



STATE OF NEW JERSEY
N J L R C
NEW JERSEY LAW REVISION COMMISSION

FINAL REPORT AND RECOMMENDATIONS
Relating to
UNIFORM COMMERCIAL CODE ARTICLE 1 (2001)
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Introduction

In 2001, the National Conference of Commissioners on Uniform State Laws and the American Law Institute adopted Revised Uniform Commercial Code Article 1 for adoption in all states. The New Jersey Law Revision Commission has examined the Official Text of Revised Article 1 and recommends that the State of New Jersey adopt it in its entirety except for the provision regarding choice of law contained in Revised Article § 1-301. The Commission recommends retention of existing law on this subject contained in UCC Article 1 § 1-105 codified at N.J.S.A. 12A:1-105. As of 15 February 2010, thirty-eight jurisdictions have adopted Revised Article 1.¹

“Article 1 of the Uniform Commercial Code (UCC) provides definitions and general provisions which, in the absence of conflicting provisions, apply as default rules covering transactions and matters otherwise covered under a different article of the UCC.”² In the intervening decade, NCCUSL and ALI have virtually revised or amended every major article of the Uniform Commercial Code to accommodate changing business practices and developments in law. The revision to Article 1 is an integral part of the Code’s revision to reflect market developments and to achieve consistency with the specific subject matter articles of the Code.

Article 1 contains many changes of a technical, non-substantive nature, such as reordering and renumbering sections, and adding gender-neutral terminology. However, certain substantive changes were made as well. First, section 1-102 now expressly states that the substantive rules of Article 1 apply only to transactions within the scope of other articles of the UCC. This clarification improves its more ambiguously worded predecessor. Second, the statute of frauds requirement aimed at transactions beyond the coverage of the UCC has been deleted. Third, section 1-103 clarifies the application of supplemental principles of law, with clearer distinctions about where the UCC is preemptive. Fourth, the definition of "good faith" found in 1-201 is revised to mean "honesty in fact and the observance of reasonable commercial standards of fair dealing". This change conforms to the definition of good faith that applies in all of the recently revised UCC articles except Revised Article 5. Finally, evidence of "course of

¹ The jurisdictions are: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, U.S. V.I., Utah, Vermont, Virginia, West Virginia, and Wisconsin. NCCUSL Legislative Fact Sheet available at [http://www.nccusl.org/LegislativeFactSheet.aspx?title=UCC%20Article%201,%20General%20Provisions%20\(2001\)](http://www.nccusl.org/LegislativeFactSheet.aspx?title=UCC%20Article%201,%20General%20Provisions%20(2001)) last visited 10 February 2012. There are five 2012 introductions: District of Columbia, Maryland, Massachusetts, Michigan, and Washington.

² NCCUSL Summary available at [http://www.nccusl.org/ActSummary.aspx?title=UCC%20Article%201,%20General%20Provisions%20\(2001\)](http://www.nccusl.org/ActSummary.aspx?title=UCC%20Article%201,%20General%20Provisions%20(2001)) last visited 10 February 2012.

performance" may be used to interpret a contract along with course of dealing and usage of trade.

However, the most important change to Article 1 involves the default choice-of-law provisions found in 1-301, designed to replace previous 1-105. Under the latter section, parties to a transaction had the freedom to choose the law of any jurisdiction bearing a reasonable relation to that transaction. Revised Article 1 provides a different basic rule, applicable to all transactions except certain consumer transactions, that lets the parties choose the law of their transaction without reference to whether the transaction bears a reasonable relationship to the selected legal regime. It is party autonomy *par excellence*. In the commercial context, the only restraint is that the parties' choice of law cannot override the mandatory law of the forum of adjudication, meaning the law related to that state's fundamental social policies. In consumer transactions, an exercise of such a choice cannot deprive the consumer of the protection afforded by the consumer law of the consumer's residence, or of the consumer law where the consumer took delivery of the goods.

Matters of Controversy: Choice of Law

While the scope for disagreement with Revised Article 1 is broad, the most serious reservations were expressed over the new "choice of law" rule.³ In a Memorandum dated 10 February 2004, the Commission analyzed the issue and, after discussion and deliberation, decided that, due to potential objections against Revised Article 1 in its entirety based on the perceived problems of the new rule, it was appropriate to retain existing law in this area. The pertinent portion of that Memorandum follows for sake of clarity and convenience.

The New Choice of Law Rule

Revised Article 1-301 provides a choice of law rule that allows commercial parties in domestic transactions to select the law of any state and in international transactions (defined as a transaction that bears a reasonable relation to a country other than the United States) to select the law of any state or country. The new rule does not require that the law selected by the parties bear any relationship to that state or country. Hence, with one caveat, the new rule provides for almost total party autonomy in a commercial transaction. The one caveat: the application of the selected law would not apply if it would violate a fundamental policy of the law of the state that would apply in the absence of the agreement.

³ For example, consumer groups, such as the Consumers Union, publisher of *Consumer Reports* magazine, object to the new definition of a "conspicuous" term in the definitions contained in §1-201; they also maintain that Revised Article 1 should contain a general "unconscionability" provision applicable to any transaction covered by the Code.

http://www.consumersunion.org/pub/core_financial_services/000206.html last visited 10 February 2012. These objections do not amount to a reason justifying wholesale rejection of the revision.

A special rule is created for consumer transactions. In that context, the choice of law must bear a reasonable relation to the law of the state or country designated and the agreed choice of law cannot deprive the consumer of the mandatory rules of the jurisdiction where the consumer resides, or if the contract and delivery are made outside the consumer's state of residence, the place where the contract and delivery took place.

In addition, there are eight specific exceptions identifying UCC substantive articles specifying the applicable law.

The Controversy

There is little doubt that Revised Section 1-301 is more complicated than existing Section 1-105, adopted in New Jersey and part of the original text. There are several groups opposed to the new rule: academics, banks and some commercial parties. In general, the arguments raised are: the new rule creates problems of interpretation by disturbing a settled and known rule supported by precedent, threatens consumers and promotes forum shopping.⁴ The banks maintain that the new rule constricts their autonomy to select the law governing consumer agreements.

The most serious argument is that the rule authorizes the unprincipled use of forum shopping, encouraging the party authoring the contract to seek out any jurisdiction providing a perceived advantage to that party. In effect, the rule would result in a competition among jurisdictions to provide the best rules for predatory contract drafters. With respect to software contracts, skeptics of the new rule, even large institutions that, without compunction, impose standard form contracts on their own customers, claim that it provides a back door to the Uniform Computer Information Transactions Act, since the contract can make the law of Virginia or Maryland applicable: the only two states that have adopted UCITA. These institutions maintain that certain companies, notably Microsoft, will take advantage of this loophole. This fear of UCITA rests presumably upon the major reasons set forth in opposition to that uniform law: enlargement of contract law, infringement of federal copyright law, codification of constructive consent⁵ and electronic self-help. In addition, an author has argued that allowing parties to choose their own law deprives government of its authority to regulate the standards of its society.⁶

⁴ No attempt is made here to duplicate the nuances of the arguments made against Section 1-301. The latter, which consists of barely more than 2 pages, has generated a law review article in opposition consisting of 87 pages. William J. Woodward, Jr., *Contractual Choice of Law: Legislative Choice in an Era of Party Autonomy*, 54 SMU L. Rev. 697 (2001).

⁵ For a history of constructive consent and the legal attempts to deflect misuse in the context of standard form contracts, see John J.A. Burke, *Reinventing Contract*, E Law Murdoch Univ. (2003).

⁶ d. This argument is a familiar one in standard form contract theory. *E.g.*, W. David Slawson, *Standard Form Contracts and Democratic Control of Law Making Power*, 84 Harv. L. Rev. 529 (1971). The argument has been raised against the process of developing the Uniform Commercial Code under the auspices of the National Conference of Commissioners on Uniform State Law.

No doubt that the critics' arguments have merit. Revised Article 1-301 is more complicated than the existing rule and would have to be interpreted over time. The rule may, but not necessarily, lead to forum shopping. The latter assumes expertise in law in a variety of jurisdictions. The rule may, but not necessarily, lead jurisdictions to compete in a race to the bottom. Arguments made in an analogous context, corporate law and the Delaware effect, are unsubstantiated hypotheses. Moreover, in the corporate context, the economic incentive is obvious for states – collection of fees; the economic incentive in choice of law is not so obvious since law and forum are separate matters.

Removing Revised Article 1-301 and retaining the existing rule would mean that the choice of law must bear a reasonable relationship to the parties or their transaction. However, the authoring party can escape the rules of any particular legal regime simply by putting an arbitration clause in the contract, or, by identifying a non-legal code, as permitted under Revised Article 1-302.⁷

Revised Definition of “Good Faith”

The revised definition of “good faith” contained in §1-201 states, “Good faith” except as otherwise provided in Article 5, means honesty in fact and the observance of reasonable commercial standards of fair dealing.” This definition is not revolutionary, already having been incorporated in the revision process for other articles except for letters of credit.⁸ Many letters of credit are governed by international rules established by the International Chamber of Commerce under the Uniform Customs and Practices for Documentary Credits (UCP 500) thereby subjecting credits to internationally recognized standards in the absence of an expanded “good faith” definition in Article 5. The definition of “good faith” in Revised Article 1 conforms to local New Jersey norms and to internationally accepted norms such as Article 1.7 of the UNIDROIT Principles of International Commercial Contracts, a model to serve as a guide for domestic legislation. Given the broad use of the revised definition in other articles, such as 2A, 3, 4, and 8, there is every reason for consistency’s sake to incorporate the revised definition in Revised Article 1.

Analysis of State Adoptions: Dispositions of 4 key sections of Revised. Article 1

The law of the states that have enacted Revised Article 1 (General Provisions) of the Uniform Commercial Code were examined to determine what decisions those states have taken in three key sections: (1) § 1-102 [scope], (2) § 1-201(20) [good faith] and also amendments reflecting adoption of Revised Article 7 (Documents of Title), and (3) § 1-303 [course of performance, course of dealing and usage of trade]. Although an earlier Final Report tracked state legislative decisions relating to § 1-301 [territorial

⁷ The Official Comment cites as an example the UNIDROIT Principles of International Commercial Transactions. It is highly unlikely that a dominant contracting party would ever use the latter, given its validity and other provisions favoring the weaker party to the contract and giving the court virtually *carte blanche* to rewrite the terms of a perceived abusive contract.

⁸ See, Articles 2A 3, 4, 4A, 8 and 9.

applicability], of the thirty-eight adopting jurisdictions, there are currently thirty-two enacted variations from the section's Official Text.⁹ Conformity with and deviations from the language of the Official Text were tracked. The results of the analysis are set forth in the following table.

State adoption and non-adoption of Official Text with respect to four sections of Revised Article 1 of the Uniform Commercial Code

State	§1-102 Scope	§1-201 Good Faith	§1-201 R. Art. 7	§1-303 Crs. Perf.
Alabama ¹⁰	Yes	No	No	Yes
Alaska ¹¹	Yes	Yes	No	Yes
Arizona ¹²	Yes	No	Yes	Yes
Arkansas ¹³	Yes	Yes	Yes	Yes
California ¹⁴	Yes	Yes	No	Yes
Colorado ¹⁵	Yes	Yes	No	Yes
Connecticut ¹⁶	Yes	Yes	No	Yes
Delaware ¹⁷	Yes	Yes	No	Yes
Florida ¹⁸	Yes	Yes	No	Yes
Hawaii ¹⁹	Yes	No	Yes	Yes
Idaho ²⁰	Yes	No	Yes	Yes
Illinois ²¹	Yes	No	No	Yes
Indiana ²²	Yes	Yes ²³	Yes	Yes
Iowa ²⁴	Yes	Yes	Yes	Yes ²⁵
Kansas ²⁶	Yes	Yes	Yes	Yes
Kentucky ²⁷	Yes	Yes	No	Yes
Louisiana ²⁸	Yes	Yes	No	Yes

⁹ See UCC §1-301 (West 2009 Electronic Pocket Part Update).

¹⁰ Ala. Code §7-1-101et seq.

¹¹ Alaska Stat. §45.01.101 et seq.

¹² Ariz. Rev. Stat. §47-1101et seq.

¹³ Ark. Code Ann. §4-1-101 et seq.

¹⁴ Cal. Com. Code §1101 et seq.

¹⁵ Colo. Rev. Stat. §4-1-101et seq.

¹⁶ Conn. Gen. Stat. Ann. § 42a-1-101 et seq.

¹⁷ 6 Del. C. §1-101 et seq.

¹⁸ Fla. Stat. Ann. §670.101 et seq.

¹⁹ Haw. Rev. Stat. Ann. §490:1-101et. seq.

²⁰ Idaho Code Ann. §28-1-101et seq.

²¹ 810 Ill. Comp. Stat. Ann. §5/1-101 et seq.

²² Ann. Ind. Code §26-1-1-101et seq.

²³ Effective July 1, 2010.

²⁴ Iowa Ann. Stat. §554.1101 et seq.

²⁵ Adopted with variations.

²⁶ Kan. Stat. Ann. §84-1-101 et seq.

²⁷ Ky. Rev. Stat. Ann. §355.1-101 et seq.

²⁸ La. Rev. Stat. §10:1-101 et seq.

Maine ²⁹	Yes ³⁰	Yes	No	Yes
State	§1-102 Scope	§1-201 Good Faith	§1-201 R. Art. 7	§1-303 Crs. Perf.
Minnesota ³¹	Yes	Yes	Yes	Yes
Mississippi ³²	Yes	Yes	Yes	Yes
Montana ³³	Yes	Yes	Yes	Yes ³⁴
Nebraska ³⁵	Yes	No	Yes	Yes
Nevada ³⁶	Yes	Yes	Yes	Yes
New Hampshire ³⁷	Yes	Yes	Yes	Yes
New Mexico ³⁸	Yes	Yes	Yes	Yes
North Carolina ³⁹	Yes	Yes	Yes	Yes
North Dakota ⁴⁰	Yes	Yes	Yes	Yes
Ohio ⁴¹	Yes	Yes	Yes	Yes
Oklahoma ⁴²	Yes	Yes	No	Yes
Oregon ⁴³	Yes ⁴⁴	Yes	No	Yes
Pennsylvania ⁴⁵	Yes	Yes	No	Yes
Rhode Island ⁴⁶	Yes	No	No	Yes
South Dakota ⁴⁷	Yes	Yes	No	Yes
Tennessee ⁴⁸	Yes	No	No	Yes
Texas ⁴⁹	Yes	Yes	No	Yes
U.S. V.I. ⁵⁰	Yes	Yes	No	Yes ⁵¹
Utah ⁵²	Yes	No	No	Yes

²⁹11 Me. Rev. Stat. Ann. §1-101 et seq.

³⁰Effective February 15, 2010.

³¹Md. Code. Com. Law § 1-101 et seq.

³²Miss. Code Ann. § 75-1-101 et seq.

³³Mont. Code Ann. § 30-1-101 et seq.

³⁴Adopted with variations.

³⁵Neb. Rev. Stat. Ann. § 1-101 et seq.

³⁶Nev. Rev. Stat. Ann. § 104.1101 et seq.

³⁷N.H. Rev. Stat. Ann. § 382-A:1-101 et seq.

³⁸N.M. Stat. Ann. § 55-1-101 et seq.

³⁹N.C. Gen. Stat. Ann. § 25-1-101 et seq.

⁴⁰N.D. Century Code Ann. § 41-01-02 et seq.

⁴¹Ohio Rev. Code Ann. § 1301.101 et seq.

⁴²12 Okla. Stat. Ann. § 1-101 et seq.

⁴³Or. Rev. Stat. Ann. § 71.1010 et seq.

⁴⁴Oregon's legislature has chosen to apply §1-102 to Articles 2, 2A, 3, 4, 4A, 5, 7, 8, and 9, while excluding Article 6.

⁴⁵13 Pa. Stat. and Consolidated Stat. § 1101 et seq.

⁴⁶Gen. Laws of R.I. § 6A-1-101 et seq.

⁴⁷S.D. Codified Laws §7A-1-101 et seq.

⁴⁸Tenn. Code Ann. § 47-1-101 et seq.

⁴⁹Tex. Bus. and Com. Code § 1.101 et seq.

⁵⁰11A U.S.V.I. Code Ann. § 1-101 et seq.

⁵¹Adopted with variations.

⁵²Utah Code Ann. § 70A-1a-101 et seq.

Vermont ⁵³	Yes	Yes	No	Yes
Virginia ⁵⁴	Yes	No	Yes	Yes
State	§1-102 Scope	§1-201 Good Faith	§1-201 R. Art. 7	§1-303 Crts. Perf.
West Virginia ⁵⁵	Yes	Yes	No	Yes
Wisconsin ⁵⁶	Yes	No	No	Yes

The Official Text defines the term “good faith”: “Good faith, except as otherwise provided in Article 5, means honesty in fact and the observance of reasonable commercial standards of fair dealing.” Rev. Art. 1 §1-201(b)(20). In its current version of Article 1, New Jersey defines “good faith” as “honesty in fact in the conduct or transaction concerned.” In the table above, most states that have rejected the revised definition of “good faith” retained the original version of “good faith” found in the New Jersey statute.⁵⁷

As the Comment indicates, only Article 2, in its original redaction, provided that: “in this Article ... good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.”⁵⁸ This definition combined subjective honesty with objective commercially reasonable behavior. However, it was limited to Article 2 transactions and to merchants. When the Code was substantially revised during the 1980’s and 1990’s, the broader definition of good faith was incorporated into Articles 2A, 3, 4, 4A, 8 and 9, but without the qualifying prepositional phrase “in the trade”. Only Article 5 retained the narrower definition and Article 7 does not contain a definition of good faith. Hence, given these developments, the revisers thought it appropriate to introduce the broader concept of “good faith” into the general provisions of Revised Article 1.

The subjective test of good faith embodied in the phrase “honesty in fact” often has been described as requiring only “a pure heart and an empty head”, and specifically excluding criteria such as “expectations of the parties”, “absence of negligence” or “standards of a reasonable and prudent person”. It is a narrowly circumscribed formulation of the obligation and differs from the common law doctrine of good faith and fair dealing implied in every contract. However, New Jersey courts do not treat UCC cases only under the Art. 1 definition of “good faith” limited to a subjective test. In New Jersey, a transaction governed by Article 1 does not exclude the application of the implied duty of good faith and fair dealing” found in the common law *E.g., Sons of Thunder v. Borden, Inc.*, 148 N.J. 396 (1997)(finding that in addition to the UCC Article

⁵³9A Vt. Stat. Ann. §1-101 et seq.

⁵⁴Va. Code Ann. § 8.1A-101et seq.

⁵⁵W. Va. Code Ann. § 46-1-101 et seq.

⁵⁶Wis. Stat. § 401.101 et. seq.

⁵⁷With the exception of Hawaii, which defines “good faith” only as “honesty in fact”.

⁵⁸Note that Revised Article 1 contains a conforming amendment to Article 2 to delete this definition of “good faith” contained in §2-103(1)(b).

1 good faith requirement, “every contract in New Jersey contains an implied covenant of good faith and fair dealing”). The *Sons of Thunder* Court specifically stated, “Although the UCC governs this case, the obligation to perform in good faith found in our common law will also influence the result.” *Id.* at 421.

While it is difficult to define the parameters of “good faith”, the *Sons of Thunder* Court, quoting *Palisades Properties, Inc v. Brunetti*, 44 N.J. 117 (1965) remarked, “In every contract there is an implied covenant that ‘neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract’.” *Sons of Thunder*, *supra* at 420. This definition broadly accords with the two preeminent theories of good faith in American law: Professor Robert Summer’s “excluder analysis” adopted in the Restatement (Second) of Contracts §205 (1981) and Professor Steven Burton’s “foregone opportunities approach. See, Emily M.S. Houh, *The Doctrine of Good Faith in Contract Law: A (Nearly Empty Vessel?*, 2005 Utah L. Rev. 1. The Summer’s approach states that good faith is the negative corollary of bad faith. Its substance derives from “rul[ing] out radically heterogeneous forms of bad faith.” Robert S. Summers, *Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 Va. L. Rev. 195, 204 (1968). The Burton approach, based on law and economics analysis, provides that bad faith constitutes a party’s attempt to recapture opportunities – “in the form of resources committed at the time of making the contract to particular uses in the future - foregone in the contracting process.” Houh, *supra* at 8. While the theories differ in approach and formulation, they are likely to produce no meaningful difference in practice.

The New Jersey approach to defining the implied covenant of good faith and fair dealing is open ended in terms of criteria. *Seidenberg v. Summit Bank*, 348 N.J. Super. 243 (App. Div. 2002)(finding that the court must consider the expectations of the parties and the purposes for which the contract was made, and finding that a party may not unreasonably frustrate the [contract’s] purpose). Significantly, the *Seidenberg* Court stated, “In the final analysis, bad faith must be judged not only in light of the proofs regarding the defendants’ state of mind (*subjective test, JB*) but also in the context from which the claim arose (*objective test, JB*).” As *Seidenberg* clarified that requires the plaintiff to demonstrate a violation of “any commercially reasonable standard.” *Id.* at 263. Hence, the New Jersey approach to “good faith” does not deviate from the revised definition of that term contained in Revised Article 1 in looking to reasonable commercial standards of conduct. The expansion of the definition of “good faith” in Revised Article 1 conforms to existing New Jersey norms and would not adversely alter New Jersey law.

Conclusion

The Commission recommends the adoption in New Jersey of the Official Text version of Revised Article 1 of the Uniform Commercial Code, except for § 1-301 containing the new choice of law rule. In that regard, the Commission recommends retention of the existing rule, requiring that the transaction bear a reasonable relationship to the legal regime selected by the parties, as now codified in § 1-105. The Commission

also recommends technical amendments to conform to New Jersey's style requirements. The Commission also recommends the simultaneous adoption of Revised Article 7 – Documents of Title with relevant conforming amendments.

Attachment

The attachment contains the entire text of Revised Article 1 containing amendments required by Revised Article 7 and omitting the new provision for choice of law and retaining existing law on that issue. Brackets indicate material that should be omitted from the New Jersey text.