

**Report on the  
Uniform Commercial Code Modernization Act of 2007**

**Prepared by the  
Uniform Commercial Code Task Force  
Of  
The Business Law Section  
Of  
The Pennsylvania Bar Association**

**To Accompany  
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## I. INTRODUCTION

**A. Overview and Background.** The proposed Uniform Commercial Code Modernization Act of 2007 (the “Act”) enacts as Pennsylvania law the revisions of two Articles of the Uniform Commercial Code (“UCC”), Article 1 – General Provisions, and Article 7 – Documents of Title. The joint sponsors of the UCC, the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) and the American Law Institute (“ALI”) promulgated Revised Article 1 in 2001 and Revised Article 7 in 2003. NCCUSL and the ALI started the Revised Article 1 drafting process in 1996 and the Revised Article 7 drafting process in 2001.

The Act includes conforming changes to other Articles of the UCC.

Article 1 of the UCC provides the definitions and general provisions which, in the absence of conflicting provisions, usually apply as default rules covering transactions and matters otherwise addressed by other Articles of the UCC. As other Articles of the UCC have been revised and amended to accommodate changing business practices and development in the law, these modifications need to be reflected in an amended Article 1. As a result, Revised Article 1 contains several provisions recognizing and enabling electronic transactions. Revised Article 1 also contains a number of non-substantive changes, such as those renumbering sections and adding gender-neutral terminology. In addition, Revised Article 1 includes a few substantive changes that are described in greater detail in Part V of this Report.

Article 7 of the UCC governs documents of title, including bills of lading and warehouse receipts. Bills of lading and warehouse receipts have traditionally been paper documents which identified the owner of certain physical goods being carried in commerce or stored in a warehouse. The document of title not only indicates ownership of goods, but also frequently incorporates the terms of the contract for carriage or storage. Documents of title may be negotiable or non-negotiable. A negotiable document can be negotiated for value like a check (a form of negotiable instrument), by signing (“endorsing”) the instrument and physically delivering it to transfer it for value to a new owner. As in the case of a check, where endorsement and delivery of a piece of paper transfers ownership of the funds in question, endorsement and delivery of a document of title transfers ownership of the goods in question.

Article 7 of the UCC, in its original form, combined two earlier acts, the Uniform Warehouse Receipts Act and the Uniform Bills of Lading Act. Article 7 was first promulgated in 1952 as part of the original UCC and had not been revisited until the revision process that culminated in the 2003 revision. The revisions to Article 7 are intended to update and clarify the law in the context of electronic commerce, and assure commercial parties that the document of title is no longer limited to paper documents, and that the concepts of endorsement and delivery are likewise no longer limited to a written endorsement on and manual delivery of a piece of paper.

Like Revised Article 1, Revised Article 7 also contains several non-substantive changes to incorporate gender-neutral language and modern statutory drafting concepts. The revisions to Article 7 are discussed in greater detail in Part VI of this Report.

Both Articles 1 and 7 have been part of Pennsylvania law since 1953, when Pennsylvania became the first state to enact the UCC. In Pennsylvania's codification, the Articles of the UCC are called "Divisions." Existing Division 1 is found at 13 Pa. C.S. § 1101 et seq. and Existing Division 7 is found at 13 Pa. C.S. § 7101 et seq.<sup>1</sup> To minimize confusion, this Report will refer to the Articles of the UCC as "Articles."

**B. Enactment Status Nationwide.** As of January 2, 2007, 22 states and the United States Virgin Islands have enacted Revised Article 1<sup>2</sup> and 24 states have adopted Revised Article 7.<sup>3</sup>

## II. DRAFTING OF THE ACT

**A. The Pennsylvania Committee.** The Act was drafted by the Uniform Commercial Code Task Force of the Business Law Section of the Pennsylvania Bar Association with the assistance of the Legislative Reference Bureau. The Task Force was appointed in 2005. The Task Force is geographically diverse and its members include private practitioners and members of the academic community. The Task Force began its review of the Official Text of Revised Articles 1 and 7 in January, 2006 and met a total of five times through January, 2007.

**B. Status of Report.** This Report will become part of the legislative history of the Act under 1 Pa. C.S. § 1939 (relating to use of comments and reports).

## III. RECOMMENDATIONS

**A. Article 1.** The Task Force recommends the adoption of the Official Text of Article 1 of the UCC with one significant change. The Official Text contains a choice of law provision that has not been adopted by any of the states that have adopted Revised Article 1. Therefore, for reasons of uniformity, which is of paramount importance in commercial law, the Act contains the choice of law provision from Existing Article 1, which is the choice of law provision that has been adopted by all of the jurisdictions that have adopted Revised Article 1. A more complete explanation of this recommendation follows in the next section of this Report.

**B. Article 7.** The Task Force recommends the adoption of the Official Text of Article 7 without amendment. The enactment of Article 7 nationwide has been non-controversial and it

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<sup>1</sup> The Official Text numbers the sections of the UCC with hyphens; for example, the first section of Article 1 is § 1-101 and the first section of Article 7 is § 7-101. Pennsylvania's codification of the UCC omits the hyphens, as does the Act.

<sup>2</sup> Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Hawaii, Idaho, Kentucky, Louisiana, Minnesota, Montana, Nebraska, Nevada, New Mexico, North Carolina, Oklahoma, Texas, Virginia, West Virginia and the United States Virgin Islands. See the web site for the National Conference of Commissioners on Uniform State Laws, [http://nccusl.org/Update/uniformact\\_factsheets/uniformacts-fs-ucc1.asp](http://nccusl.org/Update/uniformact_factsheets/uniformacts-fs-ucc1.asp)

<sup>3</sup> Alabama, Arizona, California, Colorado, Connecticut, Delaware, Hawaii, Idaho, Maryland, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, North Dakota, Oklahoma, Rhode Island, Texas, Utah, Virginia and West Virginia. See [http://www.nccusl.org/Update/uniformact\\_factsheets/uniformacts-fs-ucc7.asp](http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-ucc7.asp).

has been enacted in all of the adopting jurisdictions without changes.

#### IV. SUMMARY OF CHANGES TO ARTICLE 1 AND 7

##### A. Summary of Changes to Article 1

- **Adds definitions to accommodate electronic transactions.**
- **Revises definitions to accommodate electronic transactions.**
- **Amends the definition of “good faith” to incorporate both an objective and a subjective element. This change recognizes the fact that with one exception (explained below), the revised Articles of the UCC provide that “good faith” includes both an objective and a subjective component.**
- **Expressly provides that the meaning of an agreement can be determined by the parties’ course of performance, course of dealing and applicable usages of trade. This change is designed to clarify the rules regarding contract interpretation applicable to contracts governed by all Articles of the UCC.**

##### B. Summary of Changes to Article 7

- **Updates Article 7 to provide a framework for the use of electronic documents of title by adding and amending definitional sections and adding substantive provisions to assure that the provisions of Article 7 are “media neutral” in their application.**
- **Updates Article 7 to reflect modern industry practices by eliminating archaic terminology and references to practices that are no longer relevant.**

#### V. CHANGES TO ARTICLE 1

Revised Article 1, as promulgated by NCCUSL, makes several substantive changes to current law. With the exception of the choice-of-law provision, the Task Force recommends that Pennsylvania adopt all of these changes. In this section of the Report, we focus on sections that have changed.

Revised Article 1 reorganizes Existing Article 1. While Existing Article 1 consists of eighteen sections, Revised Article 1 consists of 23. There are few significant substantive changes, and the additional sections result in large part from the reorganization of the definitional section, § 1201. Revised Article 1 contains General Provisions in Part 1, General Definitions and Principles of Interpretation in Part 2, and Territorial Applicability and General Rules in Part 3.

##### A. Part 1: General Provisions

**Scope of Article 1:** Existing Article 1 does not contain an explicit scope provision. Revised Article 1, in § 1102, provides that Article 1 applies to a transaction “to the extent that it is governed by another Article” of the UCC. According to the Official Comment to the section, this change is intended to clarify what has “always been the case” -- that Article 1 applies only to a UCC transaction. The state of the law referred to in the Official Comment has not however been clear, due to the statute of frauds provision in Existing § 1206, which has been held to apply to sales of personal property, such as intellectual property and other intangibles, that are not covered by the other UCC Articles.<sup>4</sup>

In light of this revised scope provision, the drafters of Revised Article 1 have deleted § 1-206, which provided a statute of frauds applicable in transactions not covered any of the other statute of frauds provisions in the UCC. Now that Article 1 clarifies that it applies only to transactions covered by other Articles of the Uniform Commercial Code, § 1206 is unnecessary. As a result of this change, if a transaction does not fall within the scope of Article 2, 2A, 3, 4, 4A, 5, 7, 8, or 9 (Article 6 is no longer in force in Pennsylvania), it is not subject to Article 1.

Pennsylvania’s codification of Existing Article 1 contains a non-uniform provision excepting “qualified financial contracts” from the statute of frauds for non-UCC transactions. Because this is an exception to a statute of frauds that has been deleted from Article 1, the Task Force deems unnecessary any provision setting forth a statute of frauds for qualified financial contracts.

**Rules of Construction:** Existing Article 1 has two sections, §§ 1102 and 1103, that explain the purposes and policies of the UCC and set forth rules of construction. Those two sections have been combined into one section, §1103. The new section makes no substantive change to the existing Article 1. Existing § 1102(c), which provides that the provisions of the UCC can be varied by agreement, has been moved to a new section, § 1302.

Revised Article 1 contains several rules of construction that already exist in Article 1 of the Pennsylvania Consolidated Statutes. For the sake of consistency with other Pennsylvania statutes, we have deleted these provisions from Revised Article 1. As a result, and to preserve the uniform numbering in Revised Article 1, §§ 1105 and 1106 are described as “reserved” in the Act. These sections do not substantively change Existing Article 1, nor do they substantively change Revised Article 1.

**Electronic Transactions:** § 1108 is new, and provides that Article 1 modifies, limits and supersedes the federal Electronic Signatures in Global and National Commerce Act (“E-Sign”).<sup>5</sup> This section is consistent with E-Sign, which provides in § 7002 that a state statute can modify, limit or supersede E-Sign if it specifies alternative procedures for the recognition of electronic

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<sup>4</sup> See, e.g. *Olympic Junior, Inc. v. David Crystal, Inc.*, 463 F.2d 1141 (3<sup>rd</sup> Cir. 1972) (holding, under the New Jersey version of the UCC, that the sale of a business is governed by § 1-206). The only Pennsylvania case applying § 1206 is *Simcoe v. Huszar*, 10 Pa. D&C 3<sup>rd</sup> 298 (Carbon Cty. 1979), which involved the sale of a liquor distributorship. Because the court found that the transaction did not involve a “sale,” it held that §1206 was inapplicable.

<sup>5</sup> 15 U.S.C. § 7001 *et seq.*

records that are consistent with E-Sign. In addition, E-Sign specifies that it does not apply to a contract or other record to the extent that it is governed by the UCC.

## **B. Part 2: General Definitions and Principles of Interpretation**

**General Definitions:** Most of the definitions in Revised Article 1 are in § 1201, “General Definitions.” Three definitions have been moved from Existing § 1201 to their own sections. These new sections are § 1202 (Notice; Knowledge), § 1203 (Lease Distinguished from a Security Interest), § 1204 (Value) and § 1206 (Presumptions). The substance of these sections is unchanged and § 1203 moves the rules for distinguishing a lease from a secured sale from the definition of “security interest” in § 1201 to its own section.

There are several new definitions in § 1201. One is a definition of “consumer.” Article 9 of the UCC has several definitions related to consumers, such as “consumer transaction” but no definition of consumer. Revised Article 1 fills this void.

Another new definition is the definition of “record.” The Article 1 definition is derived from the Revised Article 9 definition, which was included to facilitate electronic transactions. The UCC definition of record is identical to the definition of record in the Pennsylvania Electronic Transactions Act, 73 P.S. § 2260.103. The term “record” includes both information that is written on paper and information that is stored in an electronic medium, and replaces the terms “writing” and “written” in many, but not all, places in the UCC.

Revised Article 1 changes several definitions to incorporate references to electronic transactions and to accommodate changes to other articles of the UCC. In the former category are the definitions of “conspicuous” and “send.” Both of these definitions have been modified to recognize and accommodate the use of electronic records. The definitions of “bearer,” “bill of lading,” “delivery,” “document of title,” “holder,” and “warehouse receipt” have been amended to conform to the amendments to Article 7 and will be explained in Part VI of this Report.

### **Definition of Good Faith:**

Revised Article 1 makes one substantive change to the Existing Article 1 definitions and this change is the new definition of “good faith.” The majority of the jurisdictions that have enacted Revised Article 1 have adopted this new definition, so for reasons of uniformity and for the reasons explained below, the Task Force recommends the adoption of the new uniform definition of good faith.

The substantive Articles of the UCC measure the conduct of a party to a transaction by reference to a standard of “good faith.” In addition, Revised § 1304 (Existing § 1203), provides that “every contract or duty within this title imposes an obligation of good faith in its performance and enforcement.” Revised § 1201 defines “good faith” as “honesty in fact and the observance of reasonable commercial standards of fair dealing,” except as otherwise provided in Article 5.

Revised § 1201 amends Existing § 1201 in three respects:

1. It explicitly declines to change the “good faith” definition in Article 5 (Letters of Credit);
2. It deletes the language, “in the conduct or transaction concerned,” as a limitation on the requirement of “honesty in fact”; and
3. It inserts the language “and the observance of reasonable commercial standards of fair dealing.”

Thus, “good faith” as contemplated by Revised §1201 has both (i) a subjective component (“honesty in fact”) and (ii) an objective component (“observance of reasonable commercial standards of fair dealing”).

The objective prong elevating the “good faith” threshold was previously incorporated into Article 2 of the UCC with respect to merchant transactions. Section 2103 provides that “in the case of a merchant, good faith means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.” The objective requirement of “reasonable commercial standards of fair dealing” has gained acceptance with the enactment of the revised Articles of the UCC. The same two elements of subjective honesty and objective reasonableness have been incorporated into other revised or recently enacted Articles. See 13 Pa. C.S. §§ 3103(a), 4104(c) (by reference to §3103(a)), 4A105(a), 8102(a) and 9102(a).

The definitions of “good faith” in each of these Articles include the two elements of honesty in fact and the observance of reasonable commercial standards of fair dealing. Furthermore, the Official Comments to sections contained in these Articles contemplate the enactment of a uniform version of Revised Article 1 that has incorporated the objective prong.<sup>6</sup>

In contrast, the only Article that measures “good faith” solely by reference to subjective honesty is Article 5 (§5102(a)), which is explicitly excepted from the definition in Revised § 1201. Article 2A incorporates by reference the “good faith” definition of Section 1201, and neither Existing Article 7 nor Revised Article 7 contains a definition of “good faith”, which means that Section 1201 will provide the definition of “good faith.”

The definition of “good faith” in Revised § 1201, therefore, accommodates the changes that have been incorporated into other Revised Articles of the UCC and would resolve any inherent tension or inconsistency that might arise between Revised Article 1 and Article 3, Article 4, Article 4A, Revised Article 8 and Revised Article 9.

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<sup>6</sup> For example, Official Comment 10 to Section 8102 states that

“section 1-201(b)(20) defines ‘good faith’ as ‘honesty in fact and the observance of reasonable commercial standards of fair dealing.’ The reference to commercial standards makes clear that assessments of conduct are to be made in light of the commercial setting. The substantive rules of Article 8 have been drafted to take account of the commercial circumstances of the securities holding and processing system.”

*See also* Official Comment 4 to Section 3103; Official Comment 4 to Section 4A105; and Official Comment 19 to Section 9102.

Reference to the acceptance of the “good faith” definition in other jurisdictions may be instructive, particularly since Revised Article 1 is intended to be a uniform law. Of the twenty-two states and one territory that have adopted Revised Article 1 as of January 2, 2007, sixteen jurisdictions<sup>7</sup> have adopted the “good faith” definition of uniform Revised Article 1. Consequently, the Task Force recommends enactment of the uniform version of the definition of “good faith” (including both subjective “honesty in fact” and objective “observance of reasonable commercial standards”) as part of § 1201 of Revised Article 1.<sup>8</sup>

**Reasonable Time; Seasonableness:** Revised § 1205 is substantively identical to Existing § 1204. Subsection (a) of Existing § 1204, which provides that the time within which an action must be performed may be fixed by agreement, has been moved to Revised § 1302.

### **C. Part 3: Territorial Applicability and General Rules**

Part 3 is new to Article 1, and results primarily from the reorganization and renumbering of Existing Article 1.

Several sections in Part 3 of Revised Article 1 are substantively identical to sections in Existing Article 1. These sections are: § 1302 (Variation by agreement), which combines the rules from Existing §§ 1102 (c) and (d) and 1204 (a); § 1304 (Obligation of good faith), which is identical to Existing § 1203; § 1305 (remedies to be liberally administered), which is identical to Existing § 1106; § 1307 (Prima Facie Evidence by Third Party Documents), which, with minor stylistic changes, is identical to § Existing 1202; § 1308 (Performance or acceptance under reservation of rights), which is identical to Existing § 1207; § 1309 (Option to accelerate at will), which, with minor stylistic changes, is identical to Existing § 1208; and § 1310 (Subordinated obligations), which is substantively identical to Existing § 1209.

**Choice of Law:** The most controversial change in the version of Revised Article 1 promulgated by NCCUSL is the choice-of-law provision. The choice of law rule in Article 1 was completely rewritten by the NCCUSL and ALI drafting committee and, in the new numbering system, is found in Proposed § 1-301.<sup>9</sup> Every state that has adopted Revised Article 1 has rejected the new provision.<sup>10</sup> Therefore, the Task Force recommends that Pennsylvania replace

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<sup>7</sup>Arkansas, California, Colorado, Connecticut, Delaware, Kentucky, Louisiana, Minnesota, Montana, Nevada, New Hampshire, New Mexico, North Carolina, Oklahoma, Texas, West Virginia and the United States Virgin Islands. Keith A. Rowley, *The Often Imitated, But Not Yet Duplicated, Revised Uniform Commercial Code Article 1*, available at <http://www.law.unlv.edu/faculty/rowley/RA1.120106.pdf>.

<sup>8</sup> In light of this changed definition, the Task Force is proposing the deletion of a Pennsylvania Bar Association Note to § 1203 from 1953, which appears in PURDON’S PENNSYLVANIA CONSOLIDATED STATUTES ANNOTATED. Because of the proposed change in the definition of “good faith” and the case law that has evolved since 1953, this note no longer provides useful guidance.

<sup>9</sup> In the Choice of Law discussion, we refer to the choice of law provision adopted by NCCUSL and the ALI as “Proposed §1-301” rather than “Revised 1301” because the Task Force does not support the adoption in Pennsylvania of the new choice of law provision. In the Act, §1301 is substantively identical to Existing § 1105.

<sup>10</sup> The Virgin Islands is the only jurisdiction that has enacted the revised choice of law rule and it did so soon after Revised Article 1 was promulgated.

the rewritten rule with the current UCC choice of law rule found in Existing § 1105, updated and renumbered so it integrates with the remaining revision of UCC Article 1. That provision, now sanctioned by NCCUSL, is incorporated into the Act.

Current Pennsylvania law with respect to choice of law is found in Existing § 1105. It provides

- that the parties can agree that the law of “this state” (i.e., Pennsylvania law) applies to their transaction provided that “the transaction bears a reasonable relation to this state.”
- that in the absence of such an agreement as to applicable law, “this Act” (i.e., Pennsylvania’s UCC) applies to those transactions “bearing an appropriate relation to this state.”

The rule functions as a conflict of laws rule directing Pennsylvania courts (and federal courts sitting in Pennsylvania) to the appropriate law to apply in disputes that are brought in courts located in Pennsylvania.

Two examples can make clear how the rule limits the law that parties can currently choose in their contract.

- Suppose the parties agreed that Pennsylvania law would govern an out-of-state transaction that bore no relationship whatsoever with Pennsylvania. If a Pennsylvania court obtained jurisdiction over a dispute arising out of that transaction, the Pennsylvania court would not, under this rule, recognize the parties’ agreement that Pennsylvania law ought to govern it.<sup>11</sup> The court, instead, would look to the Pennsylvania conflict of laws rules to determine the law that ought to be applied to resolving the dispute before it.
- Suppose a Pennsylvania court got jurisdiction of a dispute between parties arising out of a transaction bearing no relationship with Pennsylvania and the parties had not specified the applicable law in their contract. Existing § 1105 does not speak directly to this question either since, by hypothesis, the transaction does not bear an “appropriate relation” to “this state.” The court would look to Pennsylvania conflict of laws rules to determine the appropriate law to apply to the dispute before it. It is extremely unlikely that the court would use Pennsylvania law in such a setting to resolve the parties’ dispute.

This current UCC rule is consistent with the Restatement (Second) of Conflict of Laws, § 187 which requires a relationship between the law that is applied (whether by choice or otherwise) and the transaction to be governed by it. The fact that the forum is in a given State does not, under modern conflict of laws principles, mean that the court will apply its own law to a dispute if there is no other connection to the forum’s law.

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<sup>10</sup>.Actually, the rule does not speak to this situation except indirectly; it only speaks to the situation where the parties have agreed to “this state’s” law and their transaction has a relationship with “this state.” Because the rule limits the parties’ choice of law to the law of a state with a reasonable relation to the transaction, however, the court would not, under Existing § 1105, recognize the choice of Pennsylvania law.

Proposed § 1-301 eliminates the requirement that there be any connection between the law chosen and the parties or their underlying transaction. In so doing, Proposed § 1-301 parts company with the Restatement (Second) of Conflict of Laws § 187 which courts are likely to apply in non-UCC transactions. In the first situation discussed earlier, the court, under Proposed § 1-301, would recognize the parties' choice of Pennsylvania (or any other) law despite the lack of any connection between that chosen law and the parties and their transaction.

As indicated above, twenty-two states now have in place Revised Article 1 without its proposed changes to the choice of law rule. At this point, the need for uniformity in the UCC argues strongly in favor of rejecting the changes to the choice of law rule in Proposed § 1-301 and enacting an updated version of Existing § 1105 as the other states have done.

Uniformity in the UCC is important for many reasons. It may be uniquely important with choice of law rules.

A choice of law rule is a rule that applies to the forum. Pennsylvania's choice of law rules apply in its courts, Maryland's apply in Maryland courts, and so on. A choice of law rule tells the forum how to choose the law it should apply in cases before the court.

Non-uniformity in choice of law rules creates a premium for forum shopping. To give a simple example, suppose the parties to a contract chose unrelated law to govern it. They would get enforcement of that provision only in a state that has enacted the Proposed § 1-301, and would not get enforcement of the contract provision in a jurisdiction with the "reasonable relationship" rule. As all litigators understand, it is impossible (even with a strong contractual choice of forum provision) to guarantee that the unknown future dispute will be litigated in the "right" state. Uncertainty of this kind simply cannot be eliminated at the contract drafting stage. While this may mean that parties will simply choose "related" law in order to eliminate the forum shopping uncertainty, policymakers should pause before enacting a rule that would create incentives for forum shopping.

There are no substantial problems with the rule now in place in Existing § 1105. The substance of that rule is substituted for Proposed § 1-301 and, as so revised, should be enacted.

**Course of Performance, Course of Dealing and Usage of Trade:** Existing Article 1, in § 1205, defines "course of dealing" and "usage of trade" and explains how the parties' course of dealing and the applicable usages of trade should be used to determine the meaning and supplement or qualify terms of an agreement. "Course of performance" was listed in Existing Article 1 as one element of an agreement, but this term was defined and given effect by Articles 2 and 2A. Existing §§ 2208 and 2A207 define "course of performance" and provide that the course of performance between parties is relevant in determining the meaning of an agreement between those parties.

Revised Article 1 changes this by expressly providing that the meaning of an agreement may be determined by the parties' course of performance, course of dealing, and applicable usages of trade. Therefore, Revised § 1303 incorporates into a single provision the course of

performance rules found in Existing §§ 2208 and 2A207. The inclusion of all three interpretive devices in Article 1 addresses some existing confusion among the courts, some of which have held that because course of performance is defined and given effect by Articles 2 and 2A, an agreement governed by other Articles of the UCC cannot be explained or supplemented by the parties' course of performance.<sup>12</sup> The revised provision clarifies the fact that the parties' course of performance can be used to interpret agreements in transactions governed by all of the substantive Articles of the UCC. Courts applying Pennsylvania law have used course of performance in interpreting agreements under other Articles of the UCC,<sup>13</sup> so this change reflects existing Pennsylvania law.

**Waiver or Renunciation of Claim or Right After Breach** Revised § 1306 is derived from Existing § 1107, but the new section makes two changes to existing law. First, the new section embraces medium neutrality. Whereas Existing § 1107 contemplates waiver or renunciation of a claim upon delivery of a "written waiver," Revised § 1306 requires such a waiver or renunciation to be in an "authenticated record." This change is consistent with changes throughout the UCC designed to give effect to electronic communication methods.

The second change to this section is substantive. Existing § 1107, which, as noted above, requires delivery of a written waiver or renunciation, merges the separate concepts of a party's agreement to forgo rights and the manifestation of that agreement. Revised § 1306 separates those concepts by explicitly requiring the agreement of the aggrieved party.

## VI. CHANGES TO ARTICLE 7

Article 7 is the last of the articles of the Uniform Commercial Code to be revised during the last decade. The genesis of this project is twofold: to provide a framework for the further development of electronic documents of title and to update Article 7 for modern times in light of state, federal and international developments. Revised Article 7 contains several substantive changes to current law and the Task Force recommends that Pennsylvania adopt all of these changes. The changes to existing law are described in this part of the Report.

Electronic documents of title and documents in tangible form are in regular use in commerce today. As time passes, the percentage of documents that are in electronic form increases and the percentage of documents in tangible form decreases. It has been estimated by one of the largest commercial ocean carriers serving the United States in foreign commerce that if it had to use only paper documents, commerce would come to a virtual standstill. The Customs Service now requires that all cargo manifests of all imports to the United States be filed in electronic form. However, the current language of Article 7, governing bills of lading, warehouse receipts, and other documents of title, speaks in language which was intended to

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<sup>12</sup> See, e.g. *Universal C.I.T. Credit Corp. v. Middlesboro Motor Sales, Inc.*, 424 S.W. 2d 409, 411 (Ky. 1968) ("UCC § 2-208] deals with sales only. As to secured transactions the code apparently does not contain a rule for varying a contract by performance.").

<sup>13</sup> See e.g. *Major's Furniture Mart, Inc. v. Castle Credit Corporation*, 449 F. Supp. 538 (E.D.Pa. 1978), *aff'd* 602 F. 2d 538 (3<sup>rd</sup> Cir. 1979) (applying the rules of § 2208 to an Article 9 transaction); *In the Matter of Penn Housing Corp.*, 367 F. Supp. 661 (W.D. Pa. 1973) (applying § 2208 to an Article 9 transaction).

apply only to paper documents, and can only be stretched to cover electronic documents with difficulty if at all. The proposed amendments deal with these issues and bring Article 7 into the modern electronic commercial world. They do so by (1) making changes to the definitional sections of the Article and adding substantive provisions to assure that the provisions are “media neutral” in their application; and (2) adding a few modest sections to Article 7 to eliminate any difficulties in the application of existing provisions in an electronic world. Many of these changes track provisions found in the Uniform Electronic Transactions Act and the 2001 Revised Article 9 of the Uniform Commercial Code, both of which have been enacted in Pennsylvania.<sup>14</sup> Conforming amendments to other Articles of the UCC are also necessary to fully integrate electronic documents of title into the UCC.

Article 7 was updated to take into account deregulation of affected industries. For example, references to tariffs are eliminated in Revised §§ 7103, 7204, 7309, 7403, and 7601 given the deregulation in the shipping industry. Section 7104 deleted the ability to make a document of title negotiable in international trade if it “runs to a named person or assigns” and allows parties to make a document non-negotiable at issuance by a conspicuous legend to that effect.

The organization of Revised Article 7 is identical to that of Existing Article 7 and several new sections have been added.

### **A. Part 1: General**

**Definitions:** Revised Article 7, in § 7102, adds several new definitions to existing law. The new definitions of “Carrier” and “Shipper,” both bailees under current law, have been added for clarification. The bulk of the definitions that accommodate electronic commerce are being incorporated into Article 1. Those definitions are the definitions of “bearer,” “bill of lading,” “delivery,” “document of title,” “holder,” and “warehouse receipt.”

The most important definitional change is in the definition of “document of title.” The current definition, in Existing §1201, defines the term in paper terminology, referring to documents that can be “possessed.” The current definition does not explicitly provide for documents of title that are in electronic form. By contrast, the new definition describes a document of title as a “record,” which, as explained above in our explanation of the Revised Article 1 definitions, is a term that includes information written on paper and information stored in electronic form. Revised Article 7 also explicitly defines “electronic document of title” within the definition of document of title. The new definition also adds the concept of control, the electronic analogue to possession. Therefore, under the new definition, a paper document can be in the possession of a person while an electronic document can be in the control of a person. Revised Article 7 defines control in a separate section, § 7106, explained below.

The remaining new Article 1 definitions related to documents of title, “bearer,” “bill of lading,” “delivery,” “holder,” and “warehouse receipt,” have all been revised to incorporate this

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<sup>14</sup> The Uniform Electronic Transactions Act is codified in Pennsylvania as 73 P.S. § 2260.101 *et seq.*, and Revised Article 9 of the Uniform Commercial Code is codified in Pennsylvania as 13 Pa. C.S. § 9101 *et seq.*

new definition of “document of title.” Importantly, the definitions of “bearer” and “holder,” which are currently terms that refer to persons in possession of paper documents of title, have been expanded to include persons in control of electronic document of title. Likewise, the definition of “delivery” adds the voluntary transfer of control of an electronic document to the existing definition of delivery, which is the voluntary transfer of possession.

Article 7 also adds the definition of “sign,” which includes the use of both written signatures and electronic authentication methods. The Article 7 definition of sign includes the definition of “electronic signature” from the Pennsylvania Electronic Transactions Act and the federal E-Sign Act.

**Relation to Other Law:** Revised § 7103, "Relation of Article to Treaty or Statute," deletes references to tariffs and classifications that no longer track modern commercial practice, and includes additional references to the federal E-Sign Act and the Pennsylvania Electronic Transactions Act that are pertinent to electronic document of title systems. Although the textual language in Revised Article 7 differs substantially from existing law, the changes are unobjectionable. In short, Revised Article 7 provides: (i) that it is subject to treaties, federal law and relevant state law and regulation; (ii) that it does not modify or repeal any law imposing requirements on the form or content of documents of title; (iii) that it modifies E-Sign; and (iv) that Revised Article 7 prevails to the extent there is a conflict between the Pennsylvania Electronic Transactions Act and Revised Article 7.

**Negotiable and Non-Negotiable Documents of Title:** Revised § 7104, "Negotiable and Nonnegotiable Document of Title," incorporates changes for style, trade practice and medium neutrality and adds a new subsection. The changes are not important substantive changes. Under both the existing and revised versions of Article 7, a negotiable document of title is one by whose terms the goods are delivered to bearer or to order of a named person. A document of title that does not meet the foregoing prerequisites is nonnegotiable. A document of title, whether tangible or electronic, may be negotiable if the document meets the requirements of this section. Subsection (c) of Revised § 7104, which is new, derived from § 3104(d), provides that a document of title is not negotiable if, at its issuance, an issuer places a legend on the document that it is not negotiable. Once issued as negotiable, a document of title cannot be changed to a nonnegotiable document of title. Likewise, once issued as nonnegotiable, a document of title cannot be changed to negotiable by placing a notation on the document that it is negotiable.

**New Provisions Relating to the Use of Electronic Documents of Title:** Revising Article 7 to encompass electronic as well as paper documents presented two new issues that are dealt with in new sections in Article 7. The first question was how to deal with documents of title that were created in one medium, *e.g.*, paper, and were later converted to another form, *e.g.* electronic media. Revised § 7105, “Reissuance in Alternative Medium,” is a new article that pertains to electronic documents of title, which did not exist when the existing law was adopted. As explained above, Revised Article 1 changes the definition of document of title so that the document of title is required to be in a “record” as opposed to a “writing,” in order to accommodate electronic documents of title. The definition of “record” in Revised § 1201 provides for two formats, electronic and tangible. An electronic document of title is a document of title evidenced by a record consisting of information stored in an electronic medium. A

tangible document of title is a document of title evidenced by a record consisting of information inscribed on a tangible medium. Although the issuer of the document of title determines the initial format of the document of title, Revised § 7105 allows for a tangible document of title to be converted to an electronic document of title or vis versa. Pursuant to § 7105, a person entitled under the document of title may request the issuer to reissue the document of title in the alternative medium. In connection with the reissue, the person entitled under the original document of title must surrender possession or control and warrant that he was the person entitled under the original document of title. The substitute document of title must contain a notation stating that it was issued in substitution of the original document of title.

The second question was how to construct the electronic equivalent of “possession” of tangible documents of title. Revised Article 7 does this through the concept of “control” of electronic documents of title, a concept that is drawn from the Uniform Electronic Transactions Act and Revised Article 9 of the U.C.C.. Revised § 7106, “Control of Electronic Documents of Title,” is the new section that defines the concept of control as the substitute for possession and indorsement of a tangible document of title. Revised § 7106 sets out a standard for control and a set of criteria that, if met, means a person has control. The essence of the control definition is that the system employed must reliably establish that the person to whom the electronic document of title was issued or transferred has control of that document. Third party registration systems satisfy this requirement. However, Revised Article 7 does not preclude the development of different systems, so long as the system meets the requirements of Revised § 7106. Other sections were amended to integrate the control concept of § 7106 for electronic documents of title in the same way that possession is important for tangible documents of title. Examples include Revised § 7303 (consignee in possession or control of document of title giving directions regarding the goods), Revised § 7305 (surrendering possession or control of a document of title in order to procure a substitute document), Revised § 7403 (surrendering possession or control of a document of title when receiving delivery of the goods), Revised § 7502 (rights of due negotiation when person deprived of possession or control of negotiable document of title), Revised § 7601 (court orders issuance of substitute documents when possession or control of original document not surrendered), and Revised § 7602 (judicial process when possession or control of negotiable document of title not surrendered to bailee).

## **B. Part 2: Warehouse Receipts: Special Provisions**

Several of the sections in Part 2 of Article 7 were revised to reflect style changes only. The remaining changes in Part 2 fall into two categories: changes made to incorporate the use of electronic documents of title and changes made to reflect modern practices in the industries in which documents of title are used.

**Changes Made to Accommodate Electronic Commerce:** Two provisions within Part 2 were revised to eliminate paper-based references. Existing § 7202 sets forth a number of terms that must be in a warehouse receipt and requires that a warehouse receipt contain a “consecutive number.” Revised § 7202 adapts that requirement for the electronic world and instead requires that a warehouse receipt contain a “unique identification code.” This unique identification code can include any combination of letters, numbers, signs and/or symbols and thus accommodates the use of electronic documents of title.

Existing § 7210 sets forth requirements with which a warehouse must comply in order to enforce its warehouse lien. Before enforcing its lien, the warehouse must deliver notification to all persons known to have an interest in the goods subject to the lien. Under the existing provision, this notice must be delivered in person or by registered or certified mail. Revised § 7210 eliminates this requirement. As a result, notification may be sent by any reasonable means as provided in Revised § 1202, including electronic means of notification.

**Changes Made to Reflect Modern Practices:** Existing § 7204 allows a warehouse to limit its liability for breach of its duty of reasonable care if the warehouse sets forth the limitation in a warehouse receipt or storage agreement per article or per unit of weight. This requirement has been deleted as it is inconsistent with modern industry practice. Therefore, while Revised § 7204 continues the standard of reasonable care, the warehouse can limit its liability without stating the limitation per article or per unit of weight.

Existing § 7209 provides for a warehouse lien in goods covered by a warehouse receipt. Revised § 7209 recognizes a warehouse lien when there is a storage agreement between the bailor of the goods and the warehouse. This change reflects the fact that in the modern warehouse, the bailor and bailee may enter into a master contract governing the bailment with the bailor and bailee keeping track of the goods stored pursuant to the master contract by notation on their respective books and records. In such an arrangement, the parties send notification by electronic communication as to what goods are covered by the master contract and warehouse receipts are not issued.

### **C. Part 3: Bills of Lading: Special Provisions**

The changes made to Part 3 of Article 7 were made primarily to reflect modern commercial practices. For example, terminology in Revised §§ 7301 and 7302 reflects international practice. As a result, Revised § 7301 replaces the word “freight” with the word “goods” to conform with domestic and international land transport usage in which “freight” means the price paid for carriage of goods and not the goods themselves. Therefore, this is a clarifying change. In addition, Revised § 7302 modifies the language of Existing § 7302 to conform with recent proposals of the United Nations Commission on International Trade Law and the Organization of American States concerning transportation and through bills of lading. The change in terminology is not substantive.

The one substantive change to Part 3 is in Revised § 7307, which provides that a carrier’s lien extends to the proceeds of the goods covered by the bill of lading. Existing § 7307 provides only that the carrier has a lien on the goods. Under Existing § 7307, a carrier, to preserve and enforce its lien, may be forced to refuse to release goods to the consignee, even where the proceeds of the goods would be sufficient to satisfy the carrier’s unpaid charges. The proposed section facilitates the conduct of commercial transactions where the carrier’s charges are in dispute by providing a mechanism by which the carrier’s interest in payment for its services is protected, without disrupting the flow of commerce.

### **D. Part 4: Warehouse Receipts and Bills of Lading: General Obligations**

All of the changes in this part accommodate electronic documents of title and conform to modern drafting style. The definition of “person entitled under the document” has been moved from Existing § 7403 to Revised § 7102.

#### **E. Part 5: Warehouse Receipts and Bills of Lading: Negotiation And Transfer**

Most of the changes in this part accommodate electronic documents of title. Significantly, Existing § 7501 sets forth the requirements for negotiation of documents of title. Revised §§ 7501 and 7502 continue the rules applicable to due negotiation and its effects, except that they comprehend electronic documents of title. In general, a transferee may obtain greater rights than its transferor if the purchase is made for value, in good faith and without notice of defenses or claims unless the negotiation is not in the regular course of business Part 5 also contains references to Article 2A of the UCC governing leases of goods, references that are not contained in Existing Article 7.

#### **F. Part 6: Warehouse Receipts and Bills of Lading: Miscellaneous Provisions**

The only substantive change in Part 6 is to § 7601, relating to lost, stolen or destroyed documents of title. When a document of title is lost, stolen or destroyed, a court may order delivery of the goods or delivery of a substitute document of title. Under Existing § 7601, a claimant under a missing document of title is required to post security to indemnify any person who may suffer loss as the result of non-surrender of the document. Revised § 7601 provides an exception to this requirement when other possible claimants are adequately protected. This provision gives courts flexibility similar to that provided to courts by § 3309, governing lost, stolen or destroyed negotiable instruments.

#### **G. Part 7: Miscellaneous Provisions**

This Part is new. It provides an effective date and specifies that the Act will apply only to a document of title that is issued or a bailment that arises on or after the effective date of the Act.