyance of an interest in land.⁸⁶ Yet, it applies by analogy "to any transaction," regardless of its form, that creates a lease of personal property other than goods⁸⁷ but is inapplicable to money⁸⁸ and credit or debit card slips.⁸⁹ Thus, where an existing regulatory scheme provides clear rules for governing specialized transactions such as the real estate recording statutes and that scheme will neither hinder the expansion of commercial practices nor obfuscate the goals of predictability, deference should be given to the existing legal regime. Expansion or extension of the U.C.C. is unnecessary. The U.C.C. was not intended to be an exhaustive statement of all the law governing commercial transactions.

In addition to the restraints inherent in the underlying policies and purposes of the U.C.C., the role of the Permanent Editorial Board is a safeguard against the extension of the U.C.C. beyond its proper boundaries. In 1953, the Pennsylvania Legislature enacted the U.C.C. without a single non-uniform amendment to the promulgated text.⁹⁰ Shortly thereafter, the New York Revision Commission reported its assessment of the U.C.C. in 1956 with detailed suggestions regarding the codification effort.⁹¹ Inclusion of some mechanism for institutionalizing "constant re-codification" of the U.C.C. text to avoid obsolescence was among the recommendations.⁹² Both the desire to provide a mechanism for re-codi-

84. "[T]he proper construction of the Act requires that its interpretation and application be limited to its reason." U.C.C. § 1-102, cmt. 1 (1999).

85. U.C.C. § 1-102(2)(a) (1999). See generally DONALD B. KING, *THE NEW CONCEPTUALISM OF THE UNIFORM COMMERCIAL CODE* 13 n.49 (1968) (citing the drafter's reference to *Agar v. Ordin*, 264 N.Y.248, 190 N.E. 479 (1934), as an indicator of the extent the underlying purposes are to be considered).

86. U.C.C. § 2-107(1) cmt. 1 (1999).

87. U.C.C. § 2A-102 cmt. (1999).

88. U.C.C. § 3-102 (1999).

89. U.C.C. § 4-104(9) cmt. 8 (1999).

90. William A. Schnader, *The Permanent Editorial Board for the Uniform Commercial Code—Can it Accomplish Its Object?*, 3 AM. BUS. L.J. 137 (1965).

91. *Id.*

92. Peter Winship, *Symposium: As The World Turns: Revisiting Rudolf Schlesinger's Study of the Uniform Commercial Code "In the Light of Comparative Law"*, 29 LOY. L.A. L. REV. 1143, 1153 (1996).

fication and to encourage elimination of the 522 non-uniform amendments that resulted with the enactment of the U.C.C. by 30 states before 1965 led to the formation of the Permanent Editorial Board.⁹³

The U.C.C. sponsors, the American Law Institute and the National Conference of Commissioners on Uniform State Laws, received an endowment from the Maurice and Laura Falk Foundation of Pittsburgh for the continuing functioning of the Permanent Editorial Board to induce states to eliminate non-uniform amendments in their Code and to enact the U.C.C. as promulgated unless to address local litigation procedure.⁹⁴ On August 5, 1961, the Permanent Editorial Board was established and it was organized in May 1962.⁹⁵

The agreement between the Code sponsors authorizes the PEB to serve as the “watch dog” for the U.C.C. Its initial goals were

to assist in attaining and maintaining uniformity in state statutes governing commercial transactions and to this end to approve a minimum number of amendments to the Code. Amendments shall be approved and promulgated when (a) It has been shown by experience under the Code that a particular provision is unworkable or for any other reason obviously requires amendment; or (b) Court decisions have rendered the correct interpretation of a provision of the Code doubtful and an amendment can clear up the doubt or; (c) New commercial practices shall have rendered any provisions of the Code obsolete or have rendered new provisions desirable.⁹⁶

Later in 1987, the scope and function of the PEB were extended to empower the PEB to issue supplemental commentary on the U.C.C. PEB Commentaries may be issued: (1) to resolve an ambiguity by stating what the PEB considers to be the legal rule; (2) to state a preferred resolution if judicial opinions or scholarly writings diverge; (3) to elaborate on the application of the U.C.C. if the statute or Official Comments create doubt as to its applicability to particular circumstances or transactions; (4) *to apply the principles of the U.C.C. to new or changed circumstances, consistent with Section 1-102 (2)(b)*; (5) to clarify or elaborate on the operation of the U.C.C. with other statutes and general principles of law and equity pursuant to Section 1-103; and (6) to otherwise improve the operation of the U.C.C. With the PEB serving as “watch dog” over the U.C.C., a mechanism is in place to bring correction to an overly-expansive reading of the U.C.C.

93. Schnader, *supra* note 90, at 143.

94. *Id.* at 139.

95. The Director of the ALI and the Chairman of the Conference Commercial Code Committee both serve as ex officio members along with five members appointed by the ALI and four appointed by the Conference.

96. Schnader, *supra* note 90, 139.

E. ANALOGICAL DEVELOPMENT: AN EXAMPLE

Consider the following hypothetical context: Buyer receives a record⁹⁷ from Seller offering to sell 20,000 tons of gravel at \$X.00 a ton for delivery before December of that year. Seller's letterhead appears at the top of the communication and its authorized agent's signature, electronic or other symbol, also appears in the record. Within the time frame specified, Buyer sends a written communication accepting without varying the bargained-for terms of the Seller's offer. Thereafter, Seller refuses to perform. Buyer sues to enforce the agreement between the parties. Seller asserts the Statute of Frauds, Buyer lacks a writing signed by Seller that is sufficient to indicate a contract for sale has been made.⁹⁸ Under the express language of Section 2-201(1), Buyer's possession of the Seller's signed offer might not satisfy the statutory writing requirements.⁹⁹ Neither would the Buyer's acceptance satisfy the terms of the exception created for confirmatory communications between merchants.¹⁰⁰ Should Section 2-201 be extended analogically to recognize the use of the two writings, the signed offer by the Seller and the Buyer's acceptance?¹⁰¹

Consider that Section 2-201(3)(b) permits the writing requirement of the Statute of Frauds to be satisfied by an admission by the party against whom enforcement is sought if the admission is made in the party's pleadings, testimony, or otherwise in court. Consistent with the goal of liberal construction of the provisions of the U.C.C., some courts have held that testimony establishing the requirements of formation, an offer and an acceptance, rather than the stated admission of "I contracted with the plaintiff" satisfies the statutory requirement.¹⁰² Although the admission exception has inherent trustworthiness that is lacking with the use of the two writings—the setting in which the admission is made, the availability of cross examination and redirect—fundamentally, however, the ev-

97. "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form. U.C.C. § R 1-201(34) (November 2000 draft).

98. U.C.C. § 2-201(1) (1999).

99. *But see* CAROLINE BROWN, 4 CORBIN ON CONTRACTS § 22.8 at 745-46 (Rev. ed. Joseph M. Perillo editor) (stating the proposition that a signed offer is a sufficient writing to satisfy the statute of frauds).

100. U.C.C. § 2-201(2) (1999).

101. Authority is divided on the effect of the introduction language in Section 2-201(1): "Except as otherwise provided in this section." U.C.C. § 2-201(1) (1999). In *Lige Dickinson v. Union Oil*, 635 P.2d 103 (Wash. 1981), the court construed the language to limit the use of exceptions to the Statute of Frauds to those listed in subsections (2) and (3) of Section 2-201. All other exceptions were held displaced by the above quoted language of subsection (1). Others, however, have construed subsections (2) and (3) as definitional not intended to "eliminate equitable and legal principles traditionally applicable in contract actions." *Warder & Lee Elevator v. Britten*, 274 N.W.2d 339, 342 (Iowa 1979) (citing WHITE AND SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 2-6 at 59 (1972)). *See also* *Hurwitz v. Prime Communications*, 233 UCC Rep. Serv.2d 1213 (Mass. Super. 1994).

102. *Hornell Brewing Co. v. Spry*, 664 N.Y.S.2d 698 (N.Y. Sup. Ct. 1997); *Quaney v. Tobyne*, 689 P.2d 844 (Kan. 1984).

idence is the same, an offer and an acceptance. Furthermore, using the two writings avoids the unfairness that occurs in those jurisdictions that have held or intimated that the plaintiff is entitled to go to trial with the *hope* of eliciting an admission.¹⁰³ Moreover, the signed offer and acceptance provide credible evidence at least as substantial as that which must be established should a party seek to rely on the merchant's confirmatory memorandum exception of Section 2-201(2).

The analogical extension, here, is consistent with the purposes and policies of the Statute of Frauds, that is, protecting the Seller from a false or fraudulent claim of a contractual relationship. Furthermore, the extension is consistent with the strong countervailing policy of abrogating the use of the Statute of Frauds as a tool for perpetrating a fraud. Ergo, the writing in confirmation, the admission exception, as well as the specifically manufactured goods and the partial performance exceptions were included in the statute. Each exception requires some objective source of evidence as a basis for believing that the "oral evidence rests on a real transaction."¹⁰⁴ The asserted analogical extension supports and furthers the overriding policies of Section 2-201 and implements the purposes and policies of the U.C.C. Such an exception simplifies and modernizes the law and increases predictability. The analogical extension should be recognized and employed.

III. VALIDATION & INVALIDATION DEVICES: THE ROLE OF UNCONSCIONABILITY

With increased emphasis on the U.C.C. as the primary source of commercial law, what role does supplemental law play in the new U.C.C.? The inclusion of the supplemental non-statutory law through current Section 1-103 adds breadth to the U.C.C., satisfying several significant functions: (1) providing a mechanism for avoiding obsolescence and for giving continued viability to the U.C.C.; (2) preventing the statutory provisions from "operating mechanically"¹⁰⁵ without considerations of justice, fairness, or the general public order;¹⁰⁶ (3) serving as tools for adapting the U.C.C. to new conditions; and (4) facilitating "judicial interpretation ex-

103. *Gooch v. Farmers Mktg. Ass'n*, 519 So. 2d 1214 (Miss. 1988). *But see* *DF Activities Corp. v. Brown*, 851 F.2d 920 (7th Cir. 1988).

104. U.C.C. § 2-201 cmt. 1 (1999).

105. Kripke, *supra* note 36; Maggs, *supra* note 38. Professor Maggs suggest several reasons for a nonexclusive principle:

First, Llewellyn and the other drafters perceived a tension between having general legal rules and considering the equities of particular cases Section 1-103 provided a solution by requiring judges to use all available law to reach just and equitable results unless the U.C.C. specifically displaced the pre-existing background law. Second, the drafters saw theoretical difficulties with attempting to make the U.C.C. an exclusive body of law Third, Llewellyn did not want to "corral" judges.

Maggs, *supra* note 38, at 574. With the existence of Section 1-103, judges remained in a position to exercise discretion to achieve justice with the availability of common law and equitable principles. *Id.*

106. *See supra* notes 64-65 and accompanying text.

pressing the moral value of the community.”¹⁰⁷ Regrettably, under the reign of the common law, the absence of appropriate tools to adjust the equities between parties led to judicial manipulation of core concepts, such as offer and acceptance, or to determinations that a clause of the contract was contrary to public policy, to prevent injustice and unfairness because of the mechanical operation of common law rules.¹⁰⁸ These manipulations were a boon for the party who had been overreached or coerced. But they created uncertainty and unpredictability in the development of contract law and for those who sought to plan or anticipate risks associated with doing business locally or in the broader interstate markets. The use of supplemental principles avoids the need for judicial manipulation. Concrete tools are now available when the proper context arises. Doctrines of mistake, unconscionability, estoppel, ratification and the like may be marshaled when justified by the facts of the individual case. More importantly, the continued refinement of the articles and provisions of the U.C.C. through the revision process, with the occasional slanting of principles without reasonable justification toward those with substantial representation in the reform process,¹⁰⁹ mandates the availability of provisions to reaffirm or establish the morés and values of the community—the *ordre publique* to deal with unfairness, questionable business tactics and practices, fraud, and the like.¹¹⁰

Early in the process of revising Article 1, the Drafting Committee included a provision on unconscionability in the text of the revised draft.¹¹¹ Thereafter, the section and its contents were bracketed because of the “tentative nature of the section’s inclusion.”¹¹² Although the provision was bracketed, its substance was available for discussion and comment.

107. Hawkland, *supra* note 11, at 305. In his critique of the Code, Mitchell Franklin asserted that the potential for analogical development of the text through purposive reading—applying the purposes and policies to gaps within the Code—mandated that all constituencies should have been involved in the formulation of the text and that the text should have been “qualified by ideas designed to defend the [general public order] of the various constituencies of the U.C.C.” Franklin, *supra* note 39, at 340.

108. See discussion, *infra* at notes 137-38. See also KING, *supra* note 85, at 69-76.

109. See, e.g., the suretyship provisions of Revised Article 3, § 3-605 (1990).

110. See Franklin, *supra* note 39, at 340.

111. U.C.C. § 1-306. Unconscionable Contract or Term

(a) If a court finds as a matter of law that an agreement or any term thereof was unconscionable at the time it was made or was induced by unconscionable conduct, the court may refuse to enforce the agreement, enforce the remainder of the agreement without the unconscionable term, or so limit the application of any unconscionable term as to avoid an unconscionable result.

(b) Before making a finding of unconscionability under subsection (a), the court, on motion of a party or its own motion, shall afford the parties a reasonable opportunity to present evidence as to the setting, purpose, and effect of the agreement or term thereof of the conduct.

U.C.C. § 1-306 (Tentative Draft April 1997).

112. [SECTION 1-306. UNCONSCIONABLE CONTRACT OR TERM.

(a) If a court finds as a matter of law that an agreement or any term thereof was unconscionable at the time it was made [or was induced by unconscionable conduct], the court may refuse to enforce the agreement, enforce the remainder of the agreement without the unconscionable term, or so limit the application of any unconscionable term as to avoid an unconscionable result.

Six months later, the provision was deleted.¹¹³ The provision is not included in the current draft. Given this history, should a presumption arise that the drafters no longer intend for unconscionability to be used as a validating or invalidating device? Furthermore, given the decision to omit a specific unconscionability provision from Revised Article 1, is the manifestly unreasonable test, a designated tool for controlling the agreed to terms that vary from the default rules of the U.C.C.,¹¹⁴ sufficient for policing Article 1 rights?¹¹⁵

A. AVAILABILITY OF THE DOCTRINE OF UNCONSCIONABILITY AS A VALIDATING OR INVALIDATING DEVICE

Absent an express directive in the text or comments to Revised 1-103, no negative inference should arise from the exclusion of a specific unconscionability provision from the final draft of Revised Article 1. The current Reporter's Notes affirm the intent of the Drafting Committee to leave unchanged the text of current Section 1-103. Section (b) of Revised 1-103 "is identical to [the] current Section 1-103."¹¹⁶ The doctrine of unconscionability was accessible through current Section 1-103 and remains

(b) Before making a finding of unconscionability under subsection (a), the court, on motion of a party or its own motion, shall afford the parties a reasonable opportunity to present evidence as to the setting, purpose, and effect of the agreement or term thereof or of the conduct.

(c) This section does not apply to the extent that an agreement is governed by Article 5 of this [Act].

U.C.C. § 1-306 (Tentative Draft April 1997).

113. U.C.C. § 1-306 (ALI Council Draft 1999).

114. U.C.C. § 1-102. Purposes; Rules of Construction; Variation by Agreement.

(3) The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

U.C.C. § 1-102(3) (1999). The revised article maintains the substance of U.C.C. § 1-102(3) (1999).

Section 1-302. Variation by Agreement.

(a) Except as otherwise provided in subsection (b) or elsewhere in [the Uniform Commercial Code], the effect of provisions of [the Uniform Commercial Code] may be varied by agreement.

(b) The obligations of good faith, diligence, reasonableness and care prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever the [Uniform Commercial Code] requires any action to be taken within a reasonable time, any time which is not manifestly unreasonable may be fixed by agreement.

(c) The presence in certain provisions of [the Uniform Commercial Code] of the phrase "unless otherwise agreed," or words of similar import, does not imply that the effect of other provisions may not be varied by agreement under this section.

U.C.C. § R 1-302 (2000).

115. The policing tool of good faith is also available in its broadened scope. Good faith under Revised Article 1 will not only require honesty in fact but also observance of reasonable commercial standards of fair dealing for all articles except Article 5. U.C.C. § R 1-201(22).

116. U.C.C. § R 1-103, Reporter's Notes, Changes from Current Law (2000).

an available tool for judicial interpretation.¹¹⁷ The decision to omit a specific unconscionability provision may have resulted from a desire to avoid being redundant. As an invalidating device, the availability and potential use of the judicial tool of unconscionability has a developed history in case authority that establishes its effectiveness.¹¹⁸ The underlying purposes and policies of the Code, as exemplified by the inclusion of specific unconscionability provisions in Article 2 and 2A, and the expanded definition of good faith to include fairness in dealing for all articles except Article 5 support a conclusion that continued viability of the doctrine is intended under Revised Section 1-103(b) to supplement the Code unless displaced.

B. DISPLACEMENT OF THE DOCTRINE OF UNCONSCIONABILITY

The analysis for determining whether the doctrine of unconscionability supplements should not vary from that used for determining supplementation by other common law or equitable principles.¹¹⁹ Will the purposes and policies of simplification, clarification, modernization, predictability, and uniformity of commercial law be advanced through judicial scrutiny of the bargaining process and the substantive fairness of the terms in the context raised?¹²⁰ Are the policies and purposes of the relevant article advanced or compromised through supplementation by the doctrine in the specific context before the court? *Rudbart v. North Jersey District Water Supply Commission*¹²¹ is an example of the determination of the displacement of the doctrine. Here, holders of notes issued by a water supply commission alleged that the publication notice of early redemption of the notes, consistent with the terms of the notes, was inadequate, that the notes were contracts of adhesion, and that the notice term was unconscionable. Scrutinizing the transaction for both procedural and substantive unconscionability, the court considered the following factors to reach its conclusion: the sophisticated and highly regulated industry in which the transaction occurred; the policy goals of the industry; the need for certainty of terms in the industry; the subject matter of the contract—publicly traded securities rather than consumer necessities; the absence of

117. See *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965) (being remanded for evaluation of cross collateral provision—Article 9); *Perdue v. Crocker Nat'l Bank*, 702 P.2d 503 (Cal. 1985) (imposing insufficient fund charges for customer overdrawing checking account through agreement under Article 4). But see *Beathard v. Chicago Football Club, Inc.*, 419 F. Supp. 1133 (N.D. Ill. 1976) (considering the effect of revocable letter of credit under equitable unconscionability without authority for equitable unconscionability); *Best v. United States Nat'l Bank of Or.*, 714 P.2d 1049 (Or. Ct. App. 1986) (holding the applicability of Section 2-302 is only applicable to transactions in goods while applying Restatement (Second) of Contracts Section 208 without mentioning Section 1-103).

118. *Williams*, 350 F.2d at 445; *Perdue*, 702 P.2d at 503.

119. See *supra* notes 64-83 and accompanying text.

120. *Rudbart v. North Jersey Dist. Water Supply Comm'n*, 605 A.2d 681 (N.J. 1992) (considering custom, usage, and the agreement to determine whether the terms of negotiable securities were unconscionable).

121. *Id.*

superior bargaining power on the part of the issuer; the availability of other investment opportunities—no absence of meaningful choice for the investors; the fully open and competitive market; and the effects on the industry if the notice provisions were unenforceable.

Concluding that enforcement of the terms would advance rather than contravene well established and important public policies reflected in Article 8 of certainty and stability in the marketing of securities, the court held the notice provision as agreed was enforceable. Here, judicial review of the fairness of the notice term of negotiable securities would be inconsistent with state and federal securities law. Thus, in a similar context under the U.C.C., the underlying policies and purposes should be held to have displaced the doctrine of unconscionability.¹²²

Likewise, in *Old Colony Trust Co. v. Penrose Industries*,¹²³ the court weighed two competing policy considerations under the notice requirements of U.C.C. Section 9-504, the desire to impede dishonest dispositions and a reluctance to strangle honest transactions. The court also considered the overriding goal of Article 9 of providing a simple, efficient, and flexible tool to produce the maximum amount from the disposition of collateral. After weighing the goals and policies of the Article and the relevant provision, the court determined that the senior secured party's failure to disclose to a junior creditor the contract terms of the sale of collateral was not unconscionable, especially given the creditor's disruptive conduct in prior attempts to dispose of the collateral. Here, the policy goals of Article 9 and the purpose of the notice provision displaced any unfairness in the secured party's deviation from the strict notice requirements. This case may also be viewed as an example of the underlying policies and purposes creating an exception to the strict operation of the express requirements of a provision. In contrast to these cases that reflect the displacement of the doctrine of unconscionability, *Williams v. Walker-Thomas*¹²⁴ and *Perdue v. Crocker National Bank*¹²⁵ are examples where judicial scrutiny of the contractual relationship for unconscionable terms warranted remand to the lower court for consideration of the supplementation of the relevant article by the doctrine.

122. See also *Beathard*, 419 F. Supp. at 1133 (finding neither procedural nor substantive unconscionability in the issuance of a revocable letter of credit in arm's length dealing between the issuing bank and beneficiary who had the assistance of counsel); *Siemens Credit Corp. v. Marvik Colour, Inc.*, 859 F. Supp. 686 (S.D.N.Y. 1994) (holding that a waiver of warranties and the exclusion of consequential damages were not unconscionable where the terms of the contract were actively negotiated in the course of buyer's business, the terms were visible and understood, and did not violate public policy but were consistent with those customary in the jurisdiction).

123. 280 F. Supp. 698 (E.D. Pa. 1968), *aff'd*, 398 F.2d 310 (3d Cir. 1968).

124. 350 F.2d 445 (D.C. Cir. 1965) (remanding for evaluation of cross collateral provision—Article 9).

125. 702 P.2d 503 (Cal. 1985). See also *Riggs Nat'l Bank of D.C. v. District of Columbia*, 581 A.2d 1229 (D.C. 1990) (subjecting account agreement with terms on the reverse side authorizing service charges for low balance accounts to review for unconscionability).

C. IS THE MANIFESTLY UNREASONABLE STANDARD A SUFFICIENT TOOL FOR POLICING ARTICLE 1 TERMS?

Despite its brevity, Article 1 is a source of vital terms for agreements that fall within specific articles. These Article 1 terms include provisions on choice of law, notice, reasonable time, and most importantly, the right to vary any default rule or to define standards of conduct within the U.C.C. by agreement.¹²⁶ These terms are enforceable to the extent that they do not disclaim the obligation of good faith, diligence, reasonableness or care imposed by the U.C.C.¹²⁷ and are not manifestly unreasonable.

Courts construing the “manifestly unreasonable” standard have sought to determine if a term varied by the agreement or the operation of an agreed term stripped one of the parties of a right or remedy that was bargained for or a right, remedy, or protection granted by a default rule or standard of the U.C.C. Described as a limitation on the right of parties to anticipate and allocate business risks, the standard is “deferentially appl[ie]d to the contracts of . . . sophisticated parties.”¹²⁸ Thus, the parameter of the manifestly unreasonable standard is the agreement itself, which includes by definition the relevant course of dealings, trade usage, and course of performance of the parties.¹²⁹

The court in *Hart Engineering Co. v. FMC Corp.*¹³⁰ stated that the manifestly unreasonable standard assumes the agreement falls within the boundary set by oppressiveness and inequitable dealing,¹³¹ or within the standards imposed by conscionable conduct and is hence not subject to invalidation by the doctrine of unconscionability. The *Hart* court could make this observation because the matter before it, a goods transaction, was subject to the limitations of Section 2-302. Although a court may consider many of the same factors, such as the language or terms of the agreement, circumstances existing at the time of contracting, or the subsequent operation of the terms, in addressing both the manifestly unreasonable standard or unconscionability, the scope of inquiry differs. The focus of the manifestly unreasonableness test is the agreement; the doctrine of unconscionability begins with the bargaining process.

An interesting pattern emerged from a review of some of the cases where the “manifestly unreasonable” standard was discussed. When addressing issues arising in the sale or lease of goods, deference was given to the agreements of the sophisticated parties unless the agreement or the operation of an agreed term stripped one of the parties of a right or rem-

126. See *supra* note 114.

127. See *id.*

128. *PPG Indus., Inc. v. Shell Oil Co.*, 919 F.2d 17 (5th Cir. 1990) (Article 2) (addressing whether a force majeure clause that exempted non-performance for explosions within or beyond the control of seller contravened U.C.C. Section 1-102(c) duty of good faith and diligence).

129. *Nat'l City Bank v. Plechaty Cos.*, 661 N.E.2d 227 (Ohio Ct. App. 1995).

130. 593 F. Supp. 1471 (D. R.I. 1984).

131. *Id.* at 1480.

edy that was bargained for, or was a right, remedy, or protection granted by a default rule of the U.C.C.¹³² In Article 4 cases, involving an agreement defining more specifically the customer's duty to give notice of unauthorized drawer signatures or alterations of instruments with reasonable promptness¹³³ or an agreement shortening the one-year preclusion for providing notice of an unauthorized signature or alteration,¹³⁴ deference was given to the agreement of the parties despite the unequal bargaining power. Here, the strong public policy of allocating to the customer the duty to monitor her account as the least-cost-risk avoider justified the distinction. However, at least one court acknowledged that the customer had not raised the issue of whether the agreement was an adhe-

132. See, e.g., *Loucks v. New Holland Mfg., Inc.*, 1993 WL 152288 (Minn. App. 1993) (memorandum opinion). Parties agreed to a one-year warranty for a combine purchased by the buyer. Buyer asserted one-year warranty was manifestly unreasonable. Court held that where the defect could be discovered through ordinary use of the goods, the one-year term was not manifestly unreasonable. The court distinguished *Held v. Mitsubishi Aircraft*, 672 F. Supp. 369 (D. Minn. 1987) (defect only discoverable in ice storm), and *McCullough v. General Motors Corp.*, 577 F. Supp. 41 (W.D. Tenn. 1982) (only discoverable in automobile accident), where latent defects awaited discovery upon an unusual occurrence the terms were manifestly unreasonable.

133. U.C.C. § 4-406(c) (1999). *Fundacion Museo De Arte Contemporaneo De Caracas-Sofia Imber v. CBI-TDB Union Bancaire Privee*, 996 F. Supp. 277 (S.D.N.Y. 1998), *aff'd*, 160 F.3d 146 (2nd Cir. 1998). In *Fundacion Museo*, an account agreement imposed a duty on customer to exercise reasonable care and promptness in examining statements of account and to notify the bank promptly in writing of any discovery and in no event more than fifteen calendar days, later modified to 30 days, from the time the statement and items were first mailed or available to the customer. Customer notified the bank of an unauthorized signature in August after the item (\$825,000) was mailed as part of the May statement. The court held that the one-year default standard for determining whether a customer's examination was reasonably prompt could be varied by agreement so long as the agreed standard was not manifestly unreasonable. Given the unreliability of the Venezuelan mail delivery system, the thirty days of mailing standard was not manifestly unreasonable. See also *Stowell v. Cloquet Co-op Credit Union*, 557 N.W.2d 567 (Minn. 1997). Depositor of credit union sought to recover \$22,000 paid from his account on forged checks. Depositor complained in December that he had not received his statement for November. Bank sent a duplicate statement that was also intercepted by the wrongdoer. Depositor continued to complain about the absence of his statements for eight months until the vice president was contacted in August of the following year. The following month, the forgery scheme was discovered when a creditor called concerning an NSF check. The draft withdrawal agreement required depositor to examine monthly statements and notify credit union of errors within twenty days, thereby defining the "reasonable promptness" standard of Section 4-406(c). Reversing both the trial court and the court of appeals, the court held 20 days was not manifestly unreasonable.

134. U.C.C. § 4-406(f) (1999); *Borowski v. Firststar Bank Milwaukee, N.A.*, 579 N.W.2d 247 (Wis. Ct. App. 1998). Customer, personally and as personal representative of an estate, sought to recover from bank for negligently paying forged checks drawn on both accounts and for honoring forged handwritten requests for cashier's checks. Both account agreements imposed a duty on customer to give notice of unauthorized signatures or alterations within 14 days of receipt of the statement including the items. Customer failed to meet the fourteen day requirement. Court concluded the variation of Section 4-406 one-year preclusion to fourteen days was not manifestly unreasonable in view of the following factors: (1) Code policy of the relevant section of requiring customers to be vigilant in conducting and safeguarding their own affairs; (2) modifications approved by other jurisdictions; (3) substantial weight to authority from other jurisdictions to implement Code policy of uniformity; and (4) the underlying public policy justification for permitting reduction of the period to limit disputes in light of the millions of bank transactions that occur daily.

sion contract. Because the issue was not raised in the trial court, the court did not address the issue.

In another matter, the court described the depositor and the circumstances surrounding the formation of the contractual relationship: "a sophisticated businessman . . . read . . . [the account agreement], understood its terms, and recognized that he had a responsibility to review his account statements and notify the Credit Union of any errors."¹³⁵ The facts substantially replicate the assessment generally made under the procedural unconscionability prong, which includes the sophistication of the party asserting the existence of an unconscionable term, the complexity of the term, and the circumstances surrounding the party's assent to the terms. The conclusion that the manifestly unreasonable standard begins with the agreement and not the process giving rise to the agreement, is reinforced. Likewise, it is apparent that the courts are not totally oblivious to the process by which the agreement was created.

With Article 9, however, in at least one case the court uses language that is highly suggestive of analysis under the doctrine of unconscionability in determining if a term, which operated as a waiver of notice provision, was manifestly unreasonable.¹³⁶ Will the co-mingling of the two standards—unconscionability and manifest unreasonableness—lead to inconsistent results and a lack of uniformity? Regrettably, under the reign of the common law, the absence of appropriate tools to adjust the equities between parties led to the use of "covert tools"¹³⁷ or judicial manipulation of core concepts such as "adverse construction of the language of the agreement, manipulation of the rules of offer and acceptance, or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract" to prevent injustice and unfairness because of the mechanical operation of common law rules.¹³⁸ Without articulated guidelines, will the manifest unreasonableness standard become the 21st century tool of manipulation to achieve fairness?

The manifestly unreasonable standard is of limited utility, addressing the bargain and the expectations of the parties, and therefore, should be one of several tools available to courts to police bargains. Agreements resulting from oppressive conduct or unfair dealing, extending beyond set

135. *Stowell*, 557 N.W.2d at 569.

136. *See Oxford Resources Corp v. Jenkins*, 642 N.Y.S.2d 488 (N.Y. Civ. Ct. 1996). Mother signed as co-lessee for daughter's lease of a car. After daughter's default, lessor sold the car without giving co-lessee notice of the sale then sued co-lessee for the deficiency. Court held that the terms of the agreement granting lessor the right "to pursue any other remedy the law allows" was "too subtle for the commercially uninitiated lessee to understand" as a waiver of notice of sale and was an attempt to substitute a standard for the notice requirement of Section 9-501(3) that was manifestly unreasonable.

137. KARL LLEWELLYN, *THE COMMON LAW TRADITION* 370 (1960).

138. U.C.C. § 2-302 cmt. 1. Generally, courts did not inquire into the adequacy of consideration to prevent unfairness when enforcement of an agreement was sought at law. *But see Luing v. Peterson*, 143 Minn. 6, 172 N.W. 692 (Minn. 1919); *State Finance Co. v. Smith*, 112 P.2d 901 (1941). However, gross inadequacy of consideration coupled with other factors was employed to deny the grant of equitable relief. *See, e.g., McKinnon v. Benedict*, 157 N.W.2d 665 (1968); *Ogle v. Wright*, 2 S.E.2d 72 (1939).

boundaries, and violating the public policy concern which the doctrine of unconscionability was crafted to prevent, provide an opportunity for courts to become creative in inventing tools to reinforce substantive limits on contractual freedom. Courts and other legal professionals must recognize that, despite the omission of a substantive provision addressing unconscionability in the current draft of Revised Article 1, the doctrine remains a viable tool for assessing Article 1 terms, as well as an agreement subject to the provisions of the other articles.

Fear is perhaps the overriding justification for an objection to including an articulated provision on the doctrine of unconscionability—fear of frivolous defenses by parties who assumed or were allocated risks in an arm's length transaction; fear that those who possessed sufficient bargaining strength and meaningful alternatives to extract a better deal may later cry "foul;" and fear of increased litigation. But would a reasonably articulated standard for invalidating an agreement or term because of unconscionability minimize, rather than increase, the risk of frivolous defenses? With an articulated standard and guidelines in the language of the text and its comments, counselors are equipped to assess the good faith basis for asserting the defense in order to meet the requisite ethical standards imposed upon them as officers of the court and to avoid sanctions. Thus, the risk of frivolous defense is shifted to the proponent of the defense rather than the opposing party. Additionally, an articulated standard provides notice to the commercial community of the established parameters of acceptable conduct. The guesswork is eliminated.

IV. CONCLUSION

Under the current draft of Revised Article 1, courts are given guidance on determining the extent of displacement of the principles of common law and equity. If included in the promulgated version of Revised Article 1 as currently drafted, uniformity of reliance on supplementary law should increase among the jurisdictions and, correspondingly, uniformity of interpretation and uniformity of the development of the U.C.C. Further, developing the theoretical and doctrinal bases for displacement under Section 1-103 lessens the tension that appears to exist between current Sections 1-102 and 1-103 as independent statutory directives of equal weight and significance. Conflicting approaches to the relationship between the general principles of law and equity and the provisions of the U.C.C. should be minimized.

As the process of revision draws to a close, the Revised Article 1 Drafting Committee should evaluate the message, if any, being communicated through its consideration and elimination of a provision on unconscionability. More importantly, clarifying the relationship between the manifestly unreasonable standard and the supplementary doctrine of unconscionability might be wise. Clarity now will avoid needless confusion, increased uncertainty, and nonuniformity of results in the future.