

BILL ANALYSIS

HB 1394
By: Elkins
Business & Industry
Committee Report (Unamended)

BACKGROUND AND PURPOSE

Chapter 1 of the Texas Business and Commerce Code (Article 1 of the Uniform Commercial Code or UCC) provides general provisions and statutory definitions that are applicable to Chapters 2 through 9 of the Texas Business and Commerce Code, i.e., the remaining substantive articles of the Uniform Commercial Code. During the 1990's, Chapters 3, 4, 5, 8 and 9 of the UCC as originally adopted in Texas by the 1965 legislature were substantially revised, Chapter 6 was repealed, and Chapters 2A and 4A were added to the Texas UCC. This proposed revision of Chapter 1 brings its general provisions and definitions into line with the previous revisions and additions to the other substantive Chapters.

This proposed revision of Chapter 1 has been approved by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. It contains few substantive revisions to current Chapter 1. These revisions will be discussed below in the section-by-section analysis. In summary, the most important of the proposed revisions concern expanding the definition of good faith in Section 1.201(19) and changing the choice of law rules in Section 1.301 (current Section 1.105). This bill analysis recommends the expansion of the definition of good faith but rejects the recommended changes in the choice of law rules. The remaining substantive changes are of lesser importance and pertain to the scope of Chapter 2 (Section 1.102), the applicability of supplementary principles of law (Section 1.103), and the relevance of course of performance between the parties (Section 1.303).

A final substantive change is the deletion of current Section 1.206, the statute of frauds "for kinds of personal property not otherwise covered" by subsequent articles of the Uniform Commercial Code. This deletion is recommended because all subsequent articles of the Code contain provisions regarding writing requirements for transactions within their scope. Thus the only function of current Section 1.206 is to impose a writing requirement on transactions not governed by the Uniform Commercial Code. It is inappropriate for any such requirement to be implemented by this Code.

The remaining changes in this proposed revision are primarily structural. Current Chapter 1 is divided into two parts. The proposed revision is divided into three parts. Part I is entitled "General Provisions" and contains general rules applicable throughout the Uniform Commercial Code. Part II is entitled "General Definitions and Principles of Interpretation" and contains the Code's primary definitions as well as the Code's general rules of interpretation. Part III is entitled "Territorial Applicability and General Rules" and contains the substantive rules that are applicable throughout the Code.

Four definitions in current Section 1.201, which are in reality substantive rules, have been deleted from the definitions section and included elsewhere. These are: 1 & 2. the rules pertaining to notice and knowledge currently in three separate subsections of Section 1.201 (moved to Section 2.202); 3. the rules for distinguishing leases from security interests in Section 1.202(37) (moved to Section 1.203); and 4. whether one acquires rights "for value" as provided in Section 1.201(44) (moved to Section 1.204).

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly delegate any additional rulemaking authority to a state officer, department, agency, or institution.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Chapter 1, Business & Commerce Code as follows:

Sec. 1.101. **SHORT TITLES.** This section continues to identify Title 1 as the Uniform Commercial Code. New subsection (b) provides a short title for Chapter 1 of Title 1: Uniform Commercial Code-General Provisions.

Sec. 1.102. **SCOPE OF CHAPTER.** This new section now expressly states what has always been intended: The rules in Chapter 1 apply to transactions to the extent those transactions are governed by the other chapters of the Uniform Commercial Code (UCC).

Sec. 1.103. **CONSTRUCTION OF TITLE TO PROMOTE ITS PURPOSES AND POLICIES; APPLICABILITY OF SUPPLEMENTAL PRINCIPLES OF LAW.** With minor stylistic changes this section restates portions of former sections 1.102 and 1.103.

Since the Uniform Commercial Code is intended to be a semi-permanent, infrequently amended statute governing a wide variety of commercial practices, it is important to state in subsection (a) the underlying purposes and policies of the UCC to assist courts and attorneys in applying it to unforeseen and new circumstances. Those purposes and policies remain the same as in the original statute-simplifying, clarifying, and modernizing commercial law; permitting the continued expansion of commercial practices through custom, usage, and agreement of the parties; and making commercial law uniform among the different jurisdictions.

Subsection (b) retains the identical language of former section 1.103 stating the basic relationship of the UCC to supplemental bodies of statutory and common law. Such supplemental principles of law will continue to apply except insofar as they are displaced by the UCC. While the language of the statute remains the same, the Official Comment (which is not a part of the statute) has been redrafted to explain that displacement of supplemental principles of law by the UCC may occur explicitly or implicitly. Again, this has always been the intended interpretation.

Sec. 1.104. **CONSTRUCTION AGAINST IMPLIED REPEAL.** The identical language of original section 1.104 is retained, stating that no subsequent legislation should be construed as impliedly repealing any part of the UCC if such a construction can be reasonably avoided.

Sec. 1.105. **SEVERABILITY.** This section retains the severability rule of original section 1.108.

Sec. 1.106. **USE OF SINGULAR AND PLURAL; GENDER.** Other than minor stylistic changes this section is identical to original section 1.102 (e). Unless the context of a particular provision of the statute otherwise requires, the singular will include the plural, the plural, the singular, and a reference to one gender will include any gender.

Sec. 1.107. **SECTION CAPTIONS.** Original section 1.109 is retained here, making it clear that section captions are not surplusage; they are a part of the statute.

Sec. 1.108. **RELATION TO SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT.** This new section makes it clear that the UCC modifies, limits, and supersedes the federal statute popularly known as “E-Sign” to the extent permitted by that statute.

Sec. 1.201. **GENERAL DEFINITIONS.** As in the original statute this section contains definitions generally applicable to the other substantive articles. Subsection (b) states the continuing rule that these definitions are subject to different definitions of the same terms provided in particular articles of the UCC. (For example, “good faith” is defined in a more limited way in Article 5.) New subsection (a) makes it clear that these general

definitions also do not apply when the context in which a word is used indicates the term was not used in its defined sense.

Most of these definitions are retained from the original statute with minor stylistic changes. “*Good faith*” has been redefined to include not only the subjective component of honesty in fact, but also the objective component of adherence to reasonable commercial standards of fair dealing. The change is in keeping with identical changes which had been made to the definition of that term in the revisions of Articles 3, 4, 4A, 8, and 9. A definition of “*record*” is added to cover information stored, transmitted, or displayed through electronic media. The definition of “*security interest*” has been simplified by removing to a separate section (1.203) the rules for determining when a lease may in fact create a security interest.

Sec. 1.202. NOTICE; KNOWLEDGE. This section is essentially a restatement of current Section 1.201(25), (26) and (27). This section covers when a person or organization receives or sends “notice” or “knowledge” of a fact. With the exception of Section 1-202(e)(2), there are no substantive variations from the current Section 1.201(25)-(27). New section 1-202(e)(2) adds the words, “in a form reasonable under the circumstances,” which constitutes a reasonable change. Other changes in language are cosmetic, updating, for example, the word “his” to “person.” The commentary to the new section does not differ significantly from the current section.

Sec. 1.203. LEASE DISTINGUISHED FROM SECURITY INTEREST. Although this section is new, its purpose is merely to treat the substantive rules in Section 1.202(37) for distinguishing leases from disguised sales with reservations of security interests with their own separate provision. There are no substantive variations from current Section 1.201(37) in either the text or commentary to this section. Any changes in language are purely cosmetic.

Sec. 1.204. VALUE. This section restates former section 1.201(44) with changed cross-references to other articles. This section is substantive rather than purely definitional. Accordingly, it has been relocated from former section 1.201 to this section.

Sec. 1.205. REASONABLE TIME; SEASONABLENESS. This Section currently is subsections (2) and (3) of Section 1-204. Subsection (1) of current Section 1-204 is incorporated into Section 1-302(b) of the UCC Article 1 amendments.

Sec. 1.206. PRESUMPTIONS. This section currently provides a statute of frauds "for kinds of personal property not otherwise covered" by other articles of the Uniform Commercial Code. The current revision recommends deletion of this provision because all of the other UCC substantive articles now contain provisions regarding writing requirements for transactions within their respective scopes. For purposes of transactions governed by the Code, the section is thus superfluous. The only function of current Section 1.206 would be to impose a writing requirement on transactions not governed by the Uniform Commercial Code. It would be inappropriate for such a requirement to be imposed by unrelated statutory law.

Section 1.206 in the proposed revision merely restates the meaning of "presumption" or "presumed" as currently provided in Section 1.201(31) without any change in substance. The slight change in wording is only stylistic to accommodate giving a general definition its own separate section.

Sec. 1.301. TERRITORIAL APPLICATION OF THE TITLE; PARTIES' POWER TO CHOOSE APPLICABLE LAW. This section retains the current choice-of-law provisions in Chapter 1 of the Texas Uniform Commercial Code (§1.105) rather than adopting changes from the revised official text of UCC Article 1.

The existing provision (§1.105), which is renumbered §1.301, permits parties to choose the law of a particular jurisdiction to govern their transaction provided the transaction bears a reasonable relation to that state.

There is also Texas case law that Texas courts will not apply the law of a jurisdiction designated by the parties where application of such law would produce a result contrary to a fundamental policy of Texas or of another jurisdiction whose law would govern in the absence of the parties' agreement. *See DeSantis v. Wackenhut Corporation*, 793 S.W.2d 670 (Tex. 1990), *cert. denied*, 111 S.Ct. 755 (1991).

With respect to "qualified" transactions involving \$1 million or more, the existing provision (§1.105), cross-references §35.51 of the Texas Business and Commerce Code, which was added in 1993. That section for large transactions requires a reasonable relation, provides examples of situations that constitute a reasonable relation, and eliminates any fundamental policy exception. Under §35.51, the only limitation on party autonomy is that the jurisdiction whose law is selected must bear a reasonable relation to the transaction. Section 35.51 is incorporated in proposed §1.301(c) as it is in current §1.105(c).

The revised official text of UCC Article 1 would have eliminated the reasonable relation requirement except with respect to consumer transactions and would have added additional restrictions on choice of law with respect to consumer transactions. This would be a significant departure from the approach taken by the Texas Legislature in 1993.

Because proposed §1.301 (existing §1.105) provides protection both for small businesses and consumers, following the approach of the Texas legislature in expanding party autonomy while keeping the reasonable relation test for all transactions and keeping the fundamental policy test in other than "qualified transactions," it is retained and substituted instead of the version in the official text of Revised Uniform Commercial Code Article 1.

Sec. 1.302. VARIATION BY AGREEMENT. New Section 1-302 is a restatement of current Sections 1-102(3)-(4) and 1-204(1). No substantive changes are made in the text of the new section or the commentary. Some cosmetic changes in language are made.

Sec. 1.303. COURSE OF PERFORMANCE, COURSE OF DEALING, AND USAGE OF TRADE. This Section combines provisions currently appearing in §§1-205, 2-208 and 2A-207, integrating the "course of performance" concept from UCC Articles 2 and 2A into the "course of dealing" and "usage of trade" concepts of current §1-205. The text and the commentary contain only cosmetic changes in language and carry the same meaning as the current text of §§1-205, 2-208 and 2A-207 and commentary of §1-205.

Sec. 1.304. OBLIGATION OF GOOD FAITH. Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former section 1.203. This section sets forth a basic principle running throughout the Uniform Commercial Code that good faith is required in the performance and enforcement of all agreements or duties governed by the Uniform Commercial Code. This section, however, does not support an independent cause of action for failure to perform or enforce in good faith. This doctrine of good faith merely directs a court toward interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached.

Sec. 1.305. REMEDIES TO BE LIBERALLY ADMINISTERED. This section continues current Section 1.106. There are no substantive changes in either the text or commentary to this section.

Sec. 1.306. WAIVER OR RENUNCIATION OF CLAIM OR RIGHT AFTER BREACH. This new section preserves the right of an aggrieved party under the current section to discharge, in whole or in part, a claim or right in a commercial contract without consideration. In keeping with advances in electronic technology, the old requirement of a signed, delivered written waiver or renunciation is no longer necessary, although the agreement must be documented by an "authenticated record," as defined in

new Sections 1-201(b)(37) and 9-102(a)(7). The aggrieved party may “authenticate” a record by (i) signing a record that is a writing or (ii) attaching to or logically associating with a record that is not a writing in electronic sound, symbol or process with the present intent to adopt or accept the record. As with the current section, under the new section, the provisions must be read with the section imposing a duty of good faith under Section 1-304.

Sec. 1.307. PRIMA FACIE EVIDENCE BY THIRD-PARTY DOCUMENTS. This section continues current Section 1.202. This section contains no changes in the text of current Section 1.202. The only change in the commentary is the addition of a new Comment 4, which states: “Documents governed by this section need not be writings if records in another medium are generally relied upon in the context.” This comment takes cognizance of the expanding use of electronic media for commercial transactions and of the new definition of “record” in revised Section 1.201 (33a).

Sec. 1.308. PERFORMANCE OR ACCEPTANCE UNDER RESERVATION OF RIGHTS. This section is current Section 1.207, and the language used in the text remains identical to that of Section 1.207. The commentary contains only cosmetic changes in language and carries the same import as the current commentary.

Sec. 1.309. OPTION TO ACCELERATE AT WILL. Except for minor stylistic changes this section is identical to former section 1.208. A power to accelerate an obligation “at will” or when one party “deems itself insecure” may not be exercised at the whim or caprice of that party.

Sec. 1.310. SUBORDINATED OBLIGATIONS. This section continues current UCC Section 1-209, which was added as an "optional" provision to the Uniform Commercial Code in 1995. It has not been adopted in Texas.

The current revision intends no change in substance. The purpose of the provision is to make it clear that a subordination agreement does not create a security interest unless so intended. This is probably the rule of law in most states, including Texas, with or without the provision.

Current Section 1-209 states that an obligation may be subordinated to "payment" of another obligation, whereas new Section 1.310 replaces "payment" with the word "performance." The scope of the provision is thus made broader, but the change in language undoubtedly reflects the original intent of the drafters.

The provision is no longer labeled "optional" in the new revision. For purposes of uniformity, adoption of the new provision is recommended. Subordination agreements will remain enforceable between the parties themselves and will be governed by supplementary principles of law as provided in Section 1.103. ADOPTION OF THIS PROVISION IS INTENDED TO DECLARE THE CURRENT LAW IN TEXAS AS REFLECTED BY THESE SUPPLEMENTARY PRINCIPLES.

SECTION 2. Amends Chapter 2, Business & Commerce Code, Section 2.103, as follows:

Sec. 2.103. DEFINITIONS AND INDEX OF DEFINITIONS. This conforming amendment deletes the definition of good faith in UCC Article 2, relying instead on the definition of good faith in the UCC Article 1 amendments, which incorporates the broader merchant concept into such definition.

SECTION 3. Amends Chapter 2, Business & Commerce Code, Section 2.202, as follows:

Sec. 2.202. FINAL WRITTEN EXPRESSION; PAROL OR EXTRINSIC EVIDENCE. This conforming amendment corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments and contains only cosmetic changes in language, rearranging the references to course of performance, course of dealing and

usage of trade. It also deletes the section dealing with course of performance from UCC Article 2, since such concept is integrated into the UCC Article 1 amendments.

SECTION 4. Amends Chapter 2A, Business & Commerce Code, Section 2A.103, as follows:

Sec. 2A.103. DEFINITIONS AND INDEX OF DEFINITIONS. This conforming amendment (a) corrects cross-references to refer to the appropriate provision in the UCC Article 1 amendments, (b) deletes the cross-reference to the definition of good faith in UCC Article 2, relying instead on the definition of good faith in the UCC Article 1 amendments and (c) deletes the definition of present value, relying instead on the definition of present value in the UCC Article 1 amendments.

SECTION 5. Amends Chapter 2A, Business & Commerce Code, Section 2A.501, as follows:

Sec. 2A.501. DEFAULT: PROCEDURE. This conforming amendment corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 6. Amends Chapter 2A, Business & Commerce Code, Section 2A.518, as follows:

Sec. 2A-518. COVER; SUBSTITUTE GOODS. This conforming amendment corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 7. Amends Chapter 2A, Business & Commerce Code, Section 2A.519, as follows:

Sec. 2A.519. LESSEE'S DAMAGES FOR NONDELIVERY, REPUDIATION, DEFAULT, AND BREACH OF WARRANTY IN REGARD TO ACCEPTED GOODS. This conforming amendment corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 8. Amends Chapter 2A, Business & Commerce Code, Section 2A.527, as follows:

Sec. 2A.527. LESSOR'S RIGHTS TO DISPOSE OF GOODS. This conforming amendment corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 9. Amends Chapter 2A, Business & Commerce Code, Section 2A.528, as follows:

Sec. 2A.528. LESSOR'S DAMAGES FOR NONACCEPTANCE, FAILURE TO PAY, REPUDIATION, OR OTHER DEFAULT. This conforming amendment corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 10. Amends Chapter 3, Business & Commerce Code, Section 3.103, as follows:

Sec. 3.103. DEFINITIONS. This conforming amendment deletes the definition of good faith in UCC Article 3, relying instead on the definition of good faith in the UCC Article 1 amendments. It also corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 11. Amends Chapter 4, Business & Commerce Code, Section 4.102, as follows:

Sec. 4.102. APPLICABILITY. This conforming amendment corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 12. Amends Chapter 4, Business & Commerce Code, Section 4.104, as follows:

Sec. 4.104. DEFINITIONS AND INDEX OF DEFINITIONS. This conforming amendment deletes a reference to the definition of good faith in UCC Article 4, relying instead on the definition of good faith in the UCC Article 1 amendments.

SECTION 13. Amends Chapter 4A, Business & Commerce Code, Section 4A.105, as follows:

Sec. 4A.105. OTHER DEFINITIONS. This conforming amendment deletes the definition of good faith in UCC Article 4A, relying instead on the definition of good faith in the UCC Article 1 amendments. It also corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 14. Amends Chapter 4A, Business & Commerce Code, Section 4A.106, as follows:

Sec. 4A.106. TIME PAYMENT ORDER IS RECEIVED. This conforming amendment corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 15. Amends Chapter 4A, Business & Commerce Code, Section 4A.204, as follows:

Sec. 4A.204. REFUND OF PAYMENT AND DUTY OF CUSTOMER TO REPORT WITH RESPECT TO UNAUTHORIZED PAYMENT ORDER. This conforming amendment corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 16. Amends Chapter 4A, Business & Commerce Code, Section 4A.507, as follows:

Sec. 4A.507. CHOICE OF LAW. This conforming amendment corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 17. Amends Chapter 5, Business & Commerce Code, Section 5.103, as follows:

Sec. 5.103. SCOPE. This conforming amendment corrects a cross-reference to refer to the appropriate provisions in the UCC Article 1 amendments.

SECTION 18. Amends Chapter 8, Business & Commerce Code, Section 8.102, as follows:

Sec. 8.102. DEFINITIONS. This conforming amendment deletes the definition of good faith in UCC Article 8, relying instead on the definition of good faith in the UCC Article 1 amendments.

SECTION 19. Amends Chapter 9, Business & Commerce Code, Section 9.102, as follows:

Sec. 9.102. DEFINITIONS AND INDEX OF DEFINITIONS. This conforming amendment deletes the definition of good faith in UCC Article 9, relying instead on the definition of good faith in the UCC Article 1 amendments.

SECTION 20. Amends Chapters 2 and 2A, Business & Commerce Code, Sections 2.208 and 2A.207, as follows:

Sec. 2.208. COURSE OF PERFORMANCE OR PRACTICAL CONSTRUCTION. This conforming amendment deletes the section dealing with course of performance from UCC Article 2, since such concept is integrated into the UCC Article 1 amendments.

Sec. 2A.207. COURSE OF PERFORMANCE OR PRACTICAL CONSTRUCTION. This conforming amendment deletes the section dealing with course of performance from UCC Article 2A, since such concept is integrated into the UCC Article 1 amendments.

SECTION 21. Effective date: September 1, 2003.