B. History of new Official Comments for proposed New/Unadopted UCC 2A-Leases (ALI proceedings)..

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Re: New Comments for UCC Article 2A-Leases

Dear Henry and Boris:

"The store is still open for suggested Comments" to the Terrible 2s, Bill Henning said at the recent ABA meeting in San Francisco. You may see from the web site of the American Law Institute (ALI) (http://ali.org), under "Actions Taken on 2003 Annual Meeting Drafts," that the ALI, the 2/2A Drafting Committee, and both the original and current Reporters, Marion Benfield and Henry, all have agreed to the following important principle: *"Throughout their course, the Official Comments to revised UCC 2A-Leases should be revised to spell out more explicitly how and why commercial leasing law differs from sales law, to help courts and practitioners reach sound results in applying 2A."*

What follows is a check list of the subjects for new 2A Comments, for our discussion on Thursday, September 11th.[1] The suggested new 2A

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[1] Throughout the Terrible 2s revision process, everyone has acknowledged the importance of inserting more user friendly Comments in UCC 2A-Leases. *(1)* The original reporter, Marion Benfield, agreed to comprehensive new 2A Comments when the ALI approved revised UCC 2A-Leases in 1999. *See* ALI 1999 Proceedings (76th Annual Meeting) pp.372-373 (spelling out "the need for more user-friendly Comments" throughout Article 2A) pp.381-382 (ALI "final" approval given to UCC Article 2A). The specific text of some of the 2A Comments drafted by Professor Benfield is set out in my 2003 ALI motion, *"Leasing Is Distinctive!,"* which appears on the ALI's web site. *(2)* The importance of inserting more user friendly

Comments appear in ALI motions (on the ALI web site), supplemented by the article, *Leasing Is Distinctive!*, 35 UCC L.J. 15 (Winter 2003).

Part 1. General Provisions
2A-101. Short Title.
2A-106. Limitation on Power of Parties to Consumer Lease to Choose Applicable Law and Judicial Forum

Part 2. Formation and Construction of Lease Contract
2A-201. Statute of Frauds.
2A-202. Parol Evidence.
2A-210. Express Warranties.
2A-211. Warranties Against Interference and Against Infringement: Lessee's Obligations Against Infringement.
2A-220. Effect of Default on Risk of Loss.
2A-222. Electronic Lease Contracting.

Part 4. Performance of Lease Contract: Repudiated, Substituted and Excused
2A-405. Excused Performance
2A-407. Irrevocable Promises: Finance Leases.

Part 5. Default
2A-501. Default: Procedure.
2A-504. Liquidation of Damages.
2A-517. Revocation of Acceptance of Goods.

The only other issue, which Bill Henning asked about after hearing me describe it for the ABA in San Francisco last month,[2] is a policy issue:

Comments throughout Article 2A was again noted and preserved at the ALI's 2001 annual meeting. *See* ALI 2001 Proceedings (78th Annual Meeting) pp.425, 423-425 ("the Reporter and the Chairman are empowered to make the new Comments that the ALI approved two years ago spelling out these differences between commercial leases on the one hand and sales on the other in 2A, including 2A-101, where there is no statutory text change"). Accordingly, the ALI's official web site summary of the 2001 ALI Annual Meeting stated that "the Reporter and the Chair of the Drafting Committee agreed to work with Edwin E. Huddleson, III, on accommodating his Article 2A motions." *(3)* Finally, the current web site of the ALI, under "Actions Taken on 2003 Annual Meeting Drafts," states: "In response to Mr. Huddleson's motion to amend the Comments to Article 2A, the Reporter [Henry Gabriel] agreed to recommend to the Drafting Committee that the Comments be so amended."

[2] Time has elapsed, Bill seemed to suggest, for the Terrible 2s to further refine E commerce issues such as the desirability of having only two (rather than 3) levels of E commerce rules, as well as greater

whether Comments should be added to new 2-313B (mass advertising) (sales law) to make clear that it comports with the First Amendment and does not authorize suits like Nike v. Kasky, ___ U.S. ____ , 123 S.Ct. 2554 (June 26, 2003).[3]

Thank you for your consideration. I look forward to talking to you.

With kind regards,

Sincerely,

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articulation in the Terrible 2s of E-Sign §101(c) consumer protection rules (*see* ALI 2001Proceedings (78th Annual Meeting) at pp.325-326), and the policy of pretransaction disclosure of terms in a record (*see* ALI 2000 Proceedings (77th Annual Meeting) at pp.286-289, 298-302).

[3] The opinions in *Nike v. Kasky* raise three specific First Amendment issues for 2-313B: (1) Is the scope of 2-313B limited to "an advertisement or a similar communication to the public ***that does no more than propose a commercial transaction***"? *Compare* 2-313B(3) *with* United States v. United Foods, 533 U.S. 405, 409 (2001) (commercial speech "usually defined as speech that does no more than propose a commercial transaction") *and* Nike v. Kasky, 123 S.Ct. at 2566 (opinion of Breyer and O'Connor, JJ.) (citing several similar cases). (2) Must the plaintiff under 2-313B show "injury." *Compare* 2-313B(5)(c) ("damages") *with* the Solicitor General's brief in Nike v. Kasky. (3) Is 2-313B intended to create a warranty standard as opposed to the negligence standard in the Restatement (2nd) Torts §552? At the 2000 ALI Annual meeting, Henry indicated that he may add some additional Comments to 2-313B, to comport with First Amendment concerns. *See* ALI 2000 Proceedings (77th Annual Meeting) p.333.

E.E. Huddleson

Leasing Is Distinctive!

MOTION

"Throughout their course, the Official Comments to revised UCC 2A-Leases should be revised to spell out more explicitly how and why commercial leasing law differs from sales law, to help courts and practitioners reach sound results in applying 2A." To implement this important ALI-approved principle, the amendments to UCC Article 2A-Leases should include the attached new additional Official Comments.

SUPPORTING COMMENT

At its 76th Annual Meeting in San Francisco in 1999, the ALI approved the important principle set forth in this motion. The vote of the 2/2A Drafting Committee, at its last meeting, similarly [1] reaffirmed that new Comments should be included in the 2A statute on the distinctiveness of leasing. The outcome of the ALI's Annual Meeting in May 2001, on UCC Article 2A-Leases, was similarly that "the Reporter and the Chair of the Drafting Committee agreed to work" on drafting new Comments for 2A that will explain more clearly how and why commercial leasing law differs from sales law.

There are some "Preliminary Official Comments" in the April 18, 2003 Proposed Final Draft of UCC 2A-Leases. But these in several instances (*e.g.*, for 2A-504) simply repeat the current Official Comments. New clarifying Comments, explaining the distinctiveness of leasing, and how and why leases differ from sales, have yet to be inserted into UCC Article 2A-Leases. *See* Leasing Is Distinctive! 35 UCC L.J. 15 (Winter 2003). These important Comments should be inserted, as the 2/2A Drafting Committee and the ALI have repeatedly indicated.

COMMENTS ON THE DISTINCTIVENESS OF LEASING EARLIER ACCEPTED BY THE ALI IN UCC 2A-LEASES PROPOSED FINAL DRAFT (ALI April 30, 1999)

1. Section 2-201. Formal Requirements

At p.34 under the heading "Comment," the original 2A Reporter, Professor Marion W. Benfield, Jr., proposed and the ALI agreed to the following Comment:

> "This section retains the requirement of original Article 2A that contracts for $1,000 or more must satisfy the requirements of this Section. Leases, more than sales, involve an often complex on-going relationship between the lessor and lessee. Therefore, it is more important that the agreement be evidenced by a writing and a strong statute of frauds encourages the reduction of lease agreements to writing."

Similarly, the original 2A Reporter's "Presentation to the American Law Institute, May 1999" stated (p.xxvii) that "leasing contracts are seldom, if ever, made through such an exchange of forms. The typical leasing pattern is the execution of a single writing (now "record") by both parties." The original 2A Reporter also stated (on p.xxvii):

> "There are two major differences between the revised Article 2 draft and present Article 2A. First Article 2A requires a writing if the lease price is $1,000 or more while revised Article 2 sets the threshold at $5,000. The typical leasing transaction is more complex than the typical sale. Even small value leases are essentially always represented by a single written contract signed by both parties. Most commercially important leases create a long-term continuing relationship between the parties which often involves multiple duties on each side. Even short-term consumer lease agreements are usually in writing. Therefore, it is more important than in a sales transaction that the terms of the agreement be in writing. However, the $1,000 exclusion will, in fact, exclude from the statute many short-term rentals."
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> ***
>
> "Retaining the present Article 2A statute of frauds creates some additional incentive for parties to get the deal in writing. This is viewed by the people in the industry as a good thing. Also, since leases are essentially always put in writing today, retaining the present statute of frauds will not interfere with any significant practice of entering into oral leases."

2. Lease Warranties

At page 94, under the heading "Comment," the original 2A Reporter and the ALI agreed to the following Comment:

> "Article 2A has not adopted Article 2 Section 2-408. That section, titled Express Warranty Obligation to Remote Buyer and Transferee, is based on the assumption that many sellers advertise to remote buyers, or include statements which are express warranties in materials accompanying the goods which are to be delivered to remote buyers. That section addresses the liability incurred to remote buyers and lessees when advertisements or materials accompanying the goods create express warranties. There seems to be no present practice of remote *lessors* engaging in the conduct covered by 2-408. Therefore, a similar provision is not included in this article. Section 2-408 itself gives rights to remote lessees against remote *sellers* that were in the chain of distribution to their lessor. If any practice develops in the future of lessors engaging in conduct like that covered by Section 2-408, it would be appropriate to apply that section by

analogy to such lessors. (2A-508 is the analog of 2-409, not 2-408)."

Similarly, the original 2A Reporter's "Presentation to the American Law Institute, May 1999" stated (p.xxix) that

> "Section 2-408 of Revised Article 2 gives remote buyers and lessees rights against sellers who make promises or representations in advertising or in materials distributed with products. The Article 2A Committee has decided not to include a similar provision in Article 2A because we know of no instances in which remote lessors advertise or make representations in material to be delivered to remote lessees. There may be instances in which "wholesale lessors" lease to "retail lessors" but we know of no cases in which "wholesale lessors" make warranties to remote lessees. Industry advisors have argued that Article 2A should not contain a warranty provision which deals with a situation which does not exist in the industry. (The Article 2 provision (2-408) itself extends **seller** advertised, or with-the-goods, warranties to remote lessees.) A comment to 2A-501 states that if a practice does develop of remote lessors advertising or providing representations in material which accompanies goods leased to remote lessees, it would be appropriate to apply 2-408 by analogy to such a remote lessor."

3. Transcripts showing the original 2A reporter was amenable to "the strong suggestion for consideration of more fulsome and user-friendly Comments throughout the 2A draft" appear at ALI 1999 Proceedings (76th Annual Meeting) pp.372-373, 906. [2] There was a very specific vote by the 2/2A drafting committee, at its last meeting, to include more fulsome and user-friendly Comments throughout the 2A draft.

What follows (below the lines, and starting on the next page) are the suggested Comments that (with the single exception of a clarifying Comment to 2A-106, specifically voted for by the 2/2A Drafting Committee) were also put before the ALI in 2001 and the 2/2A Drafting Committee. These suggested Comments reflect substantial input from the past several Chairs of the American Bar Association's Committee on Leasing. *See also* Leasing Is Distinctive! 35 UCC L.J. 15 (Winter 2003).

2A's OFFICIAL COMMENTS

1. General Provisions

2A-101. Short Title. *(Add to Official Comments)*

Leasing is Distinctive:

Thousands of years old, leasing has always been recognized as a distinct commercial transaction: different from sales, different from secured transactions. "A lease involves payment for the temporary possession, use and enjoyment of goods, with the expectation that the goods will be returned

to the owner with some expected residual interest of value remaining at the end of the lease term. In contrast, a sale involves an unconditional transfer of absolute title to goods, while a security interest is only an inchoate interest contingent on default and limited to the remaining secured debt." White & Summers, UCC Treatise §31-2 (Identifying a Lease) (4th ed. 1995 w. 2002 pocket part).

The impact of the separation of ownership and possession, which defines what a lease is, makes leasing law different from sales law in many areas including: lease contract formation rules (the statute of frauds, the parol evidence rule, no-oral-modification clauses, and support for pre-transaction disclosure of terms in a record); lease warranties; rules about excuse or impracticality of performance in a lease; and true lease remedies.

Lease contract formation: Leases commonly involve more complex, on-going, multi-faceted obligations than casual sales. Ownership of the residual remains with the lessor in a lease, and for that reason the lessor has a continuing economic interest in the goods that is not present in a sale. Thus lease contracts commonly cover not only rent, but many other obligations, which may last twenty years or more, such as: where and when the goods (the lessor's residual) will be returned, options to renew or purchase the goods; maintenance and repairs; restrictions on use of the goods; taxes; insurance' and record-keeping obligations. To address these issues, leasing custom and practice favors more formal structured rules of contract formation than those that might suit casual sales. Tradition, custom and practice for leasing favors pre-transaction disclosure of lease terms in a record, which puts the lessor and lessee on advance notice of their rights and obligations, which are very different from those of a buyer and seller.

Warranties: Typically lessors advertise the quality of their services. Unlike manufacturers or suppliers, most lessors do not engage in mass market advertising making promises or warranties about the quality of the goods. Thus it makes little sense to talk about lessor A's advertising inducing a "remote" lessee to lease goods from another lessor B. Nor do lessors commonly create and supply owners' manuals or instructions attached to the goods.

Excused Performance: The ordinary commercial understanding of the parties in a finance lease is that "frustration of purpose" or excuse is not available as a ground for lessee excuse from performance. The very act of selecting a lease term (an inescapable necessity in any lease) represents a conscious choice by the lessee, allocating risk and agreeing about the scope and length of its undertakings.

True lease remedies: True lease remedies and measure of damages are different from sales law, essentially because of the lessor's residual interest, which exists because of the separation of ownership and possession in a lease. In a lease, the lessor owns the goods, while the lessee has only an interest in using the goods for a limited time. The impact on measure of damages for breach is that, in general, a lessor's damages for the lessee's breach are equal to lost rentals plus any damage to the residual; while the lessee's damages for breach are the extra rental expense of renting substitute goods. Though some early courts confused the two, lease remedies are very different from sales remedies. *See* DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U. San Fran. L. Rev. 257 (1978).

2A-106. Limitation on Power of Parties to Consumer Lease to Choose Applicable Law and Judicial Forum. *(Add to Official Comments)*

The 2/2A Drafting Committee voted to insert a clarifying Comment to the effect that one of the permissible choices of law in a consumer lease — the jurisdiction "in which the goods are to be used" — includes the law of the jurisdiction where the goods are physically delivered to the lessee.

Part 2. Formation and Construction of Lease Contract

2A-201. Statute of Frauds. *(Add to Official Comments)*

Tradition, custom and practice for leasing involves the execution of a single writing or record by the parties. Because a lease commonly involves more multi-faceted on-going obligations than a casual sale, it is more important for leases than sales that the agreement be evinced by a record.

2A-202. Parol Evidence. *(Add to Official Comments)*

In commercial leasing, it is common practice (and more important than it is in sales) to include a merger clause to ensure contractual certainty for the more complex, multi-faceted obligations of a typical leasing deal. As a practical matter, a merger clause in a commercial lease creates a strong, nearly conclusive presumption that both parties intended a total integration. It puts a difficult burden on one party to establish the contrary. *See* White & Summers, UCC Treatise §2-12 ("Merger" Clauses and the Parol Evidence Rule) (4th ed. 1995 w. 2002 pocket part).

2A-210. Express Warranties (Add to Official Comments)

There are important differences between leases and sales, however, that are reflected in 2A's different warranty scheme for leases. Typically lessors advertise the quality of their services. Unlike manufacturers or suppliers, most lessors do not engage in mass market advertising making promises or warranties about the quality of the goods. Thus it makes little sense to talk about advertising by lessor A inducing a "remote" lessee to lease goods from lessor B. Lessors commonly lease goods supplied by a variety of different manufacturers. In finance leasing, the lessee (not the lessor) selects the goods and the manufacturer. 2A-103(a)(12). Unusual cases involving advertising by a lessor touting the quality of the goods (such as advertising by a company that both sells and leases, or advertising by a "captive" lessor that leases only goods of a single manufacturer) are covered by §2A-210 and by analogy to the rules on advertising in Article 2-sales.

Nor do lessors commonly create and supply owners' manuals or instructions attached to the goods. Warranties made by persons who are not agents of the lessor do not create liability in the lessor. *See, e.g.*, All-States Leasing Co. v. Bass, 96 Idaho 873, 538 P.2d 1177 (1975) (court finds no lessor warranty where lessee relied on manufacturer's literature). Only where the lessor or its agent makes promises or representations about the goods is there an express warranty by the lessor.

2A-211. Warranties Against Interference and Against Infringement: Lessee's Obligations Against Infringement. *(Add to Official Comments)*

The warranty against interference in 2A-211 extends only to a lessee who is in compliance with the lease.

2A-220. Effect of Default on Risk of Loss. *(Add to Official Comments)*

There is no doctrine of lessee excuse in Article 2A. Only lessors, not lessees, may be excused from performance for delay in delivery or non-delivery under 2A-405.

2A-222. Electronic Lease Contracting. *(Add to Official Comments)*

Perfecting Interests in Electronic Chattel Paper Leases. With tangible paper leases, lease financers and syndicators often take physical possession of the original signed chattel paper lease, in

order to obtain a first priority perfected security interest. With respect to electronic leases, revised Article 9 allows this for electronic chattel paper. *See* revised §9-105, §9-314(a), §9-330, §9-102(31), (11). To perfect a security interest in electronic chattel paper, one must comply with revised §9-105, which mandates a set of factual conditions that must be met before a secured party has "control" of electronic chattel paper. Thus, for example, revised §9-105(1) requires a single authoritative copy of electronic chattel paper that is unique, identifiable, and generally unalterable; revised §9-105(2) requires that the authoritative copy of electronic chattel paper must show the secured party or its designated custodian as the assignee; and revised §9-105(5) requires that each copy of the authoritative copy be readily identifiable as a copy. To perfect a security interest in electronic chattel paper, the holder must satisfy each and every one of the conditions in revised §9-105. Satisfaction of these conditions has the same legal effect as possession of originally executed tangible paper leases.

One way in which electronic chattel paper leases might be created, stored, and transferred would involve establishing a third party record keeper and use of some version of encryption to assure non-alterability of the original records. Rapidly developing technology involving electronic contracting may create a variety of different ways of creating, storing and transferring electronic chattel paper, consistent with the control requirements of revised §9-105.

Part 4. Performance of Lease Contract Repudiated, Substituted and Excused

2A-405. Excused Performance. *(Official Comment)*

The ordinary commercial understanding of the parties in a finance lease (a statutory finance lease or any lease with a "hell or high water" clause) is that "frustration of purpose" or excuse is not available as a ground for lessee excuse from performance. The very act of selecting a lease term (an inescapable necessity in any lease) represents a conscious choice by the lessee, allocating risk and agreeing about the scope and length of its undertaking. Finance leasing accounts for billions of dollars of equipment lease transactions each year. It depends upon certainty of payment that would be severely eroded if the narrow rule of excused performance for lessors (§2A-405) were extended to lessees. Nor should any negative implication be drawn from the limited rule of lessor excuse in §2A-405: that is, other law or the lease contract itself may provide that the lessor's failure to perform is not a breach. This section creates no implication that, unless the circumstances fall within §2A-405(a)(1) and (2), delay in performance or nonperformance is a default under the lease contract.

Part 5: Default

2A-501. Default: Procedure. *(Add to Official Comments)*

True lease remedies and measure of damages are different from sales law, essentially because of the lessor's residual interest, which exists because of the separation of ownership and possession in a lease. In a lease, the lessor owns the goods, while the lessee has only an interest in using the goods for a limited time. The impact on measure of damages is that, in general, a lessor's damages for the lessee's breach are equal to lost rentals plus any damage to the residual; while the lessee's damages for breach

[3]

are the extra rental expense of renting substitute goods.

Years ago, courts sometimes confused lease remedies with sales remedies. When the lessee defaulted, some courts mistakenly credited the lessee with the entire sales proceeds in calculating the lessee's deficiency. *See* DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.San.Fran.L.Rev. 257 (1978). This improperly credited the lessee with the

value of the lessor's residual. Lease remedies are different from sales remedies.

2A-504. Liquidation of Damages. *(Add to official Comments)*

In the absence of a liquidated damages clause in the lease, a lessor who withholds or stops performance under subsection (c) can retain payments made by the lessee (including any deposit or down payment) only to the extent that the lessor can prove damages.

2A-517. Revocation of Acceptance of Goods. *(Add to Official Comments)*

Subsection (f) permits a lessee who rightfully rejects or justifiably revokes acceptance to make reasonable use of the goods and only be liable, where appropriate, for the value of the use. Reasonable use in a lease may be different than it would be in the sale of goods context. Courts must be vigilant to distinguish between legitimate mitigation of damages by the lessee (on the one hand) and an unscrupulous lessee's attempt to knock down the stated lease rental rate (on the other hand). In particular, courts should be skeptical of an alleged mitigating use by the lessee in short-term leases and in other situations, not limited to short-term leases, where the alleged mitigating use continues for the full lease term. The "value of the use," in the context of a lessee who rejects or revokes its acceptance and then uses the goods, presumably should be the stated contract rental. The burden should be on the lessee to show otherwise. This is to safeguard the stability of lease contracts and to prevent the lessee from reaping an unfair advantage by rejecting the goods or revoking its acceptance.

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[1] There also was a separate specific vote by the 2/2A Drafting Committee, at the same meeting, to include a new clarifying Comment to 2A-106. None of this has been done.

[2] The issue about inserting more user friendly Comments throughout the 2A Draft was preserved at the ALI's 2001 annual meeting. See ALI 2001 Proceedings (78th Annual Meeting) pp. 425, 423-425. The ALI's own official web site summary of the 2001 ALI Annual Meeting (which has been retained in a written record) states that "the Reporter and Chair of the Drafting Committee agreed to work with Edwin E. Huddleson, III, on accommodating his Article 2A motions."

[3] This is oversimplified, of course, since tax losses and other damages often may exist. For example, a lessee may seek damages if the lessor breaches duties in addition to supplying the goods, such as repairing and maintaining the goods. *See* current UCC 2A-103(1)(g) Comment. Often the lessor's greatest concern upon breach by the lessee is recovering possession of the goods. And a lessor often incurs incidental damages in the form of costs incurred to sell or relet the goods after repossession.

MOTION

The statutory text of proposed 2A-606(a) should be revised to read in pertinent part as follows:

2A-606. PROCEDURE ON NOTIFICATION CLAIMING EXCUSE

(a) A lessee that receives notification of a material or indefinite delay in performance.....(etc.)

The statutory text of proposed 2A-606(c) should be stricken.

The Comment to new revised 2A-606 should be amended to read: "Note that subsection (a)(1) allows the lessee under a lease, including a finance lease, the right to terminate the lease because of the lessor's excused performance (Sections 2A-604 and 2A-605). However, subsection (a)(2), which allows the lessee the right to modify the lease for the lessor's or supplier's excused performance, excludes a finance lease that is not a consumer lease...."

SUPPORTING COMMENT

1. Though revised sales law allows both buyers and sellers to be excused from contract, that result is not appropriate for leasing. Current law (2A-405/2A-406) limits excused performance to the lessor's or supplier's delay or failure to deliver in very narrow circumstances. Revised 2A (2A-605/2A-606) appears to do the same. But it is not as clear as it should be on this vitally important point for finance leasing. This is a point on which leasing law, custom and practice is different from sales.

The very act of selecting a lease term (an inescapable necessity in any lease) represents a conscious choice by the lessee about the scope and length of its undertaking. This puts leasing (as opposed to sales) outside the rationale of Comment 9 to current 2-605 (sales)-- that a buyer might be able to escape a sales contract, on ground of "frustration of purpose," when unforeseen events destroy "a definite and specific venture or assumption" that is a basis for the contract, which was not covered explicitly in the sales agreement but which all the parties knew about.

Moreover, it would wreck havoc with lease financing (where long-term deals are priced and handled very differently from short-term deals) to allow lessees to escape their lease obligations by claiming "frustration of purpose." Finance leasing accounts for billions of dollars of equipment acquisitions each year. It rests upon certainty of payment that would be severely eroded if there were a major change in current 2A law to recognize lessee excuse or frustration of purpose. Third party financers would be reluctant to loan funds to finance a lease if such uncertainty were injected in the transaction. Nor would it be fair, or consistent with leasing law, custom and practice, to threaten to impose such risks

(including paying off third party financers and disposing of equipment earlier than agreed) on the lessor throughout the lease term. Not surprisingly, no reported case has ever excused lessee performance on the ground of frustration of purpose. Nor should such a major change in leasing law be made in the careless way that is threatened by proposed 2A-606. To overthrow current leasing law, on this major point of national significance, would not be "making allowance for differences in the legal instruments and commercial practices involved" in leasing (as opposed to sales). See Proposed Final Draft p.xiii (ALI Director's "Foreword").

2. The rule for leasing is not clearly stated in new 2A-606. To be specific, the statutory text in proposed new 2A-606 changes the language of current law, which refers to "the lessee" receiving notice of the lessor's delay (2A-406), substituting new language referring to "a party" receiving notification of a delay in performance. That change in the statutory text makes ambiguous the Comment to new 2A-606 (carried forward word-for-word from the Comment to old 2A-406). The ambiguous Comment in new 2A-606 says that 2A-606(a)(1)

> "allows the lessee under a lease, including a finance lease, the right to terminate the lease for excused performance (Sections 2A-604 and 2A-605)."

The original meaning (now clouded) is that the lessee could terminate the lease because of the lessor's excused performance. The implication of the new statutory text and Comment language in proposed 2A-606(a)(1) might be that a lessee can escape from its lease obligations by claiming lessee "excuse." That would be a radical change in current law and contrary to sound public policy.

The impact of an erroneous court reading of ambiguous 2A-606 is accentuated by a proposed new section 2A-606(c), which purports to bar (or limit) the extent to which "excuse" or "frustration" can be varied by contract. Thus one could not readily "contract around" the possibility of an erroneous judicial interpretation of 2A-606. Nor could lease financers readily protect by contract the stability and certainty of finance leasing that accounts for an important part of our Nation's economy.

2. The statutory text and Comment of proposed 2A-606, as they stand, seem to invite error by courts addressing these issues in the future. The statutory text should refer to a "lessee" receiving notification of delay. The Comment should read that new 2A-606(a)(1) "allows the lessee under a lease, including a finance lease, the right to terminate the lease because of the lessor's excused performance (Sections 2A-604 and 2A-605). However, subsection (a)(2), which allows the lessee the right to modify the lease for the lessor's or supplier's excused performance, excludes a finance lease that is not a consumer lease...."

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Re: New Comments for UCC Article 2A-Leases

Dear Henry and Boris:

You requested copies of the following materials:

Tab 1: The motion submitted to the American Law Institute (ALI) in May 2003: *"Throughout their course, the Official Comments to revised UCC 2A-Leases should be revised to spell out more explicitly how and why commercial leasing law differs from sales law, to help courts and practitioners reach sound results in applying 2A."* At the bottom of page 4 of this ALI motion, you will see the note that Bill asked about concerning a clarifying new Comment on 2A-106 (Limitation on Power of Parties to Consumer Lease to Choose Applicable Law and Judicial Forum).

Tab 2: Transcript of 1999 ALI proceedings on issues of "lease contract excuse" and the underlying ALI motion about these issues.

The suggested new 2A Comments, which everyone seemed to agree to earlier,[1] also appear on the ALI's web site (http://ali.org) and are

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[1] Throughout the Terrible 2s revision process, everyone has acknowledged the importance of inserting more user friendly Comments throughout UCC 2A-Leases. *(1)* The original reporter, Marion Benfield, agreed to comprehensive new 2A Comments when the ALI approved revised UCC 2A-Leases in 1999. *See* ALI 1999 Proceedings (76th Annual Meeting) pp.372-373 (enclosed in Tab 2) (spelling out "the need for

further explained in *Leasing Is Distinctive!*, 35 UCC L.J. 15 (Winter 2003). I particularly commend to your attention Marion Benfield's proposed Official Comment on 2A-201, which was approved by the ALI in 1999:

> "This section retains the requirement of original Article 2A that contracts for $1,000 or more must satisfy the requirements of this Section. Leases, more than sales, involve an often complex on-going relationship between the lessor and lessee. Therefore, it is more important that the agreement be evidenced by a writing and a strong statute of frauds encourages the reduction of lease agreements to writing."[2]

The subject of "pre-transaction disclosure of lease terms in a record" (mentioned in the proposed new Comment to 2A-101. Short Title.- Lease contract formation) is closely tied to the strong binding effect that should be given to a merger clause in a commercial lease (*see* the proposed Comment to 2A-202). Tradition, custom and practice for leasing place a much greater emphasis on writings (or records) than does sales law.

Within the next few days, I will try to find and send to you some cases that might help illustrate the difference between permissible and impermissible lessee use of the goods (as "mitigation of damages") under new 2A-517 after the lessee either rejects or revokes acceptance.

Thank you for your consideration. What I am seeking is greater recognition and explanation, in the Comments to 2A, of the critical differences between sales and leases. I look forward to seeing the new 2A Comments as they develop further.

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more user-friendly Comments" throughout Article 2A) pp.381-382 (ALI "final" approval given to UCC Article 2A). The specific text of some of the 2A Comments drafted by Professor Benfield is set out in my 2003 ALI motion, *"Leasing Is Distinctive!,"* which appears on the ALI's web site and is attached in Tab 1. *(2)* The importance of inserting more user friendly Comments throughout Article 2A was again noted and preserved at the ALI's 2001 annual meeting. *See* ALI 2001 Proceedings (78th Annual Meeting) pp.425, 423-425 ("the Reporter and the Chairman are empowered to make the new Comments that the ALI approved two years ago spelling out these differences between commercial leases on the one hand and sales on the other in 2A, including 2A-101, where there is no statutory text change"). Accordingly, the ALI's official web site summary of the 2001 ALI Annual Meeting stated that "the Reporter and the Chair of the Drafting Committee agreed to work with Edwin E. Huddleson, III, on accommodating his Article 2A motions." *(3)* Finally, the current web site of the ALI, under "Actions Taken on 2003 Annual Meeting Drafts," states: "In response to Mr. Huddleson's motion to amend the Comments to Article 2A, the Reporter [Henry Gabriel] agreed to recommend to the Drafting Committee that the Comments be so amended."

[2] As Henry said, a particular sales transaction may be complex. But as already indicated in your possible 2A-101 comments, a mine-run lease is more complex than a casual sale.

Best regards.

Sincerely,

Edwin E. Huddleson, III

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Tab 1

E.E. Huddleson

Leasing Is Distinctive!

MOTION

"Throughout their course, the Official Comments to revised UCC 2A-Leases should be revised to spell out more explicitly how and why commercial leasing law differs from sales law, to help courts and practitioners reach sound results in applying 2A." To implement this important ALI-approved principle, the amendments to UCC Article 2A-Leases should include the attached new additional Official Comments.

SUPPORTING COMMENT

At its 76th Annual Meeting in San Francisco in 1999, the ALI approved the important principle set forth in this motion. The vote of the 2/2A Drafting Committee, at its last meeting, similarly [1] reaffirmed that new Comments should be included in the 2A statute on the distinctiveness of leasing. The outcome of the ALI's Annual Meeting in May 2001, on UCC Article 2A-Leases, was similarly that "the Reporter and the Chair of the Drafting Committee agreed to work" on drafting new Comments for 2A that will explain more clearly how and why commercial leasing law differs from sales law.

There are some "Preliminary Official Comments" in the April 18, 2003 Proposed Final Draft of UCC 2A-Leases. But these in several instances (*e.g.,* for 2A-504) simply repeat the current Official Comments. New clarifying Comments, explaining the distinctiveness of leasing, and how and why leases differ from sales, have yet to be inserted into UCC Article 2A-Leases. *See* Leasing Is Distinctive! 35 UCC L.J. 15 (Winter 2003). These important Comments should be inserted, as the 2/2A Drafting Committee and the ALI have repeatedly indicated.

COMMENTS ON THE DISTINCTIVENESS OF LEASING EARLIER ACCEPTED BY THE ALI IN UCC 2A-LEASES PROPOSED FINAL DRAFT (ALI April 30, 1999)

1. Section 2-201. Formal Requirements

At p.34 under the heading "Comment," the original 2A Reporter, Professor Marion W. Benfield, Jr., proposed and the ALI agreed to the following Comment:

> "This section retains the requirement of original Article 2A that contracts for $1,000 or more must satisfy the requirements of this Section. Leases, more than sales, involve an often complex on-going relationship between the lessor and lessee. Therefore, it is more important that the agreement be evidenced by a writing and a strong statute of frauds encourages the reduction of lease agreements to writing."

Similarly, the original 2A Reporter's "Presentation to the American Law Institute, May 1999" stated (p.xxvii) that "leasing contracts are seldom, if ever, made through such an exchange of forms. The typical leasing pattern is the execution of a single writing (now "record") by both parties." The original 2A Reporter also stated (on p.xxvii):

> "There are two major differences between the revised Article 2 draft and present Article 2A. First Article 2A requires a writing if the lease price is $1,000 or more while revised Article 2 sets the threshold at $5,000. The typical leasing transaction is more complex than the typical sale. Even small value leases are essentially always represented by a single written contract signed by both parties. Most commercially important leases create a long-term continuing relationship between the parties which often involves multiple duties on each side. Even short-term consumer lease agreements are usually in writing. Therefore, it is more important than in a sales transaction that the terms of the agreement be in writing. However, the $1,000 exclusion will, in fact, exclude from the statute many short-term rentals."
>
> ***
>
> "Retaining the present Article 2A statute of frauds creates some additional incentive for parties to get the deal in writing. This is viewed by the people in the industry as a good thing. Also, since leases are essentially always put in writing today, retaining the present statute of frauds will not interfere with any significant practice of entering into oral leases."

2. Lease Warranties

At page 94, under the heading "Comment," the original 2A Reporter and the ALI agreed to the following Comment:

> "Article 2A has not adopted Article 2 Section 2-408. That section, titled Express Warranty Obligation to Remote Buyer and Transferee, is based on the assumption that many sellers advertise to remote buyers, or include statements which are express warranties in materials accompanying the goods which are to be delivered to remote buyers. That section addresses the liability incurred to remote buyers and lessees when advertisements or materials accompanying the goods create express warranties. There seems to be no present practice of remote *lessors* engaging in the conduct covered by 2-408. Therefore, a similar provision is not included in this article. Section 2-408 itself gives rights to remote lessees against remote *sellers* that were in the chain of distribution to their lessor. If any practice develops in the future of lessors engaging in conduct like that covered by Section 2-408, it would be appropriate to apply that section by

analogy to such lessors. (2A-508 is the analog of 2-409, not 2-408)."

Similarly, the original 2A Reporter's "Presentation to the American Law Institute, May 1999" stated (p.xxix) that

> "Section 2-408 of Revised Article 2 gives remote buyers and lessees rights against sellers who make promises or representations in advertising or in materials distributed with products. The Article 2A Committee has decided not to include a similar provision in Article 2A because we know of no instances in which remote lessors advertise or make representations in material to be delivered to remote lessees. There may be instances in which "wholesale lessors" lease to "retail lessors" but we know of no cases in which "wholesale lessors" make warranties to remote lessees. Industry advisors have argued that Article 2A should not contain a warranty provision which deals with a situation which does not exist in the industry. (The Article 2 provision (2-408) itself extends **seller** advertised, or with-the-goods, warranties to remote lessees.) A comment to 2A-501 states that if a practice does develop of remote lessors advertising or providing representations in material which accompanies goods leased to remote lessees, it would be appropriate to apply 2-408 by analogy to such a remote lessor."

3. Transcripts showing the original 2A reporter was amenable to "the strong suggestion for consideration of more fulsome and user-friendly Comments throughout the 2A draft" appear at ALI [2] 1999 Proceedings (76th Annual Meeting) pp.372-373, 906. There was a very specific vote by the 2/2A drafting committee, at its last meeting, to include more fulsome and user-friendly Comments throughout the 2A draft.

What follows (below the lines, and starting on the next page) are the suggested Comments that (with the single exception of a clarifying Comment to 2A-106, specifically voted for by the 2/2A Drafting Committee) were also put before the ALI in 2001 and the 2/2A Drafting Committee. These suggested Comments reflect substantial input from the past several Chairs of the American Bar Association's Committee on Leasing. *See also* Leasing Is Distinctive! 35 UCC L.J. 15 (Winter 2003).

2A's OFFICIAL COMMENTS

1. General Provisions

2A-101. Short Title. *(Add to Official Comments)*

Leasing is Distinctive:

Thousands of years old, leasing has always been recognized as a distinct commercial transaction: different from sales, different from secured transactions. "A lease involves payment for the temporary possession, use and enjoyment of goods, with the expectation that the goods will be returned

to the owner with some expected residual interest of value remaining at the end of the lease term. In contrast, a sale involves an unconditional transfer of absolute title to goods, while a security interest is only an inchoate interest contingent on default and limited to the remaining secured debt." White & Summers, UCC Treatise §31-2 (Identifying a Lease) (4th ed. 1995 w. 2002 pocket part).

The impact of the separation of ownership and possession, which defines what a lease is, makes leasing law different from sales law in many areas including: lease contract formation rules (the statute of frauds, the parol evidence rule, no-oral-modification clauses, and support for pre-transaction disclosure of terms in a record); lease warranties; rules about excuse or impracticality of performance in a lease; and true lease remedies.

Lease contract formation: Leases commonly involve more complex, on-going, multi-faceted obligations than casual sales. Ownership of the residual remains with the lessor in a lease, and for that reason the lessor has a continuing economic interest in the goods that is not present in a sale. Thus lease contracts commonly cover not only rent, but many other obligations, which may last twenty years or more, such as: where and when the goods (the lessor's residual) will be returned, options to renew or purchase the goods; maintenance and repairs; restrictions on use of the goods; taxes; insurance' and record-keeping obligations. To address these issues, leasing custom and practice favors more formal structured rules of contract formation than those that might suit casual sales. Tradition, custom and practice for leasing favors pre-transaction disclosure of lease terms in a record, which puts the lessor and lessee on advance notice of their rights and obligations, which are very different from those of a buyer and seller.

Warranties: Typically lessors advertise the quality of their services. Unlike manufacturers or suppliers, most lessors do not engage in mass market advertising making promises or warranties about the quality of the goods. Thus it makes little sense to talk about lessor A's advertising inducing a "remote" lessee to lease goods from another lessor B. Nor do lessors commonly create and supply owners' manuals or instructions attached to the goods.

Excused Performance: The ordinary commercial understanding of the parties in a finance lease is that "frustration of purpose" or excuse is not available as a ground for lessee excuse from performance. The very act of selecting a lease term (an inescapable necessity in any lease) represents a conscious choice by the lessee, allocating risk and agreeing about the scope and length of its undertakings.

True lease remedies: True lease remedies and measure of damages are different from sales law, essentially because of the lessor's residual interest, which exists because of the separation of ownership and possession in a lease. In a lease, the lessor owns the goods, while the lessee has only an interest in using the goods for a limited time. The impact on measure of damages for breach is that, in general, a lessor's damages for the lessee's breach are equal to lost rentals plus any damage to the residual; while the lessee's damages for breach are the extra rental expense of renting substitute goods. Though some early courts confused the two, lease remedies are very different from sales remedies. *See* DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U. San Fran. L. Rev. 257 (1978).

2A-106. Limitation on Power of Parties to Consumer Lease to Choose Applicable Law and Judicial Forum. *(Add to Official Comments)*

The 2/2A Drafting Committee voted to insert a clarifying Comment to the effect that one of the permissible choices of law in a consumer lease — the jurisdiction "in which the goods are to be used" — includes the law of the jurisdiction where the goods are physically delivered to the lessee.

Part 2. Formation and Construction of Lease Contract

2A-201. Statute of Frauds. *(Add to Official Comments)*

Tradition, custom and practice for leasing involves the execution of a single writing or record by the parties. Because a lease commonly involves more multi-faceted on-going obligations than a casual sale, it is more important for leases than sales that the agreement be evinced by a record.

2A-202. Parol Evidence. *(Add to Official Comments)*

In commercial leasing, it is common practice (and more important than it is in sales) to include a merger clause to ensure contractual certainty for the more complex, multi-faceted obligations of a typical leasing deal. As a practical matter, a merger clause in a commercial lease creates a strong, nearly conclusive presumption that both parties intended a total integration. It puts a difficult burden on one party to establish the contrary. *See* White & Summers, UCC Treatise §2-12 ("Merger" Clauses and the Parol Evidence Rule) (4th ed. 1995 w. 2002 pocket part).

2A-210. Express Warranties (Add to Official Comments)

There are important differences between leases and sales, however, that are reflected in 2A's different warranty scheme for leases. Typically lessors advertise the quality of their services. Unlike manufacturers or suppliers, most lessors do not engage in mass market advertising making promises or warranties about the quality of the goods. Thus it makes little sense to talk about advertising by lessor A inducing a "remote" lessee to lease goods from lessor B. Lessors commonly lease goods supplied by a variety of different manufacturers. In finance leasing, the lessee (not the lessor) selects the goods and the manufacturer. 2A-103(a)(12). Unusual cases involving advertising by a lessor touting the quality of the goods (such as advertising by a company that both sells and leases, or advertising by a "captive" lessor that leases only goods of a single manufacturer) are covered by §2A-210 and by analogy to the rules on advertising in Article 2-sales.

Nor do lessors commonly create and supply owners' manuals or instructions attached to the goods. Warranties made by persons who are not agents of the lessor do not create liability in the lessor. *See, e.g.*, All-States Leasing Co. v. Bass, 96 Idaho 873, 538 P.2d 1177 (1975) (court finds no lessor warranty where lessee relied on manufacturer's literature). Only where the lessor or its agent makes promises or representations about the goods is there an express warranty by the lessor.

2A-211. Warranties Against Interference and Against Infringement: Lessee's Obligations Against Infringement. *(Add to Official Comments)*

The warranty against interference in 2A-211 extends only to a lessee who is in compliance with the lease.

2A-220. Effect of Default on Risk of Loss. *(Add to Official Comments)*

There is no doctrine of lessee excuse in Article 2A. Only lessors, not lessees, may be excused from performance for delay in delivery or non-delivery under 2A-405.

2A-222. Electronic Lease Contracting. *(Add to Official Comments)*

Perfecting Interests in Electronic Chattel Paper Leases. With tangible paper leases, lease financers and syndicators often take physical possession of the original signed chattel paper lease, in

order to obtain a first priority perfected security interest. With respect to electronic leases, revised Article 9 allows this for electronic chattel paper. *See* revised §9-105, §9-314(a), §9-330, §9-102(31), (11). To perfect a security interest in electronic chattel paper, one must comply with revised §9-105, which mandates a set of factual conditions that must be met before a secured party has "control" of electronic chattel paper. Thus, for example, revised §9-105(1) requires a single authoritative copy of electronic chattel paper that is unique, identifiable, and generally unalterable; revised §9-105(2) requires that the authoritative copy of electronic chattel paper must show the secured party or its designated custodian as the assignee; and revised §9-105(5) requires that each copy of the authoritative copy be readily identifiable as a copy. To perfect a security interest in electronic chattel paper, the holder must satisfy each and every one of the conditions in revised §9-105. Satisfaction of these conditions has the same legal effect as possession of originally executed tangible paper leases.

One way in which electronic chattel paper leases might be created, stored, and transferred would involve establishing a third party record keeper and use of some version of encryption to assure non-alterability of the original records. Rapidly developing technology involving electronic contracting may create a variety of different ways of creating, storing and transferring electronic chattel paper, consistent with the control requirements of revised §9-105.

Part 4. Performance of Lease Contract Repudiated, Substituted and Excused

2A-405. Excused Performance. *(Official Comment)*

The ordinary commercial understanding of the parties in a finance lease (a statutory finance lease or any lease with a "hell or high water" clause) is that "frustration of purpose" or excuse is not available as a ground for lessee excuse from performance. The very act of selecting a lease term (an inescapable necessity in any lease) represents a conscious choice by the lessee, allocating risk and agreeing about the scope and length of its undertaking. Finance leasing accounts for billions of dollars of equipment lease transactions each year. It depends upon certainty of payment that would be severely eroded if the narrow rule of excused performance for lessors (§2A-405) were extended to lessees. Nor should any negative implication be drawn from the limited rule of lessor excuse in §2A-405: that is, other law or the lease contract itself may provide that the lessor's failure to perform is not a breach. This section creates no implication that, unless the circumstances fall within §2A-405(a)(1) and (2), delay in performance or nonperformance is a default under the lease contract.

Part 5: Default

2A-501. Default: Procedure. *(Add to Official Comments)*

- True lease remedies and measure of damages are different from sales law, essentially because of the lessor's residual interest, which exists because of the separation of ownership and possession in a lease. In a lease, the lessor owns the goods, while the lessee has only an interest in using the goods for a limited time. The impact on measure of damages is that, in general, a lessor's damages for the lessee's breach are equal to lost rentals plus any damage to the residual; while the lessee's damages for breach

[3]

are the extra rental expense of renting substitute goods.

Years ago, courts sometimes confused lease remedies with sales remedies. When the lessee defaulted, some courts mistakenly credited the lessee with the entire sales proceeds in calculating the lessee's deficiency. *See* DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.San.Fran.L.Rev. 257 (1978). This improperly credited the lessee with the

value of the lessor's residual. Lease remedies are different from sales remedies.

2A-504. Liquidation of Damages. *(Add to official Comments)*

In the absence of a liquidated damages clause in the lease, a lessor who withholds or stops performance under subsection (c) can retain payments made by the lessee (including any deposit or down payment) only to the extent that the lessor can prove damages.

2A-517. Revocation of Acceptance of Goods. *(Add to Official Comments)*

Subsection (f) permits a lessee who rightfully rejects or justifiably revokes acceptance to make reasonable use of the goods and only be liable, where appropriate, for the value of the use. Reasonable use in a lease may be different than it would be in the sale of goods context. Courts must be vigilant to distinguish between legitimate mitigation of damages by the lessee (on the one hand) and an unscrupulous lessee's attempt to knock down the stated lease rental rate (on the other hand). In particular, courts should be skeptical of an alleged mitigating use by the lessee in short-term leases and in other situations, not limited to short-term leases, where the alleged mitigating use continues for the full lease term. The "value of the use," in the context of a lessee who rejects or revokes its acceptance and then uses the goods, presumably should be the stated contract rental. The burden should be on the lessee to show otherwise. This is to safeguard the stability of lease contracts and to prevent the lessee from reaping an unfair advantage by rejecting the goods or revoking its acceptance.

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[1] There also was a separate specific vote by the 2/2A Drafting Committee, at the same meeting, to include a new clarifying Comment to 2A-106. None of this has been done.

[2] The issue about inserting more user friendly Comments throughout the 2A Draft was preserved at the ALI's 2001 annual meeting. See ALI 2001 Proceedings (78th Annual Meeting) pp. 425, 423-425. The ALI's own official web site summary of the 2001 ALI Annual Meeting (which has been retained in a written record) states that "the Reporter and Chair of the Drafting Committee agreed to work with Edwin E. Huddleson, III, on accommodating his Article 2A motions."

[3] This is oversimplified, of course, since tax losses and other damages often may exist. For example, a lessee may seek damages if the lessor breaches duties in addition to supplying the goods, such as repairing and maintaining the goods. *See* current UCC 2A-103(1)(g) Comment. Often the lessor's greatest concern upon breach by the lessee is recovering possession of the goods. And a lessor often incurs incidental damages in the form of costs incurred to sell or relet the goods after repossession.

Tab 2

old 2B. We have now chosen to conform to Article 2 and to adopt the rules based on the Electronic Contracting Act provisions.

Finally, in the Memo [sub J], there is a discussion of new 2A title warranties [§ 2A-502]. Present 2A has quite restricted warranty of quiet enjoyment warranties by lessors. Ordinary equipment lessors warrant only against their own acts, and finance lessors make no title warranty at all. In considering that issue in the revision process, we concluded that those rules were much too narrow, so we have now adopted provisions in which ordinary equipment lessors, nonfinance lessors, make sort of usual title warranties. They warrant against actions of third parties that would interfere with the right or colorable claims of third parties that would interfere with the right, and finance lessors warrant against their own acts which interfere with the rights of the lessee.

There is one other issue that I would like to call your attention to. If you look at the scope section of Article 2A, § 2A-103, which is on page 19 of the draft, it does not have a (b). Yesterday, we had a long discussion about the scope section of Article 2 [§ 2-103] and its (b), which excludes computer information transactions from Article 2. At the time this scope provision in 2A was drafted, Article 2 had not yet decided exactly what it was going to do, and frankly, when this section was drafted, the 2A Committee believed that this was what Article 2 was going to do. Bob and I think that there is no reason for having a different rule, and we will recommend to our Committee that it adopt the Article 2 provision, which will have the effect of excluding from 2A computer information transactions to the same extent as they are excluded from Article 2.

Mr. Chairman, that completes my —

President Wright: Thank you. Mr. Chow, I noticed that you had a presubmitted motion dealing with the question of electronic commerce. Does Mr. Benfield's statement satisfy you, or do you wish to press your motion?

Mr. Stephen Yee Chow (Mass.): I withdraw the motion.

President Wright: Thank you. He said, "I withdraw the motion."

Mr. Huddleson has a presubmitted motion that goes generally to the draft, rather than to a particular provision. Mr. Huddleson, are you here?

Mr. Edwin E. Huddleson, III (D.C.): Thank you, Mr. Wright. One of the presubmitted motions I made has really been graciously acknowledged by the Director to be a strong suggestion for consideration of more fulsome and user-friendly Comments throughout the draft. I spell that out, it is in your written materials here, in the pink materials starting at page 7.[2] The Reporter was just running through all of the various differences between leases and sales. The whole 2A revision process really

[2]For text of amendment, see Appendix 3(B.1).

showed the need for more user-friendly Comments in Article 2A. What the process consisted of was a more in-depth examination and a greater articulation of exactly what those differences are. It would be very unfortunate if that work product were not to appear in the Comments in the final draft. The Drafting Committee worked hard to achieve those insights, and they belong in the draft along with the substance of the Reporter's Memo to the ALI which he just ran through.

Any smart lawyer ought to be able to pick up this draft and look at page 2, just before it says "Issues," [§ 2A-101, Comment] and see something more than what is there now, which just says, "Article 2 was the appropriate statutory analogue." What any smart lawyer ought to be able to see there and elsewhere throughout the draft is a more explanatory Comment that would lead him to say, "Oh, I see, commercial law, commercial leasing law, is different from commercial sales law in many important respects, how interesting." This would mark a welcome sea change in understanding Article 2A and the commercial law of leasing.

Now I have discussed this suggestion with the Reporter. I understand that he is amenable to it. I want to thank the Reporter for his graciousness and his consideration throughout the project, so this is a strong suggestion for consideration, and I leave that to the Reporter, and I want to thank the Reporter for his consideration.

President Wright: Thank you, Mr. Huddleson. Mr. Huddleson says the Reporter is amenable to the strong suggestion in the presubmitted motion, and so we need not debate or vote on the motion.

Since we have only about an hour, I wonder if it would be meet to go through the various matters that Mr. Benfield has identified as areas in which Article 2A differs from Article 2, and, when we have done that, any other matters that members have would be in order. We will get to those when we get to the particular matters that have been identified for us.

So that, if that is an acceptable procedure, we would go first to what is listed as "A," on page Roman numeral xxvi, the special rule for determining whether terms in a record are binding. Is that still a live issue, Mr. Benfield?

Professor Benfield: Well, if anyone has comments, I think they would be welcome.

President Wright: Are there any comments or questions on the matters listed under "A" at page Roman numeral xxvi? The member at microphone 4.

Mr. Andrew D. Koblenz (D.C.): I was present and participated in the discussion yesterday on the proper treatment of unconscionability under Article 2 [§ 2-105], and I am not rising to revisit that debate today. I just want to note and make a comment, if I could.

The Reporter indicated that it is his belief that the Comment that he has prepared that appears on pages 26 through 28 regarding unconscionability [§ 2A-107, Comment] captures in a Comment the intent of the black-letter changes that were made yesterday or that were approved yesterday in Article 2, and that just illustrates the points that I was trying to make yesterday. There can be no mistake about it, at this point, that an increase and expansion of the concept of unconscionability is clearly being intended. I asked yesterday what the problem that is bringing that about is, and there was deafening silence. I don't believe, for the reasons I said yesterday, that this expansion is warranted. I point out that the most problematic provision of the Comment appears on page 28, in Comment 4, in which it says there is a justification for finding a somewhat less oppressive term to be unconscionable. Historically, as the Comments to Article 2 have stated for some time now, the principle is one of the prevention of oppression. I don't know what the justification for finding something less than oppression is, and this is going to, as it will in Article 2, introduce a tremendous amount of uncertainty and litigation into it for no apparent purpose, and I just reiterate my comments from yesterday that I think it is unwise, but I am not rising now to seek the change, because I think that decision was made yesterday. Thank you.

President Wright: Thank you. Are there other comments on point A in the Reporter's Memorandum? If not, we move to point B on page Roman xxvii, the battle of the forms. Is there discussion on that? I see none.

At page xxviii, point C is the treatment of the statute of frauds [§ 2A-201]. The member at microphone 1.

Professor Robert J. Levy (Minn.): I notice that the Reporter did not make any oral comment about the second change in 2A from 2, on the second full paragraph on page Roman xxviii, with respect to admissions by a party with respect to a statute of frauds defense, leaving out the words "pleadings, testimony, or otherwise in court that a lease contract was made." It seemed to me that it was a rather inoffensive part of Article 2, and it was left out by the Article 2A Drafting Committee because they were uncertain of the effect, and I just wonder why the uncertainty, or perhaps we should instruct the Drafting Committee of Article 2 that they should be uncertain of the effect, too. I would like more explanation.

Professor Benfield: If I understood your comment, I think what I have said here may not be clear. We do have this language, which is in the last couple lines of that paragraph, "admits in its pleading, testimony, or otherwise in court" [§ 2A-201(d)(2); see also § 2A-201(e)(2)], we do have that language, and I was suggesting that we would also add the language from Revised Article 2 [§ 2-201(a)], which will say that you must deny facts that are alleged to form a contract if you are going to plead the statute of frauds as a defense.

President Wright: Mr. Levy.

Professor Levy: I am talking about the second part of that paragraph, in which you say that the Drafting Committee of Article 2A decided not to recommend the language which says that a defendant who admits in its pleadings the contract is bound by it even though it would not otherwise be.

Professor Benfield: I'm sorry, my paragraph is unclear. The last sentence, "The 2A Committee was uncertain of the effect of the new language," refers not to what immediately preceded it but to the language in the first sentence of the paragraph, which required that you deny.

Professor Levy: Thank you.

President Wright: Anything else on the statute of frauds?

Point D at page xxix, extension of express warranties to remote lessees. Is there any discussion of that? I see none.

Point E on the same page, contractual modification of remedy [§ 2A-711].

You have a remarkably acquiescent group this morning, Mr. Benfield.

Professor Benfield: I put people to sleep.

President Wright: Point F on page xxx, limitation on choice of law and choice of forum in consumer transactions [§ 2A-106]. Anyone wish to comment on that?

Point G, also on page xxx, statute of limitations [§ 2A-715], accrual of cause of action.

Point H at page xxxi, remedial promise.

We have touched on point I, electronic contracting [§§ 2A-110 and 2A-111; §§ 2A-206 through 2A-211], at page xxxii in the memo. Anyone have anything more with regard to that? Yes.

Mr. Edwin E. Huddleson, III (D.C.): The next one.

President Wright: Why don't you speak in the microphone.

Mr. Huddleson: Mr. Wright, I am waiting for you to come to J. (*Laughter*)

President Wright: Well, you need not retreat, because I think we are — ah, here is someone who wants to speak on I, the member at microphone 5.

Ms. Gail K. Hillebrand (Cal.): I would like to retreat to H very briefly. I don't quibble with the decision made by the Drafting Committee here not to pursue the remedial promise concept, but there are promises that, under Article 2 case law, were treated as express warranties, and now Article 2 will say those are not express warranties because they are

remedial promises. It might be helpful if you have commentary here saying you are not disturbing their status as express warranties under 2A.

President Wright: The Reporter agrees to that. I think we are now to J.

Mr. Edwin E. Huddleson, III (D.C.): Thank you, Mr. Wright. Item J refers to § 2A-502, which has been described as the warranty against interference or the warranty of quiet enjoyment. There is a presubmitted motion on this in your pink booklet at page 13.[3]

President Wright: It is at page 13, yes.

Mr. Huddleson: The thrust of this motion is simply that one way or another this section should be clarified to make it clear that no lessor should be subject to suit and liability for clouds on the title that arise from the lessee's own acts or omissions. For example, neither Hertz nor any other auto lessor should be subject to suit and liability to the lessee if the lessee's car is booted because the lessee ran up a lot of traffic tickets and didn't pay them.

Now I have discussed this with the Reporter, who, as I understand it, agrees with me that this is a matter of law and equity, and, as a matter of law and equity in good faith, no court should interpret this section in that manner, and his proposal was to cover this in a Comment. If he will give me his word on that, that is good enough for me.

Professor Benfield: Yes.

Mr. Huddleson: And I accept that.

President Wright: Thank you. Anything else on title warranties? Mr. Chow.

Mr. Stephen Yee Chow (Mass.): I had made a presubmitted motion, at page 3 of the pink pamphlet,[4] and this is, again, similar to the motion I made in Article 2 that the traditional warranty against infringement doesn't anticipate actually the acts of infringement, which are cast differently from delivery. I think some of the issues with respect to leasing may be slightly different from that with respect to sales, but I was wondering if the Committee or anyone had considered the issue of whether some infringements may occur only when you use a particular leased item, rather than when it is actually delivered, and whether the warranty extends to the use, rather than simply the delivery, and the question is whether that issue has been considered.

Professor Benfield: I agree with Mr. Chow's point, and I invite you, Steve, to send me a suggested draft paragraph.

[3] For text of amendment, see Appendix 3(B.2).

[4] For text of amendment, see Appendix 3(B.3).

Mr. Chow: I will do that, just for the Comments in any case. Thank you.

President Wright: Thank you. Ms. Boss.

Professor Amelia H. Boss (Pa.): When it comes to accommodating the last two comments in the official commentary, I would like to point out that, to some extent, those two comments are inconsistent. The first comment was that no liability should arise because of acts of the lessee, and indeed, if you are looking at the booting of a car because of the failure to pay fines, I fully agree. However, Mr. Chow's comment pointed out that infringement claims arise because of the use by the lessee, and to that extent it is inconsistent with Mr. Huddleson's point, so I think you are going to have to do some careful drafting of that commentary.

President Wright: Are you going to do careful drafting, Mr. Benfield? (*Laughter*)

Professor Benfield: I am going to have to speak to Amy.

President Wright: Well, we have gone through all of the points that were in the Reporter's introductory memorandum. Have we gone through all of the presubmitted motions? We have gone through Mr. Chow's.

Mr. Huddleson, do you have another presubmitted motion that you would like to present?

Mr. Edwin E. Huddleson, III (D.C.): Yes, Your Honor.

Director Hazard: Your grace, not Your Honor. (*Laughter*)

Mr. Huddleson: Your grace.

President Wright: Thank you.

Mr. Huddleson: One of the motions, which appears in your pink booklet at page 12,[5] should be noncontroversial and is intended to be noncontroversial, and, if there is any controversy about it, I will withdraw the motion and submit this to the discretion of the Reporter and the Drafting Committee. This is a point that was unclear in original 2A, it has nothing to do with the current revision. It is simply that this important section, § 2A-403, on the transferability of lease interests, the statutory text is impenetrable even to people who are experts in the field, and they have complained about this repeatedly.

The motion, which I would like the Reporter's reaction to, is simply to make the text reflect what is in the Comments.

[5] The amendment was to add the following text at the beginning of § 2A-403(b): "Transfer of a lessor's interests under a lease agreement, or creation of a security interest in the lessor's interests under the lease contract or in the lessor's residual interest in the goods, subject to the specific rules in this section, is allowed and may not be prohibited or defined as a default."

Professor Benfield: Ed, I'm sorry to say that I don't agree with adding this language to the text. The situation is that it is fair to say that Ed's language is not substantive. However, I'm afraid it is confusing. The rule which Ed's draft tries to capture here in four lines is dealt with in § 9-407 in about 12 lines, so this is an attempt to simply state a rule which is somewhat more elaborately stated in Article 9. It is perhaps unfortunate that the drafting process between 9 and 2A has led to a separation of the rules here so that part of them are in 9 and part are in 2A, but I do think, Ed, it is better to deal with that in the Comment than to state the same rule here in different language than is in 9. It can lead to some unhappy consequences if one judge focuses on this, another judge focuses on 9, so I agree with you that it is a somewhat unfortunate circumstance, but I think it is better to try to deal with it in the Comment.

Mr. Huddleson: I will cede to the Reporter's judgment on that and withdraw that motion, with the hope that the Drafting Committee may look at this again, hearing the anguished cries of practitioners.

President Wright: Thank you. What is your next motion, Mr. Huddleson?

Mr. Huddleson: The only other motion I wish to press is the one that appears on page 18 of the pink booklet,[6] and it has to do with § 2A-606. The motion is to restore some of the clarifying language of current law, which is § 2A-406, in order to give assurance that no change is being made in the law about frustration of purpose or excuse from lease contract performance. This is a crucial point to the hundred billion dollar a year commercial lease financing industry, which depends for its existence on the validity of hell-or-high-water clause financing and accounts for about 10 to 20 percent of all capital acquisitions in the United States each year. The cost of these goods, such as the cost of airline travel to this conference, would go up, to the injury of the American people, if the current law were unsettled on this point.

Once again, I have discussed this briefly with the Reporter, and it is my understanding, Marion, that you are essentially in agreement with this.

Professor Benfield: I agree with the change that you propose in (a) to substitute "lessee" for "party," because in fact the previous section, of which this is relating, really deals only with lessor's excuses, and therefore the word "party" really meant "lessee" here, and I think it is reasonable to clear that up.

I do not agree with your proposal to strike subsection (c) of that section.

[6] For text of amendment, see Appendix 3(B4).

Mr. Huddleson: Well, if you change the word to "lessee," it will no longer be necessary to strike subsection (c).

Now, Mr. Wright, I have an inquiry. If the Reporter and I agree, is that sufficient to ensure that the change will be made?

President Wright: If this were strictly a Law Institute project, that would be. Here we are working in collaboration with the Commissioners. They have their own procedures. A Reporter does not have the authority, as I understand it, with the Commissioners that ALI Reporters have, and so he will have to take what he has agreed to back to the Drafting Committee and undertake to persuade them. What you have, Mr. Huddleson, is the Reporter's assurance that he will press for that view, but he cannot promise that the Drafting Committee will agree with what he says.

Mr. Huddleson: Well, I appreciate that, and I guess my motion is to endow the Reporter with the backing of The American Law Institute in that endeavor.

President Wright: Are you really pressing that as a motion, Mr. Huddleson?

Mr. Huddleson: I am interested in substance. I am a commercial lawyer. I am interested in the result, and I defer to you about the parliamentary means that is best suited to achieve that objective.

President Wright: Well, I think you have already achieved as much as can be achieved in this room.

Mr. Huddleson: Very well. Thank you.

President Wright: You have the Reporter's assurance that he will push for it.

Mr. Huddleson: Thank you, and I thank the Reporter.

President Wright: And Mr. Tennessen says that he also will push for it, so you have the Reporter and the Chair of the Drafting Committee, and I think you can rest reasonably content. (*Laughter*)

Professor Benfield: I would like to point out that I am also a member of the Committee, so I have a vote. (*Laughter*)

President Wright: Excellent.

Are there other matters with regard to anything in Article 2A? The floor is open for any comments, motions, suggestions. Yes, the member at microphone 5.

Mr. John G. Brooks (Mass.): A small matter in the definitions section, where I think there has been an omission which should be taken care of. In § 2A-102(a)(6), the definition of "computer" I believe ought to add, where it says "device that can perform substantial computations, including numerous arithmetic operations," etc., should add, after the word "com-

Alternative A

Add a section numbered (c)(4)(B) and renumber the current section (c)(4) as (c)(4)(A).

(c)(4)(B): In the case of a building product for which the generally accepted expected performance of the product extends beyond four years following delivery of the product and which is sold without disclaimer or limitation under Section 2-406, a right of action accrues when the buyer discovers, or should have discovered the breach. However this section shall not extend the statute of limitations beyond ten years following the date the seller has tendered delivery to the aggrieved party.

B. Uniform Commercial Code
Revised Article 2A (Leases)

1. An amendment was submitted by Mr. Huddleson regarding the Official Comments to Revised Article 2A, as follows:

"Throughout their course, the Official Comments to revised UCC Article 2A-Leases should be revised to spell out more explicitly how and why commercial leasing law differs from sales law, to help courts and practitioners reach sound results in applying 2A."

2. An amendment was submitted by Mr. Huddleson to amend § 2A-502 of the Proposed Final Draft and its Comment, as follows:

"The statutory text of 2A-502 should be amended, so that it does not create a lessor warranty to safeguard the lessee against the consequences of the lessee's own acts or omissions. As amended, 2A-502(a) and (b) should read as follows:"

2A-502. WARRANTY AGAINST INTERFERENCE AND AGAINST INFRINGEMENT; LESSEE'S OBLIGATION AGAINST INFRINGEMENT

(a) Except in a finance lease, a lessor in a lease contract warrants that, except for claims by any person by way of infringement or the like, at the outset of a lease no person holds a claim or interest in the goods that arose from an act or omission of the lessor or a third party which will interfere with the lessee's enjoyment of its leasehold interest, or unreasonably expose the lessee to litigation.

(b) There is in a lease contract a warranty that, except for claims by way of infringement or the like, for the duration of the lease no person holds a:

(1) claim or interest in the goods that arose from an act or omission of the lessor which will interfere with the lessee's enjoyment of its leasehold interest, or

(2) colorable claim to or interest in the goods that arose from an act or omission of the lessor which will unreasonably expose the lessee to litigation.

"The Comments to new 2A-502 should say that there is an implied warranty (unless disclaimed) that the goods are free at the outset of the lease from any charge or encumbrance caused by the lessor or a third party (not the lessee). Thus, in a change from current law 2A-211, a lessee would have a remedy under this new warranty section (unless negated by contract or circumstances) if a true owner makes a claim because the goods were sold to the lessor by a thief. But a lessor is not responsible for safeguarding the lessee's interests against claims or encumbrances that might arise because of the lessee's own actions or omissions."

3. An amendment was submitted by Mr. Chow regarding the Comment to § 2A-502(c) of the Proposed Final Draft, as follows:

"I move that the ALI resolve that the warranty in subsection 2A-502(c) that certain goods are 'delivered free of the rightful claim of a third party by way of infringement or the like' be clarified in the Official Comments to include infringement by uses of the goods that the merchant dealer should reasonably expect under the circumstances."

4. An amendment was submitted by Mr. Huddleson to substitute the word "lessee" for "party" in line 1 of § 2A-606(a) of the Proposed Final Draft, to strike the statutory text of § 2A-606(c), and to amend the Comment to § 2A-606 to read: "Note that subsection (a)(1) allows the lessee under a lease, including a finance lease, the right to terminate the lease because of the lessor's excused performance (Sections 2A-604 and 2A-605). However, subsection (a)(2), which allows the lessee the right to modify the lease for the lessor's or supplier's excused performance, excludes a finance lease that is not a consumer lease...."