

UNIFORM COMMERCIAL CODE - BACKGROUND MEMORANDUM

Senate Concurrent Resolution No. 4032 (attached as an appendix) directs the Legislative Council to study Revised Article 1 of the Uniform Commercial Code - General Provisions (2001). The purpose of the study is to determine the feasibility and desirability of adopting Revised Article 1. In 2005 the Legislative Assembly considered Senate Bill No. 2143, which would have provided for the adoption of Revised Article 1. Senate Bill No. 2143 failed to pass the Senate. Supporters of Senate Concurrent Resolution No. 4032 testified that an interim study of Revised Article 1 would provide opponents of harmonization of the various articles of the Uniform Commercial Code an opportunity to identify those provisions that should be unique to North Dakota.

BACKGROUND

North Dakota Statutory Provisions

North Dakota's current version of the Uniform Commercial Code Article 1 - General Provisions is contained in North Dakota Century Code Chapter 41-01. Article 1 was adopted by the Legislative Assembly in 1965. This chapter provides definitions and general provisions that, in the absence of conflicting provisions, apply as default rules covering transactions and matters otherwise covered under a different article of the Uniform Commercial Code.

Revised Article 1 of the Uniform Commercial Code

According to the National Conference of Commissioners on Uniform State Laws (NCCUSL), the purpose of Revised Article 1 is to update the general provisions section of the Uniform Commercial Code and to harmonize Article 1 with ongoing Uniform Commercial Code projects and recent revisions. Revised Article 1 was completed by the Uniform Law Commissioners and the American Law Institute in 2001. Revised Article 1 has been approved by the American Bar Association. Alabama, Arkansas, Connecticut, Delaware, Hawaii, Idaho, Minnesota, Montana, Nebraska, Nevada, New Mexico, Oklahoma, Texas, United States Virgin Islands, and Virginia have adopted Revised Article 1.

Uniform Commercial Code Article 1 provides definitions and general provisions that, in the absence of conflicting provisions, apply as default rules covering transactions and matters otherwise covered under a different article of the Uniform Commercial Code. According to NCCUSL, as other parts of the Uniform Commercial Code have been revised and amended to accommodate changing business practices and development in the law, these modifications need to be reflected in an updated Article 1. Revised Article 1

contains many changes of a technical, nonsubstantive nature, such as reordering and renumbering sections, and adding gender-neutral terminology. In addition, over the years it has been in place, NCCUSL reports that certain provisions of Article 1 have been identified as confusing or imprecise. Several changes reflect an effort to add greater clarity in light of this experience. According to NCCUSL, developments in the law have led to the conclusion that certain changes of a substantive nature needed to be made.

The first substantive change is intended to clarify the scope of Article 1. 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 Uniform Commercial Code. The statute of frauds requirement aimed at transactions beyond the coverage of the Uniform Commercial Code has been deleted. Second, amended Section 1-103 clarifies the application of supplemental principles of law, with clearer distinctions about where the Uniform Commercial Code is preemptive. Third, the definition of "good faith" found in Section 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 Uniform Commercial Code articles except Revised Article 5. Finally, evidence of "course of performance" may be used to interpret a contract along with course of dealing and usage of trade.

Another change in Revised Article 1 deals with default choice-of-law provisions found in Section 1-301, which replaces previous Section 1-105. Under Article 1, before the 2001 amendments, parties to a transaction may agree to be governed by the law of any jurisdiction that bears a reasonable relation to that transaction. Revised Article 1 provides a different basic rule that applies except for consumer transactions in certain circumstances.

With respect to all transactions, an agreement by the parties to use the law of any state or country is effective, regardless of whether the transaction bears a reasonable relation to that state. However, if one of the parties to a transaction is a consumer, such a choice-of-law provision in a contract may not deprive the consumer of legal protections afforded by the law of the state or country in which the consumer resides, or of the state or country where the consumer contracts and takes delivery of goods. Also, with respect to all transactions, an agreement to use the law of a designated state or country is ineffective to the extent that application would violate a fundamental public policy of the state or country which has

jurisdiction to adjudicate a dispute arising out of the transaction. The forum state's law will govern the transaction if the contract is silent on the issue of choice of law.

According to NCCUSL, Revised Article 1 improves old Article 1 in the following ways:

- **Modernization** - The Uniform Commercial Code has entirely been amended or revised between 1985 and 2003. Most states have enacted these revisions and amendments. It is time to bring Article 1 as up to date as the rest of the Uniform Commercial Code.
- **Narrower scope** - The intentionally narrowed scope of the substantive rules in Article 1 prevents them from being applied outside the Uniform Commercial Code with potentially serious unintended consequences.
- **Clarifies when non-Uniform Commercial Code rules apply** - Other law will clearly supplement, but does not supplant Uniform Commercial Code rules. This reduces interpretation problems and the opportunities for litigation.
- **Good faith** - Reasonable commercial standards will affect the determination of what is good faith in any given case for the entire Uniform Commercial Code, not just individual articles. This is a fairer standard for courts to enforce and is the existing standard in most of the substantive articles of the Uniform Commercial Code.
- **Broader choice of law** - Parties to transactions under the Uniform Commercial Code may choose any law that best governs their transaction, except in a consumer transaction in which the choice of law would deprive a consumer of the protections of the consumer's own state's law. This amendment provides for greater flexibility in doing business interstate and is good for business.
- **Course of performance added** - Absent express terms, evidence of "course of performance," a concept currently utilized only in Articles 2 and 2A of the Uniform Commercial Code, may be used in court to interpret a contract along with course of dealing and usage of trade. Courts will have more complete evidence on the meaning of contracts and the intent of the parties to them.
- **Statute of frauds deleted** - General writing and signature requirements are deleted to make way for the specific provisions for electronic records and signatures that are contained in the substantive Uniform Commercial Code articles.
- **Modifications and revisions of other articles in the Uniform Commercial Code require the revision of Article 1 of the Uniform Commercial Code** - This required

harmonization of Article 1 with the other revised articles as well as the need to reflect in Article 1 recent changes and developments in law are both expressed in Revised Article 1.

PREVIOUS STUDIES AND LEGISLATION

The 2001-02 interim Judiciary A Committee, pursuant to North Dakota Century Code Section 54-35-02, studied Uniform Commercial Code Article 1 - General Provisions (2001). The committee made no recommendations regarding Revised Article 1. During the 2003 legislative session, the Legislative Assembly considered House Bill No. 1069, which would have codified the changes proposed in Revised Article 1. The bill was withdrawn from consideration.

In addition to the 2001-02 study of Revised Article 1, a number of other articles of the Uniform Commercial Code have been studied in recent years. The 2001-02 interim Judiciary A Committee and the 2003-04 interim Judicial Process Committee studied Uniform Commercial Code Article 2 - Sales, Article 2A - Leases, Article 3 - Negotiable Instruments, and Article 4 - Bank Deposits and Collections. The 2003-04 interim Judicial Process Committee also studied Uniform Commercial Code Article 7 - Documents of Title. The 1999-2000 interim Judiciary Committee studied Uniform Commercial Code Article 9 - Secured Transactions. Revised Article 7 was passed by the Legislative Assembly in 2005 and Revised Article 9 was passed by the Legislative Assembly in 2001.

2005 Legislation

The Legislative Assembly considered Senate Bill No. 2143 (2005), a bill that would have codified the change proposed in Uniform Commercial Code Article 1 - General Provisions (2001). Testimony in opposition to the bill indicated concerns that Revised Article 1 has not been embraced by many states, including large commerce states such as California, New York, and Illinois. It was also noted that the states that have enacted Revised Article 1 have done so with major substantive changes. The testimony also indicated that of the few states that have adopted some version of Revised Article 1, none have adopted the change on choice of law proposed by NCCUSL. A number of amendments were proposed to the bill. The amendments related to the definition of "good faith" in Revised Article 1. The bill failed to pass the Senate.

SUGGESTED STUDY APPROACH

The committee, in its study of Uniform Commercial Code Article 1 - General Provisions (2001), may wish to approach this study as follows:

- Receive information from the National Conference of Commissioners on Uniform State Laws regarding adoption of Revised Article 1.
- Receive information comparing current North Dakota Century Code Chapter 41-01 with Revised Article 1.
- Receive information and testimony from the State Bar Association of North Dakota, the North Dakota Bankers Association, and the

North Dakota Credit Union League regarding the feasibility and desirability of adopting Revised Article 1.

- Develop recommendations and prepare legislation necessary to implement the recommendations.

ATTACH:1