

**How the Uniform
Commercial Code
Affects
Transactions with
Small Businesses**

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12:30 – 2 p.m. ET



**NEW YORK
CITY BAR**



Program Faculty

Introduction of Faculty

Professor Neil Cohen: 1901 Distinguished Research Professor of Law, Brooklyn Law School; Director of Research of the Permanent Editorial Board for the Uniform Commercial Code; and American Law Institute, Member.

Eric Marcus: City Bar Commercial Law & Uniform State Laws Committee, Member and Retired Partner, Arnold & Porter Kaye Scholer LLP.

Brian Rauer: City Bar Task Force Subcommittee on Cybersecurity, Privacy and Data Protection, Co-Chair; City Bar Consumer Affairs Committee, Member; and General Counsel and Executive Director, Better Business Bureau of Metropolitan New York and Mid-Hudson BBB.

Edwin Smith: City Bar Task Force Subcommittee on Articles and Blogs, Co-Chair; City Bar Commercial Law & Uniform State Laws Committee, Member; Massachusetts Uniform Law Commissioner; ULC/ALI Drafting Committee for the 2022 Amendments to the Uniform Commercial Code to address Emerging Technologies, Chair; Permanent Editorial Board for the Uniform Commercial Code, Member; and Partner at Morgan, Lewis & Bockius LLP.

Program Goals

- To assist small businesses in recognizing the relevance and applicability of the Uniform Commercial Code (UCC) to many common business transactions

Program Goals

- To explain and highlight how the UCC provides for the standardization of commerce/commercial law across states

Program Goals

- To explain and highlight that when business is conducted beyond the home state of the small business, the UCC will be relevant to the transaction

Program Goals

- To explain and highlight the value of the UCC in resolving a contractual dispute with vendors; when leasing equipment; when selling goods; when purchasing inventory; and when borrowing funds

Program Goals

- To demystify the UCC through real-world examples of its impact on - and value to – small businesses

Program Goals

- To engage small businesses in a pragmatic business discussion about the UCC

What is the Uniform Commercial Code?

- State law addressing common commercial transactions
 - Long history dating back to the 1940's
- Sponsored by the American Law Institute and the Uniform Law Commission and submitted to the states for enactment
- Intended to be adopted by states on a uniform basis so as to create efficiencies on interstate transactions and reduce transaction costs
- Is found in the general laws of each state including New York
- Has been highly successful in practice and application

What is the Uniform Commercial Code?

- The UCC is generally organized into separate Articles focusing on the life cycle of a typical commercial transaction:
 - Buyer purchases goods from a seller (Article 2) or leases goods from a lessor (Article 2A)
 - Buyer pays for the goods by check (Article 3) or by wiring funds (Article 4A)
 - Buyer arranges for a letter of credit in favor of the seller or lessor to assure the seller or lessor that the buyer will pay for the goods (Article 5)

What is the Uniform Commercial Code?

- The UCC is generally organized into separate Articles focusing on the life cycle of a typical commercial transaction:
 - The goods are stored in a warehouse for which the buyer receives a warehouse receipt or are shipped to the buyer under a bill of lading (Article 7)
 - To obtain the funds to pay for the goods the buyer borrows funds and gives the lender a security interest in the goods and other collateral (Article 9)
 - The seller or lessor may in turn obtain secured financing or may sell its rights to payment to a factor (Article 9 and, for some electronic invoices, proposed Article 12)

Article 2 – Sale of Goods

- *Consider a small grocer that buys its inventory from a distributor. Why is the UCC relevant to the inventory purchases?*
 - Grocer is trading money for goods – a contract
 - UCC Article 2 governs sale of goods
 - Same law in all states (except LA), so location of distributor does not change the rules
 - Article 2 determines:
 - when a deal is binding
 - when a deal has to be in writing (or its electronic equivalent)
 - what quality standards the goods must meet
 - what remedies are available to the grocer if the distributor does not live up to its obligations

Article 2A – Lease of Goods

- *Let's say that the grocer leases computer terminals and some trucks and vans to make deliveries to customers. Why is the UCC relevant to those leases?*
- Addresses leases (and subleases) of goods
 - A lease is a transfer of right of possession and use of goods for a term in return for consideration, but excludes a sale
 - May be difficult to distinguish between an installment sale and a true lease, but UCC provides guidance

Article 2A – Lease of Goods

- *Key concepts*
 - Provides standard terms and conditions, such as warranties, risk of loss, ability to sell leasehold interest or sublease goods, statute of limitations and rights and remedies after default
 - Many of these terms can be waived or varied by the lease contract
 - “Finance Lease” (as defined in Article 2A)
 - Three-party arrangement among a supplier, lessor and lessee, where the lessee orders the goods from the supplier, and the supplier sells the goods to the lessor for lease to lessee.
 - Special provisions apply to finance lease, recognizing that supplier (not the lessor) is the primary responsible party.
 - Supplier’s warranties and other promises to the lessor under the supply contract are extended to the lessee
 - No implied warranty of merchantability or fitness for a particular purpose
 - “Hell or high water” provision: upon lessee’s acceptance of the goods, lessee’s payment obligations become irrevocable (provided finance lease is not also a consumer lease).

Article 3 – Negotiable Instruments

- *The grocer paid one of the rental payments on a lease by check. But the check was intercepted by a fraudster who changed the payee line to the name of a similar company and cashed the check for deposit to the other company's account. The money is now gone, and the grocer had to issue a new check to the lessor. Does the UCC address that type of problem?*
- It provides rules for:
- when a bank can charge a customer's account
- how much time a customer has to notify its bank about a wrongfully paid check
- when a bank must recredit a customer's account for improperly paid checks
- who ultimately bears the loss resulting from check forgery

Article 4A Funds Transfers

- *The grocer is a little late on making a rental payment on one of the leases and needs to quickly get money to the lessor to avoid a default. How is the UCC relevant to the grocer doing that?*
- Addresses funds transfers by ACH, FedWire, RTP, FedNow and the like
- Key concepts
 - Customer's bank offers a “commercially reasonable security procedure” for “payment orders” submitted by the customer
 - The bank can generally rely on compliance with the procedure
 - The customer, though, has a “money back” guarantee if the bank makes a mistake on its end or the transfer does not otherwise go through
- Typically, the bank and the customer enter into a funds transfer agreement as part of the customer's account relationship with the bank

Article 5 – Letters of Credit

- *The grocer is leasing new space, and the landlord is requiring the grocer to provide a security deposit covering two months' rent. The deposit may be in the form of cash or a bank-issued letter of credit. What should the grocer do, and how is the UCC relevant?*
- An L/C should be less costly than a cash deposit.
- How does the L/C work? The bank issues a written agreement to pay the landlord an amount up to two months' rent upon the landlord's presentation to the bank of a signed statement that rent in the amount of \$___ is past due.
- What is the grocer's obligation? The bank will require the grocer to enter into a reimbursement agreement, in which the grocer agrees to reimburse the bank for any drawing. The bank may require the reimbursement obligation to be secured by collateral, such as certain business assets of the grocer. The bank will also require the payment of certain fees in consideration of the L/C.
- What if the grocer doesn't pay rent because of a dispute with the landlord? The landlord may still draw on the L/C, and the bank is obligated to pay, in the absence of forgery or material fraud. This is the "independence principle." The grocer may assert any dispute with the landlord in a separate claim against the landlord.

Article 5 – Letters of Credit

- *Other Provisions*
 - The L/C will likely incorporate certain internationally recognized terms and conditions:
 - UCP 600 (Uniform Customs and Practices)
 - ISP 98 (International Standby Practices)
 - Documentary L/C vs. Standby L/C

Article 7 – Documents of Title

- *Some of the grocer's dry goods inventory are purchased in bulk with a portion being stored for the time being in a local warehouse. How is the UCC relevant to storage at the warehouse?*
- Article 7 addresses warehouse receipts and bills of lading
 - Goods stored in a warehouse
 - Goods in transit by land, sea or air carrier
- Key concepts
 - Whoever controls the documents controls the goods
 - Negotiable vs. non-negotiable
 - Tangible vs. electronic
 - Warehouseman and carrier liens

Article 9 – Secured Transactions

- *The grocer needs a revolving credit line to borrow some funds to purchase inventory. The lender is willing to provide the credit line but only if the credit line is secured by collateral. How does the UCC facilitate that financing?*
- Addresses (1) interests in personal property or fixtures that secure an obligation and are created by contract and (2) sales of accounts and certain other intangible payment rights

Article 9 – Secured Transactions

- *Key Concepts*
 - Creation (attachment) of a security interest
 - Security interest is effective between the parties
 - Requirements: value, debtor has rights in the collateral, security agreement
 - Perfection of a security interest
 - Security interest is effective against third parties, including a bankruptcy trustee for the debtor
 - Requirements: filing of a financing statement, delivery of possession or control, depending on nature of collateral
 - Priority
 - Conflicting security interests generally rank in priority according to time of filing or perfection
 - But there are special priority rules for certain types of collateral
 - Enforcement

Article 12 (proposed in New York) – Controllable Electronic Records

- *The grocer’s distributor has offered a new contract to the grocer. In that contract, the grocer agrees to (a) receive electronically an invoice for each shipment to the grocer, (b) pay the person in “control” of the electronic invoice, and (c) not assert any claims or defenses against any other who obtains control of the invoice. What is that all about?*
- Grocer distributor is likely using new technology to get money right away by electronically assigning an electronic token representing its rights to payment from the grocer to a financial institution or the like.
 - Who must the grocer pay? How will it know?
 - What if the grocer would have a defense against the distributor – can it refuse to pay an assignee that has control of the invoice?

Questions & Answers

We would love to hear from you. How can we help? Any Questions?

Course Materials: *How the Uniform Commercial Code Affects Transactions with Small Businesses*

1. Report by the Task Force on Digital Technologies in Support of Enactment of the New York Version of the Amendments to the Official Text of the Uniform Commercial Code (2022) available at <https://www.nycbar.org/member-and-career-services/committees/reports-listing/reports/detail/emerging-technology-amendments-to-uniform-commercial-code>
2. City Bar Talking Points & Resources | NY Emerging Technologies Amendments to the UCC available at <https://www.nycbar.org/issues-policy/policy-department-resources/talking-points-resources-ny-emerging-technologies-amendments-to-the-ucc/>
3. New York UCC Article 2 (Sale of Goods) available at <https://codes.findlaw.com/ny/uniform-commercial-code/#!tid=NC41C5807C791452195526572BD7CF6FB>
4. New York UCC Article 2A (Lease of Goods) available at <https://codes.findlaw.com/ny/uniform-commercial-code/#!tid=N788F32DC98914571A15D5353A03A1405>

Course Materials: *How the Uniform Commercial Code Affects Transactions with Small Businesses*

5. New York UCC Article 3 (Negotiable Instruments) available at <https://codes.findlaw.com/ny/uniform-commercial-code/#!tid=ND333B17BF0D7483B827974496F09AC2B>
6. New York UCC Article 4A (Funds Transfers) available at <https://codes.findlaw.com/ny/uniform-commercial-code/#!tid=N2BCB1B1F9A1B4785A801932B82C9D0AA>
7. New York UCC Article 5 (Letters of Credit) available at <https://codes.findlaw.com/ny/uniform-commercial-code/#!tid=N991F88C87C544A70BDF503AFFBA108BA>
8. New York UCC Article 7 (Documents of Title) available at <https://codes.findlaw.com/ny/uniform-commercial-code/#!tid=N5F6A58A0960711E4A83F96C24911DE6F>
9. New York UCC Article 9 (Secured Transactions) available at <https://codes.findlaw.com/ny/uniform-commercial-code/#!tid=N351EA45E1A2D4E00AA2ACA5835809827>

NEIL COHEN

Professor

Neil B. Cohen, 1901 Distinguished Research Professor of Law, Brooklyn Law School, has taught courses in domestic and international commercial law, contracts, and conflicts of laws. For over two decades, Professor Cohen has been a key participant in major domestic and international law reform projects with respect to commercial transactions. In recognition of his accomplishments, Professor Cohen received both the American Law Institute's John Minor Wisdom Award and the Homer Kripke Lifetime Achievement Award of the American College of Commercial Finance Lawyers. He was the Reporter for Revised Article 1 of the Uniform Commercial Code and for the American Law Institute's Restatement of the Law of Suretyship and Guaranty. In honor of his accomplishments as Reporter for the Restatement, he was named as the Institute's R. Ammi Cutter Reporter. Professor Cohen currently serves as the Director of Research of the Permanent Editorial Board for the Uniform Commercial Code. In addition, he has been a member of several drafting committees for revising various articles of the Uniform Commercial Code, including the two most recent revisions of Article 9 (Secured Transactions), and has served as an adviser for several projects of the American Law Institute, including Principles of Software Contracts and the Restatement of the Law of Conflict of Laws.



ERIC MARCUS

Retired Partner

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Eric Marcus is a member of the City Bar Commercial Law & Uniform State Laws Committee.

Eric was a partner for 30 years in the law firm of Kaye Scholer LLP, where he was a member of the Banking and Finance Group in New York. He represented many U.S. and international banks and finance companies in securitization and secured lending transactions, with a particular emphasis on asset-backed commercial paper programs and trade finance and supply chain finance programs. Eric frequently represented banking institutions in programs for the purchase of accounts and drafts. He has extensive experience with cross-border transactions.

Eric was an active participant, as an Observer, from 2020 to 2022, in the Drafting Committee sponsored by ULC/ALI which prepared the 2022 Amendments to the UCC. Following the finalization of the 2022 Amendments, Eric turned his attention to working for the enactment of the 2022 Amendments in New York State. He was a member of the drafting subcommittee which prepared a report recommending the adoption of the 2022 Amendments in New York. Eric is the author of many articles on UCC and securitization topics, including *Bringing Drafts into the Digital Age*, Uniform Commercial Code Law Journal, May 2020, and *The Imperative for New York to Adopt the 2022 Amendments to the UCC*, New York Law Journal, December 6, 2023.



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Brian Rauer is the General Counsel and Executive Director, Better Business Bureau of Metropolitan New York and Mid-Hudson BBB. He is also a Co-Chair of the City Bar Task Force on Digital Technologies Subcommittee on Cybersecurity, Privacy and Data Protection and a Member of the City Bar Consumer Affairs Committee.

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He concentrates his practice in general commercial and insolvency law. He has been a member of the teaching faculty at Boston University Law School, Northeastern University Law School, Harvard Law School and Suffolk Law School. As a Uniform Law Commissioner for the Commonwealth of Massachusetts, he has served as a member of numerous Uniform Commercial Code and other commercial law drafting committees.