Section 1-208: "Good Faith" and the Need for a Uniform Standard

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COMMENT

SECTION 1-208: "GOOD FAITH" AND THE NEED FOR A UNIFORM STANDARD

I. INTRODUCTION

Uniform Commercial Code section 1-208 addresses the acceleration of an obligation by a creditor upon the belief that the debtor will not satisfy the debt. In particular, the section states that "[a] term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral 'at will' or 'when he deems himself insecure' . . . only if he in good faith believes that the prospect of payment or performance is impaired." Hence, creditors can accelerate obligations only if they do so in good faith. There has been considerable confusion, however, concerning the meaning of the term "good faith," and whether it is properly measured subjectively or objectively.

The trouble of defining "good faith" began at the Uniform Commercial Code's inception, and has now cursed the court system. "Good faith" under section 1-208 has been read by the courts to mean: 1) a purely subjective standard focusing on the creditor's state of mind; 2) a purely objective standard focusing on the creditor's state of mind; 3) negligence is irrelevant to good faith. The standard is what plaintiff actually knew, or believed he knew, not what he could or should have known. Because plaintiff believed defendant had been denied a loan, and acted in accordance with that belief, he acted in good faith.

2. See infra notes 35-52 and accompanying text.
3. E.g., Farmers Coop. Elevator, Inc. v. State Bank, 236 N.W.2d 674, 678 (Iowa 1975) ("The Elevator has not adduced substantial proof that the Bank's concern about the security of its loans, whether or not reasonable, was not genuine or that the Bank had an ulterior motive."); Fort Knox Nat'l Bank v. Gustafson, 385 S.W.2d 196, 200 (Ky. 1964) ("It must be remembered that here we are dealing with the good faith belief of the bank—that is, its state of mind." (emphasis added)); Van Horn v. Van de Wol, Inc., 6 Wash. App. 959, 497 P.2d 252 (1972).

Even if plaintiff was negligent in not checking to determine whether defendant had in fact been denied a loan, negligence is irrelevant to good faith. The standard is what plaintiff actually knew, or believed he knew, not what he could or should have known. Because plaintiff believed defendant had been denied a loan, and acted in accordance with that belief, he acted in good faith.

tive standard utilizing the “reasonable man” analysis;\(^4\) and 3) a two-part combination of the objective and subjective standards.\(^5\) This confusion is not restricted to jurisdictional borders; rather, it exists among courts within a jurisdiction and even within a single courtroom. The result is that:

Acceptable conduct according to one court . . . may be completely unacceptable according to another . . . . As a result, contracting parties, and lenders in particular, face inconsistent determinations. They are then unable to project when the exercise of their rights under the loan agreements may be deemed in ‘bad faith’. Such inconsistency and unpredictability in a commercial setting significantly undermines the goals of uniformity and predictability which lie at the heart of the U.C.C.\(^6\)


For a brief discussion concerning the two-tiered test, see Note, Standards For Insecurity Acceleration Under Section 1-208 of the Uniform Commercial Code: A Proposal For Reform, 13 MICH. J.L. REFORM 623, 634-35 (Spring 1980).

Because the consequences of accelerating debt obligations are so great, as lenders can lose as much as $18.5 million if acceleration is made in bad faith, and debtors can lose everything they own in bankruptcy if acceleration is made in good faith, the need for one uniform standard clearly exists. Part II of this comment will illustrate the inconsistencies developed by the drafters of section 1-208. Part III will demonstrate the inconsistent application of this section by the courts. The concluding sections of the article present a recommendation and support for that recommendation.

II. GOOD FAITH AND SECTION 1-208

A. The Origin of Good Faith

Although principles of “good faith” can be traced to the Bible and various writings from biblical times, the term “good faith” evolved from Roman law with respect to informal consensual commercial contracts.


9. E.g., Exodus 20:15 (“[t]hou shalt not steal”). There is established authority stating that “[t]his Commandment has a wider application than theft and robbery.” J.H. HERTS, THE PENTATEUCH 299 (1960). Referring to the same Commandment, M. Friedlander comments:

There are transactions which are legal and do not involve any breach of the law, and which are yet condemned by the principles of morality as base and disgraceful. Such are all transactions in which a person takes advantage of the ignorance or embarrassment of his neighbour for the purpose of increasing his own property.

Eisenberg, Good Faith Under the Uniform Commercial Code—A New Look at an Old Problem, 54 Marq. L. Rev. 1, 10 n.45 (1971) (citing M. FRIEDLANDER, THE JEWISH RELIGION 294 (1891)).

10. See Eisenberg, supra note 9, at 10 (“[l]et the property of thy fellowman be as dear to thee as thine own” (quoting Aboth 2:12); “[w]hat is displeasing to thee, that do thou not to others” (quoting BABYLONIAN TALMUD, Shabbath 31a); and “[t]hou shalt love thy fellowman as thyself” (quoting Leviticus 19:18)).

In fact, many scholars believe that the canon law of the Roman Catholic Church put religious and moral ideas into legal form by prescribing the enforcement of high standards of good faith and fair dealing in mercantile law. See, e.g., H. BERMAN, LAW AND REVOLUTIONS: THE FORMATION OF THE WESTERN LEGAL TRADITIONS 344-45 (1983); Comment, infra note 15; S. HOLDSWORTH, A HISTORY OF ENGLISH LAW 79-81 (2d ed. 1937).

11. Comment, supra note 6, at 919.

In the sixth century, Emperor Justinian introduced the notion of good faith in the CORPUS JURIS CIVILIS (“law of the land”), a chronological compilation of the academic Roman law of which included the law of the Twelve Tables (promulgated in the stone, 451 B.C.); the law of
involving sale, partnership, hire and mandate. When any of the aforementioned consensual contracts were in dispute, and the Roman judges and jurists decided in favor of the plaintiff, the court directed the defendant to pay the plaintiff whatever the judge:


found to be due ex bona fides, that is to say, in accordance with the requirements of good faith; and this cast on the judge, or rather the jurists who advised him, the burden of deciding what the defendant ought in good faith to have done, in other words what kind of performance the contract called for. This meant that, in contrast to the stipulation, where all the terms had to be expressed, the parties would be bound not only by the terms they had actually agreed to, but by all the terms that were naturally implied in their agreement.

In the eleventh and twelfth centuries, the principle of "good faith" emerged in Europe as an important part of its mercantile law system. The growth of commercial transactions produced a class of professional

12. Consensual contracts were enforceable agreements formed by mere consent between the parties. See F.H. Lawson, A COMMON LAWYER LOOKS AT THE CIVIL LAW 116-17 (1955).

13. Comment, supra note 6, at 919. In particular:

[s]ale was the most extensive of the Roman consensual contracts; it was used for the creation of obligations to transfer things in perpetuity for a price calculated in money. Hire comprised all contracts where one person placed anything, including his own services, temporarily at the disposal of another, and money was to pass, with one exception: contracts for services which created an agency relationship, such as services of a lawyer, fell not under hire, but under mandate. Partnership comprised all cases where two or more parties agreed to pool money or other property, knowledge, skill, or experience for a common purpose. Unlike its counterpart in modern law, partnership under Roman consensual contracts need not be for profit. Mandate was a form of agency and comprised all cases where one person gratuitously undertook to carry out a task imposed on him by another. All in all, the consensual contracts covered virtually every aspect of everyday Roman business operations except the loan of money and certain types of security.


It is important to note that Professor Farnsworth states that "good faith" was used in classical Roman law in the same sense in which it is used in the Uniform Commercial Code's general obligation of good faith performance. Its significance was in implying terms in the agreement. It was not until a later period of Roman law that "good faith" came to be used in the sense of good faith purchase. Id. at 670. For a discussion concerning good faith performance versus good faith purchase, see infra notes 20-34 and accompanying text.

15. Comment, supra note 6, at 920 (citing Berman, supra note 10, at 334). "It was at this period in history that commentators feel that religious and moral ideas 'colored the economic thought' of the European nations." Id.
merchants in Europe which required a new body of mercantile law. The system that developed to meet this new class's needs focused on reciprocity of rights. Professor Berman\(^\text{16}\) explains reciprocity of rights as "‘involv[ing] something more than mere exchange . . . [I]t involves, ideally, the element of equality of burdens and or benefits as between the parties to the transaction—the element, that is, of fairness of the exchange.'"\(^\text{17}\)

By the eighteenth century, English common law had completely absorbed the mercantile law and its interest in good faith.\(^\text{18}\) However, by this time the term "good faith" was being applied in two fundamentally different senses: good faith performance and good faith purchase.\(^\text{19}\)

### B. Good Faith Performance Versus Good Faith Purchase

Transactions involving good faith performance describe the term "good faith" as having "nothing to do with a state of mind—with innocence, suspicion, or notice. Here the inquiry goes to decency, fairness or reasonableness in performance or enforcement."\(^\text{20}\) Good faith performance relates

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17. Comment, supra note 6, at 920-21 (quoting H. Berman, supra note 10, at 344).

18. The principle of procedural reciprocity was highly developed in the jurisprudence that accompanied the Papal Revolution. The canon law, in particular, stressed principles of equity in contract formation. As a pledge of faith gave the ecclesiastical courts jurisdiction over contracts, so good faith (bona fides) was itself a necessary test of the sanctity of the contractual undertaking.

Berman, supra note 10, at 344-45.

19. Comment, supra note 6, at 921 (citing Farnsworth, supra note 14, at 670); accord Eisenberg, supra note 9, at 9; Recent Development, Implied Covenants of Good Faith and Fair Dealing: Loose Cannons of Liability for Financial Institutions?, 40 VAND. L. REV. 1197, 1202 (1987) (authored by Patricia Milon). Professor Farnsworth stated:

While the varieties of good faith are not quite as infinite as those of religious faith, it would be quite extraordinary if this protean concept were used in the same sense in all of these assorted instances. We may count ourselves fortunate that we need speak of good faith in but two senses.

Farnsworth, supra note 14, at 668.

20. Farnsworth, supra note 14, at 668.

Some illustrative Code sections governing good faith performance follow:

1) U.C.C. §§ 2-305(2) and 2-311(1) (1988) state that when a term, price or performance is left open to be fixed at a later date, the party is to fix them in good faith.
back to the Roman application of good faith,21 "resulting in an implied term of the contract requiring cooperation on the part of one party to the contract so that another party will not be deprived of his reasonable expectations."22 Meanwhile, in transactions that require a good faith purchase, good faith "is used to describe a state of mind: A party is advantaged only if he acted with innocent ignorance or lack of suspicion. This meaning of 'good faith' is very close to that of lack of notice."23 The good faith purchase standard developed in the English courts by the early 1800s as a response to the growing desire for free trade of goods and the marketability of commercial paper.24

2) U.C.C. § 2-306(1) (1988) requires that seller's output or buyer's requirements be in good faith.
3) U.C.C. § 2-603(3) (1988) provides that a merchant buyer must effect salvage in good faith when left in possession of rightfully rejected goods.
4) U.C.C. § 9-318(2) (1988) allows modifications to be made to a contract when they are made in good faith.
21. See supra note 13 and accompanying text.
22. Farnsworth, supra note 20, at 669.
23. Id. at 668.
Professor Farnsworth also cites illustrations of good faith purchase within the Uniform Commercial Code:
1) U.C.C. §§ 3-205 and 3-302 (1988) provide a holder in due course status to a good faith purchaser of a negotiable instrument.
2) U.C.C. § 2-403(1) (1988) gives good title from a seller whose own title was voidable due to fraud if buyer purchased the item in good faith.
3) U.C.C. § 7-404 (1988) gives protection to a warehouseman or carrier on the receipt of stolen goods if he receives and delivers the goods in good faith.
4) U.C.C. § 3-417(1)(c) (1988) affords the drawee bank protection from the acceptance and subsequent payment as an altered check if the drawee bank paid in good faith.
24. Comment, supra note 6, at 921-22 (citing Farnsworth, supra note 14, at 670).
In Lawson v. Weston, 4 Esp. 56, 170 Eng. Rep. 640 (K.B. 1801), the King's court ruled that a holder of a negotiable instrument need not make a diligent inquiry upon negotiation. Farnsworth, supra note 14, at 670 (citing Lawson, 4 Esp. 56, 170 Eng Rep. 640). To require such an inquiry "could be at once to paralyze the circulation of all the paper in the country." Id. (quoting Lawson, 4 Esp. 56, 170 Eng. Rep. 640). Thus, Lord Kenyon introduced the subjective test of good faith — "the test of the 'pure heart and the empty head.'" Id.
In Gill v. Cubitt, 3 B. & C. 466, 107 Eng. Rep. 806 (K.B. 1824), however, the subjective test was discarded for an objective test — the prudence and caution of a reasonable man. Farnsworth, supra note 14, at 640.
However, by 1836 Gill had been overruled by Goodman v. Harvey, 4 A. & E. 870, 111 Eng. Rep. 1011 (K.B. 1836). Farnsworth, supra note 14, at 670.
For an in-depth analysis of the development of the good faith standard for good faith purchase specifically as it relates to negotiable instruments law, see Comment, Holder in Due Course - - The Requirements of Good Faith and Notice, 28 MD. L. REV. 145 (1968); see also W. BRITTON, HANDBOOK OF THE LAW OF BILLS AND NOTES 246 (2d ed. 1961); W. HAWKLAND, CASES AND MATERIALS ON COMMERCIAL PAPER AND BANK DEPOSITS AND COLLECTIONS 196-200 (1967);
By the end of the nineteenth century most American states had adopted the same subjective standard for good faith purchase.25 "As a result of the attention directed toward good faith purchase and the neglect of good faith performance, two general misconceptions arose: first, that the obligation of good faith governed only purchase and, second, that the only proper test of good faith was a subjective one."26

By the end of the twentieth century, "good faith" had long been incorporated into various laws within the United States.27 Field used it in drafting his New York Civil Code;28 Chalmers in the British Bills of Exchange and Sales of Goods Acts; Crawford in the Negotiable Instruments Law;29 and Williston in the Uniform Sales Act, Uniform Warehouse Receipts Act, and Uniform Bills of Lading Act.30 The drafters of the Uniform Commercial Code made frequent references to the standard of good faith.31 Indeed, there are several federal statutes that reference a good faith standard.32 However, the notion of good faith was largely limited to good faith


25. Farnsworth, supra note 14, at 670 (citing Goodman v. Simonds, 61 U.S. 343, 367-70 (1857)).

Out of approximately fifty references to good faith contained in the uniform acts, not once is the standard used in the sense of good faith performance. Farnsworth, supra note 14, at 671.

26. Comment, supra note 6 at 922-23 (citing Farnsworth, supra note 14, at 670).

27. Farnsworth, supra note 14, at 667.

28. "The offer of performance must be made in good faith by the party owing performance to the party who is entitled to the same, and the former must be ready and willing to perform his obligation . . . ." Farnsworth, supra note 14, at 667 n.6 (quoting Field's Civil Code § 642 (New York State Commissioners’ Draft of a Civil Code for the State of New York (1862))).

29. See Farnsworth, supra note 14, at 667.


31. There is express mention of "good faith" requirements in about fifty of the four hundred sections of the Uniform Commercial Code. Farnsworth, supra note 14, at 667.


In fact, for over a decade it has been the custom for graduating students of the University of Chicago Law School to take the "Karl Llewellyn" pledge: "[each will] work always with care and with a whole heart and with good faith." Id. at 667-68 (quoting the Chicago Lawyer's Pledge, Llewellyn, Jurisprudence — Realism in Theory and Practice 395 (1962) (brackets in original)).
purchase until the drafting of the Uniform Commercial Code. The drafters attempted to revive the Roman law objective test for determining whether a contracting party had performed in good faith. Their attempt blatantly failed regarding section 1-208.

Section 1-208 governs the lender's performance in accelerating a debt based on insecurity. The standard of good faith cross-referenced in section 1-208, however, has been interpreted by the courts as being purely subjective. Courts create an anomalous exception to the notion that good faith performance is to be measured by an objective standard when they allow acceleration due to insecurity to be measured by a subjective standard. The courts' confusion can be traced to the draftsmen's failure to consider the consequences of neglecting to distinguish transactions involving performance and purchase when they defined "good faith" under section 1-201(19).

C. Good Faith Under the Uniform Commercial Code

The initial draft of the Code provided only a general definition of good faith in Article 1, which was to be used for all purposes throughout the Code. The draft provided that "[u]nless otherwise agreed, in this Act: . . . 'good faith' means honesty in fact in the conduct or transaction concerned. Good faith includes good faith toward all prior parties and observance by a person of the reasonable commercial standards of any business

33. See, e.g., Financial Credit Corp. v. Williams, 246 Md. 575, 229 A.2d 712 (1967). In Williams, the court applied section 75 of the Negotiable Instruments Law (MD. ANN. CODE, § 75 (1957)), in effect at the time of the execution of the mortgage. The Williams court concluded that:

A purchaser lacks the good faith requisite for attaining holder in due course status only if he has actual knowledge of fraud or other defect . . . or if he consciously ignores facts which would lead him to discover the defect. The test is said to be subjective, for a purchaser may be a holder in due course, if he purchases with a "white heart" but an "empty head."

Id. at 584-85, 229 A.2d at 716.

The uniform acts which precede the Code refer to good faith over fifty times and not once is good faith used in terms of good faith performance. "A subjective test of 'honesty in fact' is used consistently throughout the uniform acts." Id. at 671; see also supra note 24.

The Uniform Commercial Code has placed significance on both good faith purchase and good faith performance. In the Code, good faith purchase refers mostly to the articles dealing with negotiable instruments and sales. (This is consistent with the development of a good faith purchase standard); see, e.g., supra note 23. On the other hand, good faith performance has a direct impact on all agreements governed by the Code. Comment, supra note 6, at 923; see also Sections cited supra note 20.

34. But cf. Comment, supra note 33, at 923 (The drafters have revived the notion of good faith performance and developed an objective standard for determining whether a party has performed in good faith. "Thus, far from being neglected in modern law, the doctrine of good faith performance has eclipsed the doctrine of good faith purchase in importance and general application.").

35. Farnsworth, supra note 14, at 673.
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or trade in which he is engaged.” Thus, the section added an objective standard to good faith purchase and good faith performance. In September 1950, the American Bar Association’s Committee on the Proposed Commercial Code of the Section on Corporation, Banking, and Business Law objected to the inclusion of the objective component. In a spirit of compromise, the drafters limited the general definition of good faith to its current “honesty in fact” standard, and inserted objective standards in several specific provisions. The draftsmen apparently believed that what

36. See Lawrence & Wilson, Good Faith in Calling Demand Notes and in Refusing to Extend Additional Financing, 63 IND. L.J. 825, 843 n.86 (1988) (citing U.C.C. § 1-201(16) (May 1949 Draft)).

37. An objective standard can be defined as an observance of reasonable commercial standards from the perspective of a reasonable man.

38. The drafters did not restrict good faith as defined in accordance with “reasonable commercial standards” to dealings between businesspeople, but provided only a single, unitary definition. Summers, supra note 30, at 207.

39. The American Bar Association’s committee gave three reasons for its recommendation: (1) belief that the average person and the average lawyer understand good faith to mean primarily “honesty;” (2) “observance of reasonable commercial standards” carries (with it) implications of usages, customs or practices which are ambiguous; and (3) reasonable commercial standards could freeze customs and destroy flexibility essential for growth of commercial practices.

Malcolm, The Proposed Commercial Code, 6 BUS. L. 113, 128 (1951); see also Braucher, The Legislative History of the Uniform Commercial Code, 58 COLUM. L. REV. 798, 812 (1958). Consider, as well, that the “subjective-objective” controversy raged for decades in the context of good faith purchase. See generally infra, note 106. Proponents of the subjective standard were not going to allow one hundred years of precedent (good faith purchase — subjective standard) to be changed by a general overriding definition in the Code.

But Professor Gilmore suggests a less “altruistic” motivation existed for limiting the obligation of good faith. G. GILMORE, THE AGES OF AMERICAN LAW 83-86 (1977) (practicing attorneys who participated in the drafting of the Code became more influential as the document reached its final stage).

40. It has been noted that the drafters were significantly influenced by formulations of good faith in the purchase context. Summers, supra note 38, at 208. Professor Summers stated:

In the early drafts, Karl N. Llewellyn, the chief draftsman of the code, had the purchase context very much at the forefront of his mind in drafting good faith definitions. See, e.g., U.C.C. § 10, comment (1948 Draft). No doubt many other scholars of commercial law were, at this time, thinking in the same vein. For example, one author stated: “In its customary setting in problems of bona fide purchase, a concept such as ‘good faith’ is necessary, and reasonably workable.” Honnold, Buyer’s Right of Rejection, 97 U. PA. L. REV. 457, 475 (1949).

Id. at 208 n.53.


42. E.g., U.C.C. § 2-103(1)(b) (1988) (defines “good faith” for merchants as including the observance of reasonable commercial standards); U.C.C. § 3-302(1)(b) (1988) (requires that a holder must take instrument in good faith); U.C.C. § 3-406 (1988) (protects the drawee bank that makes payment to customer in accordance with reasonable standards); U.C.C. § 3-419(3) (1988) (affords protection to person who deals in accordance with reasonable commercial standards with
would suffice in the purchase context would also suffice in other contexts (i.e., "good faith is good faith"). As Professor Farnsworth states: "The demise of the single, unitary definition of good faith . . . was one of the major casualties during the drafting of the Code."\(^4\)

The development of good faith performance and the history of the "good faith" definition in subsection 1-201(19) demonstrate the sacrifice made by the drafters in their selection of "honesty in fact." Section 1-208 by its nature concerns good faith performance — a creditor's acceleration of debt when he deems himself insecure. "Good faith performance properly requires some objective standard tied to commercial reasonableness."\(^5\)

This principle existed under Roman law\(^6\) and under pre-Code case law in this country,\(^7\) and it remains intact under most provisions of the Code.\(^8\) Professor Grant Gilmore, a drafter of the Code, stated that: "[T]he creditor has the right to accelerate if, under all circumstances, a reasonable man, motivated by good faith, would have done so."\(^9\) Professor Farnsworth added:

Good faith performance has always required the cooperation of one party where it was necessary in order that the other might secure the expected benefits of the contract. And the standard for determining what cooperation was required has always been an objective standard, based on the decency, fairness or reasonableness of the community and not on the individual's own beliefs as to what might be decent, fair or reasonable. Both common sense and tradition dictate an objective standard for good faith performance.\(^10\)

\(^{43}\) Summers, supra note 30, at 208.

\(^{44}\) E. Allen Farnsworth is a professor of law at Columbia Law University. He is often cited for the distinction made between good faith performance and purchase. His publications include: CONTRACT LAW IN THE USSR AND THE UNITED STATES; HISTORY AND GENERAL CONCEPT (1987); AN INTRODUCTION TO THE LEGAL SYSTEM OF THE UNITED STATES (1963); and a law review article; see FARNSWORTH, supra note 14.

\(^{45}\) Farnsworth, supra note 14, at 673.

\(^{46}\) Id. at 671.

\(^{47}\) See generally supra notes 10-13 and accompanying text.

\(^{48}\) See generally infra note 115 and accompanying text.

\(^{49}\) Farnsworth, supra note 14, at 672. See also list of U.C.C. sections with specific objective good faith provisions, supra note 42.

\(^{50}\) 2 G. Gilmore, SECURITY INTERESTS IN PERSONAL PROPERTY § 43.4, at 1197 (1965) (quoted in Sheppard Federal Credit Union v. Palmer, 408 F.2d 1369, 1371 n.2 (5th Cir. 1969)).

\(^{51}\) Farnsworth, supra note 14, at 672.
Yet the courts are led to apply a subjective test because no specific objective element is supplied in the text.\(^{52}\) Section 1-103 answers the courts' concerns. The drafters' sacrifice of the good faith performance and good faith purchase dichotomy has left the courts fumbling over which standard to apply in analyzing section 1-208 cases.

### III. COURTS' CONFUSION

Most courts rely on subsection 1-201(19) to define good faith.\(^{53}\) "'Good faith' means honesty in fact in the conduct of the transaction concerned."\(^{54}\) The courts have interpreted this phrase to be subjective in nature\(^{55}\) — a "white heart-empty head" test.\(^{56}\) An "honesty in fact" standard

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\(^{52}\) Note that although the U.C.C. sections listed, supra note 42, contain an objective element in the text, they still refer the reader to § 1-201 to define good faith.

\(^{53}\) The Uniform Commercial Code is composed of nine substantive articles. The first provides general definitions and principles applicable throughout the Code. Section 1-208 is contained in Article 1. Each official comment within a Code section cross-references to relevant definitions of cognate Code sections. Section 1-208 refers the reader to § 1-201 for the definition of "good faith." It is at this stage that the confusion begins.


\(^{54}\) U.C.C. § 1-201(19) (1988).

\(^{55}\) One of the strongest statements of this subjective approach appears in Werner v. Bergman, 28 Kan. 60 (1882). The Werner court held:

The only question at all material in such a case is whether the mortgagee [creditor] does in fact so feel (insecure); and if the mortgagee claims that he has such a feeling, and afterward on the trial testifies that at the time he took possession of property he had such a feeling, and if upon the facts of the case it is possible at all to believe that any person, however timid and fearful he might be, might have had such a feeling, then it should be held that the mortgagee had a right to take possession of the property.

*Id.* at 65; *accord*, American State Bank v. Holding, 189 Kan. 641, 371 P.2d (1962); City Loan & Sav. Co. v. Sheban, 65 Ohio App. 7, 29 N.W.2d 171 (1939) (note that Werner is a pre-Code case
requires the trier of fact\textsuperscript{57} to focus on the creditor's state of mind.\textsuperscript{58} The creditor need only have an honest belief that payment of the obligation is impaired. Under this standard there is no requirement that the belief be reasonable. Therefore, creditors are afforded an opportunity to abuse the drafters' initial intent—to protect the debtor.\textsuperscript{59}

A recent decision by the Kansas Supreme Court demonstrates the inequities of applying a subjective standard to section 1-208 acceleration clauses. In Karner \textit{v. Willis},\textsuperscript{60} a bank officer, knowing that the debtor was not delinquent on any payments and without any knowledge that the debtor was insolvent, exercised the bank's common law right to set-off.\textsuperscript{61} The officer claimed that he deemed the bank was impaired in its security based on

and thus the discussion of the scope of § 1-208, \textit{supra} notes 47-63, is inapplicable; \textit{see also} Farmers, 237 N.W.2d at 678; Eldon's, 296 Minn. at 133, 207 N.W.2d at 287.

\textsuperscript{56} Despite the apparent approval of the subjective "white heart-empty head" test (\textit{see supra} note 53 and accompanying text), there exists authority criticizing its use. \textit{See} W. \textsc{Hawkland}, \textsc{Bills and Notes }194-97 (1956); \textit{Recent Case}, 53 \textsc{Harv. L. Rev. }1200 (1940).

The "white heart-empty head" test has also been called the "blundering fool doctrine." \textit{See}, e.g., Schnitz \textit{v. American Trust \& Sav. Bank}, 152 Ill. App. 76, 78 (1909) ("A blundering fool may therefore be found to have acted in good faith, though under like circumstances a shrewd business man might be deemed to have acted in bad faith.").


\textsuperscript{58} \textit{McKay}, 92 N.M. at 185, 585 P.2d at 329 (Sutin, J., concurring).

\textsuperscript{59} \textit{See Note, supra} note 5, at 630 (citing Farnsworth, \textit{Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code}, 30 \textsc{U. Chi. L. Rev. }666, 672 (1963) and Official Comment U.C.C. § 1-208: "according to the Official Comment, the section was included in the U.C.C. to alleviate the confusion about 'the effect to be given to a clause which seemingly grants the power of an acceleration at the whim and caprice of one party.'" \textit{Id.} at 650 n.32.; \textit{see also} Universal C.I.T. Credit Corp. \textit{v. Shepler}, 164 Ind. App. 516, 329 N.E.2d 620 (1975):

It is clear that the drafters of the U.C.C. intended to promote commercial dealing and credit financing by permitting creditors to realize upon their security in doubtful situations without the necessity of a specific default.

It is however, equally clear that a purely subjective test is subject to arbitrary abuse. It would allow a creditor to be unreasonable and place the debtor in an unjust position since the creditor might at any time call the entire debt and require the debtor to prove the nonexistent state of mind of the creditor. Thus, under this interpretation, the Code would permit a creditor to destroy a viable contractual relationship without requiring him to justify his actions. \textit{Id.} at 524, 329 N.E.2d at 625-26.


\textsuperscript{61} Set-off is described as a remedy "employed by [a creditor] . . . to discharge or reduce [a debtor's] . . . demand by an opposite one arising from [a] transaction which is extrinsic to [the debtor's] . . . cause of action." \textsc{Black's Law Dictionary} 1230 (5th ed. 1979). A creditor reduces the amount he owes the debtor via bank accounts by the amount owed to him by the
his knowledge of the registration of a foreign judgment against the debtor. Yet only thirteen days after the set-off of $39,178.20, the bank loaned the debtor an additional $50,000 (partially secured by the collateral pledged for the original loan).\textsuperscript{62}

The court of appeals recognized that there certainly was evidence presented that, viewed objectively, the bank was not insecure, but that the test of good faith dictated by \ldots 1-208 is subjective and requires only honesty in fact \ldots . The court of appeals then applied the subjective test required by the statute and concluded that the trial court's finding of good faith was supported by substantial competent evidence.\textsuperscript{63}

A majority of the Kansas Supreme Court concluded that the lower court correctly decided this issue.\textsuperscript{64} Thus, even though the bank thought itself insecure, with the Kansas Supreme Court supporting this contention, the bank was willing to loan the same debtor an amount 125\% greater than the amount upon which it based its initial insecurity.\textsuperscript{65}

The confusion created by the drafter's use of subsection 1-201(19) in defining good faith in section 1-208 can be demonstrated in conflicting decisions among jurisdictions, confusion within state jurisdictional boundaries, and confusion even within one courtroom.

\textit{A. Conflicting Decisions Among Jurisdictions}

To illustrate the inequity of the nonuniform application of section 1-208, compare the outcomes in \textit{Van Horn v. Van de Wol, Inc.},\textsuperscript{66} and \textit{Richards Engineers, Inc. v. Spanel}.\textsuperscript{67}

In \textit{Van Horn}, the creditor deemed himself insecure on a loan taken to operate a golf course. The creditor based his action on an erroneous belief that the debtor had been denied additional financing, when in fact the debtor had not been denied a loan. The Washington Court of Appeals,

\begin{align*}
\text{Additional amount loaned to debtor} & \quad \text{Amount that debtor owed when bank deemed itself insecure} \\
\$50,000 & \quad \frac{\$39,178.20}{1.25} = 1.25 \\
& \quad 1.25 \times 100\% = 125\%
\end{align*}

\textsuperscript{66} 6 Wash. App. 959, 497 P.2d 252 (1972).
\textsuperscript{67} 745 P.2d 1031 (Colo. Ct. App. 1987).
using a subjective standard, held that the creditor's acceleration was in
good faith, and was therefore valid.\(^6\)

Similarly, in Richards, the debtors obtained a loan to operate their busi-
ness. The creditor deemed himself insecure when the debtors were unsuc-
sessful in obtaining additional financing. However, the Colorado Court of
Appeals suggested that a subjective test of insecurity would be wholly
unjust:

It would be highly inequitable to require less than reasonable
grounds in order to accelerate an entire debt based on insecurity,
especially in light of the more onerous burden placed on the debtor
by acceleration. The facts of the present case make clear the ineq-
uity of a purely subjective standard.\(^6\)

The result is that different treatment is afforded the debtor depending
upon the state in which he is doing business. Indeed, it must be noted that
the creditor in Washington was found to have acted in good faith based on
a mistake of fact, while, based upon similar facts in Colorado, the creditor
was found to have acted in bad faith.

\section*{B. Confusion Within State Jurisdictional Boundaries}

In Universal C.I.T. Credit Corp. \textit{v.} Shepler,\(^7\) a debtor brought a torti-
ous repossession action against his creditor. The parties had entered into
a retail installment contract containing an insecurity clause.\(^7\) Upon deem-
ing himself insecure, the creditor repossessed the collateral that the debtor
had pledged. The creditor claimed the collateral was not insured and the
debtor was behind on his payments. The court held that the good faith
provision governing the creditor's actions in section 1-208, in conjunction
with the good faith definition provided in subsection 1-201(19),\(^7\) must be
modified in order to have any real effect.\(^7\) In addition to “coming to that
fixation of the mind that their security was in jeopardy,”\(^7\) a creditor’s de-
termination must be one which would be made by a “reasonable man”
under the same set of facts or circumstances.\(^7\)

\begin{footnotes}
\item[68.] \textit{Van Horn}, 6 Wash. App. at 961, 497 P.2d at 254.
\item[69.] \textit{Richards}, 745 P.2d at 1033.
\item[70.] 164 Ind. App. 516, 329 N.E.2d 620 (1975).
\item[71.] An insecurity acceleration clause is a “[p]rovision in [a] contract that allows a creditor to
make an entire debt come due if there is good reason to believe that the debtor cannot or will not
\item[72.] \textit{See supra} notes 35-53 and accompanying text (discussing the relationship between § 1-
208 and § 1-201(19)).
\item[73.] \textit{Universal}, 164 Ind. App. at 520, 329 N.E.2d at 623.
\item[74.] \textit{Id.}
\item[75.] \textit{Id.} at 521, 329 N.E.2d at 626.
\end{footnotes}
A little over a year later, the same Indiana Court of Appeals held a creditor to a subjective, honest belief standard. In 1981, the Indiana Supreme Court reaffirmed the use of this subjective standard in another insecurity acceleration case. Similarly to the facts in Universal, the parties in this case had entered into a retail installment sale agreement containing an insecurity acceleration clause. The creditor deemed himself insecure and repossessed the debtor's collateral. The creditor argued that delinquent payments, the imposition of a lien on the collateral, and nonperformance by the debtor formed the basis for his insecurity. The court concluded that a secured party need not observe reasonable commercial standards, but must act with honesty in fact in the transaction. The confusion, unfortunately, does not end at this point.

The Indiana appellate court, in a 1983 decision, reinstated the use of the two-step determination of good faith. "A good faith belief under 1-208... means at least 'honesty in fact in the conduct or transaction concerned.' In addition, the determination of insecurity must have been objectively reasonable...." Thus, in one state, within a period of less than ten years, the courts have been confused at best. However, Indiana is not alone in its lack of a coherent definition of good faith.

C. Confusion Within the Courtroom

The definitional confusion has emerged even within single court opinions. In Reid v. Key Bank of Southern Maine, the appellate court examined the trial court judge's jury instructions outlining the standard of good faith and found that:

[T]he judge initially formulated two standards. First, he stated that the contract, as a whole, was subject to a "convenant of good faith and fair dealing." Second, with specific reference to the claim that Depositors inappropriately disposed of Reid's collateral, he stated that the bank had a duty to act in a "commercially reasonable manner." In seeing the latter standard, he cited Article 9 of the UCC. He then twice defined "good faith" in terms indicating a purely subjective standard. He concluded the instruction, however,

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78. Id. at 566, 419 N.E.2d at 122.
80. Id. at 1064.
81. See supra notes 66-69 and accompanying text.
82. 821 F.2d 9 (1st. Cir. 1987).
by reformulating the "good faith" test as including an objective standard of reasonableness.

The jury later requested that the judge clarify these instructions. In his new instructions, the judge clearly formulated a subjective standard for good faith. 83 Although a clear standard was enunciated at the conclusion of the trial, the jury had already been confronted with statements defining the law of the case as being both subjective and objective.

These cases demonstrate a clear need for a uniform standard for the good faith acceleration contained in section 1-208. The purpose for adopting a uniform code is uniformity, and this, in and of itself, warrants a uniform standard.

IV. THE NEED FOR A UNIFORM STANDARD

A. The Adoption of the Uniform Commercial Code

The Uniform Commercial Code 84 has been adopted in full by all states except Louisiana. 85 The Code can trace its genesis to preceding acts instituted by the National Conference of Commissioners on Uniform State Laws (National Conference of Commissioners). 86 By the late 1930s, these acts had clearly failed to fulfill their purpose of keeping up with modern com-

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83. Id. at 14.
84. The Uniform Commercial Code is "[o]ne of the Uniform Laws drafted by the National Conference of Commissioners on Uniform State Laws governing commercial transactions (sales of goods, commercial paper, bank deposits and collections, letters of credit, bulk transfers, warehouse receipts, bills of lading, investment securities and secured transactions)." BLACK'S LAW DICTIONARY 1373 (5th ed. 1979).
Wisconsin adopted the Uniform Commercial Code Official Text of 1958. Through the work of Justice John H. Wickhem and the Wisconsin Legislative Council, the Commercial Code was adopted in 1961 and became effective on July 1, 1965. Justice Wickhem was a member of the American Law Institute ("ALI") and advisor for Article 3 of the Code. For a discussion of the ALI, see infra note 91. COMMERCIAL CODE COMM., REPORT TO THE WISCONSIN LEGISLATIVE COUNCIL OF 1963 (1963) [hereinafter COMMERCIAL CODE COMM.].
86. In 1892, the American Bar Association created the National Conference of Commissioners on the Uniform State Laws to promote uniformity in state law on all subjects where deemed desirable and practicable. This Conference sponsored a number of "uniform acts" in the field of commercial law including the following:
commercial practices in a uniform manner. At the fiftieth annual meeting of

<table>
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<th>Act</th>
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<tr>
<td>Uniform Negotiable Instruments Law</td>
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<td>Uniform Warehouse Receipts Act</td>
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<td>Uniform Conditional Sales Act</td>
<td>1918</td>
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<tr>
<td>Uniform Trust Receipts Act</td>
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For acts less accepted, see R. Braucher & A. Sutherland, Commercial Transactions, Selected Statutes x-xi (1964 ed.) (Table of Statutes Adopted). But see Comment, Uniform Commercial Code Commentary, 8 B.C. INDUS. & COM L. REV. 568, 569-70 n.8 (1967) (authored by William Hicks) (suggests that all acts received widespread adoption).

For more information concerning the National Conference on Uniform State Laws, see Dunham, A History of the National Conference of Commissioners on Uniform State Laws, 30 LAW & CONTEMP. PROBS. 233 (1965); Schnader, A Short History of the Preparation and Enactment of the Uniform Commercial Code, 22 U. MIAMI L. REV. 1 (1967). For work undertaken by the Commissioners in recent years, see the reports in the Unification of L. Y.B. published by the International Institute for the Unification of Private Law:

- Pascal, Unification of L. Y.B. 435 (1947-52);
- Pierce, Unification of L. Y.B. 247 (1953-55);
- Barrett, Unification of L. Y.B. 199 (1956);
- Dezendorf, Unification of L. Y.B. 237 (1957);
- Dezendorf, Unification of L. Y.B. 141 (1958);

87. The purpose of the conference is best stated in the National Conference of Commissioners' Constitution:

- Its object shall be (1) to promote uniformity in state laws on all subjects where uniformity is deemed desirable and practicable; (2) to draft model acts on (a) subjects suitable for interstate compacts, and (b) subjects in which uniformity will make more effective the exercise of state powers and promote interstate cooperation; and (3) to promote uniformity of judicial decisions throughout the United States.

Legislative Research Comm'n Commonwealth of Kentucky, Uniform Commercial Code Analysis of Effect on Existing Kentucky Law, Report No. 49, at xxi (1957); General Assembly of Missouri, supra note 86, at 7.

Malcolm explained that:

The basic reason for the code was the recognition that, during the period since 1900, there has been tremendous growth in the commercial activity of the country; that in many areas new patterns of commerce have sprung up and in others material changes have occurred;
the National Conference of Commissioners, held in 1940, the Commissioners adopted a proposal to prepare a uniform commercial code. In conjunction with the American Law Institute, the National Conference of Commissioners released its first official text of the Uniform Commercial Code in September of 1951. It was known as the 1952 Official Text and Comments Edition. Since then the official text of the Uniform Commer-

that the 1900 versions of our commercial acts do not adequately handle these new patterns of activity and these changes, with the result that there is a very real need for an "updating" of the commercial law.


To illustrate the need to update the Acts forming the basis for commercial law, see the specific examples laid out in id. at 318-39; and Malcolm, The Uniform Commercial Code as Enacted in Massachusetts, 13 BUS. LAW. 490, 490-91 (1958).

88. For a discussion of the composition of members at the 1940 Conference, see generally Mentschikoff, The Uniform Commercial Code An Experiment in Democracy in Drafting, 36 A.B.A. J. 419 (1950); see also AMERICAN LAW INSTITUTE & NAT'L CONFERENCE OF COMM'RS ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE 23-72 (West 10th ed. 1988).

At the present time the Conference is composed of from one to five commissioners from each of the fifty states, the District of Columbia and Puerto Rico. The commissioners are appointed by the chief executive acting under express legislative authority, or by general executive authority. The commissioners are selected from the legal profession — lawyers, judges of standing, or professors of law. They serve without compensation for an appointment period of about three years. An annual meeting is held for five or six days immediately preceding the meeting of the American Bar Association. Malcolm, supra note 86, at 227-28.

89. The proposal was made at the 1940 conference by William A. Schnader, the President of the National Conference of Commissioners at that time. To gain a better perspective concerning Schnader's contribution to the development of the Uniform Commercial Code, see Schnader, supra note 86. Schnader states:

Could not a great uniform commercial code be prepared, which would bring the commercial law up to date, and which could become the uniform law of our fifty-three jurisdictions, [at that time the 48 states plus the District of Columbia, Alaska, Hawaii, the Philippines, and Puerto Rico] by the passage of only fifty-three acts instead of many times that number?


90. Malcolm, supra note 86, at 229. Since each of the uniform acts preceding 1940 had become a part of the statutory law relating to commercial transactions, there was a need to integrate each of these acts with the others. B. STONE, UNIFORM COMMERCIAL CODE IN A NUTSHELL 2 (1975). The proposal updated and coordinated the Uniform Sales Act, the Uniform Negotiable Instruments Law, the Uniform Bills of Lading Act, and the Uniform Warehouse Receipts Act with new provisions for a fresh approach to commercial law. Malcolm, supra note 86, at 229.

91. The American Law Institute is defined as a "[g]roup of American legal scholars who are responsible for the Restatements in the various disciplines of the law and who... prepare some of the Uniform State Laws." BLACK'S LAW DICTIONARY 75 (5th ed. 1979). The American Law Institute is a voluntary organization comprised of approximately 1500 judges, law professors and leading members of the American Bar Association. It was organized in 1923 to improve the law. Malcolm, supra note 86, at 228.

92. J. WHITE & R. SUMMERS, supra note 85, § 1 at 4; Malcolm, supra note 86, at 230.
cial Code has been revised several times.93 Despite the many variations of the Code,94 the Code sections adopted by most states are almost identical.95

93. There were several opponents to the adoption of the Uniform Commercial Code. Professor Beutel of the University of Nebraska criticized the Code on numerous occasions. See, e.g., Beutel, The Proposed Uniform [?] Commercial Code Should Not Be Adopted, 61 YALE L.J. 334, 362-63 (1952); Beutel, The Proposed Uniform Commercial Code as a Problem in Codification, 16 LAW & CONTEMP. PROBS. 141 (1951); Beutel, Comparison of the Proposed Commercial Code Article 3 and the Negotiable Instruments Law, 30 NEB. L. REV. 531 (1951).


During the years of debate over the states' adoption of the Code, various committees and subcommittees were created to evaluate the effectiveness of the Code. For instance, a New York subcommittee reviewed the Code's provisions from 1953 to 1956 and concluded that:

(1) The "preponderance" of the arguments for or against codification "is in favor of careful and foresighted codification of all or major parts of commercial law."

(2) Such a commercial code "would be of greater value to the public and the legal profession than the enactment, even with revisions, of separate uniform laws."

(3) Such a code "is attainable with a reasonable amount of effort and within a reasonable amount of time."

(4) The Uniform Commercial Code "is not satisfactory in its present form."

(5) The Uniform Commercial Code "cannot be made satisfactory without comprehensive re-examination and revision in the light of all critical comment obtainable."

Braucher, supra note 86, at 803-04 (citing the 1956 N.Y. REPORT 65(A), at 57-58 (1956)). This particular subcommittee's examination and recommendations led to the revised Uniform Commercial Code.

The Uniform Commercial Code has been revised and republished as official texts in 1957, 1958, 1962, and 1972. In fact, the Permanent Editorial Board for the U.C.C. was formed in 1961 to promote uniformity of enactment and construction of the Uniform Commercial Code, and to evaluate and prepare proposals for amendments of the 1962 official text. As a result, the 1972 official text is almost the same as the 1962 official text, aside from the Article 9 covering secured transactions. See J. WHITE & R. SUMMERS, supra note 85, §§ 1 at 4-5. For a more thorough analysis of the Permanent Editorial Board, see Hart, UCC Brief No. 2: Interpreting the Uniform Commercial Code, 12 PRAC. LAW. 39, 43-44 (Nov. 1966).

94. See Schnader, supra note 89, at 578. For a general discussion of the various state variations, see id. at 574-78. For instance, § 1-208, the major focus of this Comment, has been adopted by all fifty states. Only Virginia, Washington, and Wisconsin have varied the 1962 official text's language of the section.

Virginia has added "[i]n any transaction arising out of the sale or financing of consumer goods as defined in § 8.9-109 of this Code, the burden of proof establishing good faith shall be on the party seeking to exercise the power." VA. CODE § 8.1-208 (1950). Washington omits the last sentence of § 1-208. See WASH. REV. CODE § 62A.1-208 (1950). Wisconsin replaces "shall have the power" with "may." This amendment arguably has no effect on the meaning of § 1-208. See WIS. STAT. ANN. § 401.208 (1965).
B. Purpose of the Uniform Commercial Code

It is essential to give strong considerations to the underlying purposes and policies of the Code when analyzing a problem within its scope. The Code expresses one of its primary purposes and policies as follows: "[T]o make uniform the law among the various jurisdictions." Several arguments can be posited supporting the Code's necessity for uniformity: 1) the inherent nature of commercial activity; 2) the need for predictability; and 3) the use of the optimum commercial rule.

First, commercial transactions are no longer restricted to jurisdictional boundaries, but often extend from state to state. As one commentator has noted:


97. Article 1 of the Uniform Commercial Code guides courts in their interpretation of the adopted code sections. Specifically, § 1-102 addresses the purposes and rules of construction of the Code. In pertinent part, it provides the following:

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.

(2) Underlying purposes and policies of this Act are

(a) to simplify, clarify and modernize the law governing commercial transactions;
(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;
(c) to make uniform the law among the various jurisdictions.

U.C.C. § 1-102 (1988); see infra notes 98-109 and accompanying text.


Many judges, law professors and practicing lawyers contend that the most important underlying purpose and policy of the "Uniform" Commercial Code is uniformity:

One would think that if the hundreds of thousands of hours of time and the hundreds of thousands of dollars of money which went into the drafting of the Uniform Commercial Code had produced a "model" commercial Code, to serve as the base for any state desiring to improve its statutory law governing commercial transactions, the states would have enacted it immediately. The truth is that the busy judges, law professors and practicing lawyers who contributed the hundreds of thousands of hours, and the foundations and business concerns that contributed the hundreds of thousands of dollars, would never have contributed their time or their money for the preparation of a "model" Commercial Code.

Schnader, supra note 89, at 237, 69 Com. L.J. at 117 (emphasis added). But cf. Comment, supra note 86, at 579-80 (the Code was sold as a "model").

99. As of 1963, William Schnader commented that: "Today, in the United States, the number of important concerns which transact business in every state is growing every year and the number which transact business in only one state is becoming less and less percentagewise." Schnader, supra note 89, at 248, 69 Com. L.J. at 121. Schnader continues by citing an article written by Walter Malcolm in the April 1958 edition of THE BUSINESS LAWYER:

[T]he number of "items" handled by banks as a part of the bank collection process has, since 1900, grown to tremendous proportions. It has been estimated that throughout the entire country, banks handle not less than 25,000,000 items every business day. As a matter of fact, a rough test, made after that 25,000,000 estimate was made, indicates that the figure is nearer to 50,000,000 items per day rather than twenty-five.
with increased speeds of communication and transportation the world grows smaller every day. So also do the United States and the several states in the United States. With business, commerce and financing becoming increasingly interstate, it is seriously inefficient to have the degree of variation in rules of commercial law presently existing between one state and another. Commerce does not flow nearly as smoothly as it might and a major objective of the Code is to modernize the rules and make them uniform in the several states so that commerce, business, and finance can operate more efficiently. 100

"Commercial law . . . deals with matters of world-wide moment. It subserves universal needs. In consequence, to achieve its end, it must be more or less universal." 101

Second, uniformity of commercial law is needed to create a precise guide for commercial transactions under which the participants may predict with confidence the results of their dealings. 102 Considering the amount of interstate activity, laws governing transactions must be uniform from state to state. If one lender is subject to a less stringent standard of good faith than another when accelerating debt, there is nothing to prevent the unwary debtor from entering into a bargain believing he will be subject to reasonable expectations, but instead become subjected to the lender's whim. The Uniform Commercial Code was created to displace scattered legislation or decisional law and to formulate, as fully as practicable, a com-

This tremendous volume moving with surprising speed and efficiency from one bank to another within single cities and towns over state boundary lines has created a set of problems which are in no way satisfactorily handled by the commercial acts of 1900.

Id.


prehensive and workable set of guidelines to govern all aspects of commercial dealing.103

Last, the drafters of the Code spent many hours of debate considering the specific language, the structure of that language, and its relation to commercial practices. The result must be the optimum rule for the achievement of efficient commercial activity.104 The Code does not take sides between creditors and debtors, buyers and sellers, or bankers and finance companies. Rather, it seeks to facilitate all business by incorporating modern practice, and by making the governing law easier to understand.

However, the uniformity of the Code depends upon uniform interpretation in the adopting states.105 Without consistent application of the official text throughout the jurisdictions, the very purpose for which the Code was enacted will be lost. Many court opinions have reflected this attitude by considering decisions of other jurisdictions regarding the interpretation of the Code.106 At least one court accepted other jurisdictions’ decisions and

103. Pacific Prod., 528 S.W.2d at 291.
104. Commercial Code Comm., supra note 85, at 569; see also Financial Universal Corp. v. Mercantile Nat’l Bank, 683 S.W.2d 815 (Tex. Ct. App. 1984) (encourages the adoption of the majority rule); Malcolm, supra note 86, at 226 (U.C.C. is one coherent statement of the best laws and practices in the United States.).
105. Hart, supra note 93, at 40. See generally Comment, supra note 86, at 578-86.


But see International Harvester Credit Corp. v. American Nat’l Bank, 296 So. 2d 32, 34-35 (Fla. 1974), superseded by statute, ITT Indus. Credit Corp. v. Regan, 487 So. 2d 1047 (Fla. 1986). The Florida Supreme Court explicitly diverged from decisions held by other courts. The Florida Legislature registered its disapproval and amended the statute being interpreted in International Harvester to incorporate other state’s decisions. See In re Outrigger Club, Inc., 6 Bankr. 78, 81 (Fla. 1980).
stated that "[u]nder the last provision [the uniform construction clause] decisions of the highest courts of other states are, speaking generally, precedents by which we are more or less imperatively bound in cases where similar questions are presented."107

Another court justified uniform interpretation as follows: "A court should be particularly mindful of the importance of reaching a decision in harmony with decisions in other states in order to avoid trapping an out-of-state person who would not suspect any local variation."108 The Code was designed to employ language that would control courts and compel decision. "The personal predilections of a particular judge are not properly part of the interpretive process."109

V. WHICH STANDARD SHOULD BE APPLIED TO SECTION 1-208

A. The Standard

The rationale behind section 1-208 is to protect the debtor from the unexpected acceleration of the contract payment due to the uncontrolled will of the creditor.110 The acceleration provision should be exercised only as a "shield against security impairment[s]," and not as a "sword [in the creditor's hand] for economical gain."111 To ensure such protection to debtors, and to provide a nonrevocable guideline for creditors an objective standard should be adopted by courts on their own initiative or in response to legislative reform.

B. Support for the Use of an Objective Standard of Good Faith

The use of an objective standard of good faith by the courts can be supported by the construction of various Code sections within the Uniform Commercial Code—Sections 1-103, 2-609 and 1-203.

1. Section 1-103

Uniform Commercial Code Section 1-103 states that "[u]nless displaced by the particular provisions of this Act, the principles of law and equity . . .

109. International Harvester, 296 So. 2d at 36.
110. Big Horn Coal Co. v. Commonwealth Edison Co., 852 F.2d 1259, 1269 n.15 (10th Cir. 1988) (citing Brown v. AVEMCO Inc., 603 F.2d 1367, 1378-79 (9th Cir. 1979)).
111. AVEMCO, 603 F.2d at 1379.
shall supplement its provisions." An acceleration clause, by its very existence, is guided by equitable considerations. The drafters of the Code designed section 1-208 in furtherance of these equitable principles. Although the official comment to section 1-208 cross-references subsection 1-201(19) to define good faith, the official comment to subsection 1-201(19) states that "good faith," as it is defined in that section, provides only a minimum standard. Hence, the drafters left room for an objective application.

To demonstrate the inequities of the use of the subjective standard of good faith, a discussion of pre-Code cases and the creditor-debtor relationship will follow.

a. Pre-Code Case Analysis

An analysis of cases decided before the adoption of the Uniform Commercial Code reveals that many courts applied an objective standard to determine whether the creditor had accelerated in good faith. An extreme
example of the inequities which followed from the adoption of a subjective standard was demonstrated in the state of Washington. In *Hines v. Pacific Car Co.*, the defendant sold a truck to the plaintiff on an installment plan. The agreement contained a clause allowing the defendant to repossess property, and retain paid-up installments, at any time it deemed itself insecure. Before the adoption of the Code, the Washington court held creditors to an objective standard. The *Hines* Court held that the defendant repossessed the truck without reasonable cause to deem itself insecure.

After the Code was adopted, the Washington Court of Appeals held that "[e]ven if [a creditor] was negligent in... [deeming himself insecure], negligence is irrelevant to good faith. The standard is what [the creditor] actually knew, or believed he knew, not what he could or should have known."  

approximated what was most fair to both parties. The third view appeared to be unnecessarily harsh on the vendee. Recent Decision, 21 COLUM. L. REV. 10 (1921).


*But see* Huebner v. Koebke, 42 Wis. 319, 321 (1877) ("We can have no doubt that the [insecurity acceleration] clause operates to vest an absolute discretion in the mortgagee."); Frisbee v. Langworthy, 11 Wis. 393, 396-97 (1860) (Chief Justice Dixon stated "by the express terms of the mortgage, the plaintiff was authorized to take possession of and sell the property at any time he saw fit, or what is the same thing, at any time he deemed his debt insecure."); see also Gage v. Wayland, 67 Wis. 566, 31 N.W. 708 (1887); Cline v. Libby, 46 Wis. 123, 49 N.W. 832 (1879); Welch v. Sackett, 12 Wis. 270 (1860); Cotton v. Watkins, 6 Wis. 603 (1858); Cotton v. Marsh, 3 Wis. 199 (1854).

Wisconsin affirmed its pre-Code subjective good faith approach recently. *See* Ford Motor Co. v. Lyons, 137 Wis. 2d 397, 405 N.W.2d 354 (Ct. App. 1987) (In one of the longest and most complex jury trials in Wisconsin's legal history, the court concluded that the trial court's subjective interpretation of § 208 was the only logical answer).

For pre-Code analysis of states' treatment of insecurity acceleration of chattel mortgage, see Annotation, *Validity, Construction, and Application of Insecurity Clause in Chattel and Mortgage*, 125 A.L.R. 313 (1940).

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117. 110 Wash. 75, 188 P. 29 (1920).
118. *Id.* at 75, 188 P. at 29.
119. *Id.*

A reasonable person standard is typically couched in terms such as "what one could or should have known." *Id.*
The Illinois Appellate Court, in Burris v. Commercial Credit Corp., also applied a subjective standard. In Burris, a pre-Code case, the plaintiff brought an action against the defendant to recover damages suffered for the alleged wrongful repossession and resale of an automobile. The appellate court upheld the county court's decision that the holder of the contract did not have reasonable grounds to feel insecure merely because the automobile in question had been used by the plaintiff's brother, without permission, in alleged criminal activity. In this case, it was undisputed that the plaintiff had not defaulted. Yet, after the Code had been adopted in Illinois, the same court in a recent case, Bartlett Bank & Trust Co. v. McJunkins, stated that "[a]though Illinois has not decided the question, the majority of courts from other jurisdictions have held that good faith under section 1-208 is tested by subjective standards in accordance with the Code's general definition of good faith as honesty in fact." It was not until November 1988, in Watseka First National Bank v. Ruda, that the Illinois courts committed to their pre-Code objective standard. "Illinois courts have not previously determined whether the test of good faith under ... section [1-208] is a subjective ... or an objective standard ... ." Hence, parties to agreements containing insecurity acceleration clauses within Illinois, or dealing in Illinois, had no clear foundation upon which to rest their bargaining positions.

121. 15 Ill. App. 2d 458, 146 N.E.2d 218 (1957) (published abstract only).
122. Id. at 458, 147 N.E.2d at 218.
124. Id. at 59, 497 N.E.2d at 404.
126. Id. at 756, 531 N.E.2d at 30.

In Watseka, a secured creditor brought an action against the guarantors of the debt. The guarantors owned approximately one hundred acres of farmland. The principal debtor on the loan was the guarantor's grandson who farmed Ruda's land. Upon the discovery of a prior lien on the farmland, the bank accelerated the note. Other reasons given by the bank included a half interest held by a partner and bad weather conditions. The Watseka court held that the "bank can not advance as a good faith reason for acceleration of due date the same facts which were the basis for requiring a guarantor of the loan some five months earlier." Id. at 756, 531 N.E.2d at 31. The bank did not have a reasonable basis to accelerate the due date of the notes. Id., 531 N.E.2d at 30.
A fairer approach would be the one applied by the Colorado Court of Appeals in Richards Engineers v. Spanel. The Richards court held that "[i]n determining the appropriate standard [for section 1-208 good faith], we are... guided by pre-Code Colorado case law governing similar transactions. Under such rulings... a determination had to be founded upon good faith, and the decision had to be based on reasonable grounds and probable cause." In addition to the pre-Code versus post-Code case analysis, the nature of the debtor-creditor relationship reveals the use of a subjective good faith standard to be inequitable.

b. Debtor-Creditor Relationship

The nature of a debtor-creditor relationship requires that some reasonableness be applied. Acceleration clauses were developed to solve the needs of both the creditor and the debtor by permitting them to create an obligation which matured at a fixed date, but was payable earlier upon the happening of certain prescribed events. In particular, insecurity acceleration clauses deal with acceleration of debt when events portend the likelihood of nonperformance. Section 1-208 "recognize[s] that acceleration is a harsh remedy which should be allowed only if there is some reasonable justification for doing so, such as a good faith belief that the prospect of payment is impaired." Mandating that creditors satisfy the good faith obligation of section 1-208 before accelerating debt fulfills the expectation of the parties that demand will be made in specific circumstances to protect the debtor against nonpayment. Requiring the creditor to prove only a mere honest belief that payment of the obligation was impaired allows for abuse. The creditor need not act reasonably, but may

128. Id. at 1033 (citing Thomas v. Beirne, 94 Colo. 429, 30 P.2d 863 (1934)).
129. According to Professor Gilmore, "[f]or a hundred years... no security agreement has failed to include an acceleration clause." 2 G. GILMORE, supra note 50, § 43.4, at 1105.
130. An acceleration clause permits the creditor to make an entire immature debt due immediately so that satisfaction may promptly ensue.
131. Williamson, 545 P.2d at 1149.
instead benefit from a mistake of fact,\textsuperscript{133} or mistake in judgment.\textsuperscript{134} The subjective good faith test dispenses with terms such as diligence, negligence, and notice, thereby escaping all aspects of prudent business activity.\textsuperscript{135}

The speed with which the axe can fall on a debtor whose contract includes an insecurity clause is illustrated by cases brought under section 1-208 in which the creditor is the bank where the debtor also has his checking account. The bank’s common law right of set-off allows it to deem itself insecure, to accelerate, and to pay itself out of the debtor’s checking account . . . . The bank’s swift and silent action is lawful although it may push the debtor to bankruptcy.\textsuperscript{136}

In fact, applying the subjective test of good faith counters the initial intention of the drafters to impose restrictions on a creditor’s power over the


\textsuperscript{134} Compare Ginn v. Citizens & S. Nat’l Bank, 145 Ga. App. 175, 243 S.E.2d 528 (1978) (The court made a finding of good faith irrespective of a mistake in judgment. The mistake concerned the truthfulness of the debtor’s answers on a loan application. Meanwhile, the debtor was tried and acquitted for the charge.), and Karner v. Willis, 238 Kan. 246, 249 710 P.2d 21, 23-24 (1985) (Herd, J., dissenting) (The bank argued the garnishment of the debtor’s bank accounts would have destroyed the liquidity of the debtor, thereby justifying the bank’s acceleration. “This argument ignores the nature of a secured note. Neither the garnishment nor the foreign judgment affect the bank’s security. As testified to, the bank was satisfied with the security for the [debtor’s obligation]. The garnishment was seeking payment from [the debtor’s] unmortgaged assets.” id.) with Sheppard Fed. Credit Union v. Palmer, 408 F.2d 1369 (5th Cir. 1969) (Four months after receiving a loan, the debtor resigned from the Air Force as a registered nurse. He informed the Credit Union he was considering moving to Texas to find employment. The Credit Union demanded possession of the debtor’s car, despite the fact that the debtor had always made prompt payments and his R.N. license was valid in forty-eight of the fifty states. The Fifth Circuit Court of Appeals ruled that “the Credit Union’s determination that it was insecure was certainly erroneous; it could hardly have asked for a more conscientious and responsible debtor.” id. at 1373. In fact, despite the creditor’s repossession, the debtor continued to make full payments on his loan to the Credit Union. Id.).

\textsuperscript{135} If a creditor is not penalized for accelerating unreasonably, either by mistake in fact or in judgment, incentive exists for the creditor to exercise sound business judgment when making his decision.

debtor.\textsuperscript{137} Section 1-208 thereby becomes a "sword for commercial gain rather than . . . a shield against security impairment."\textsuperscript{138}

2. Section 2-609

Section 2-609\textsuperscript{139} also supports, by analogy, the adoption of a reasonableness standard for good faith through Code construction. Section 2-609 of the Uniform Commercial Code addresses performance insecurity whereby one party may, in writing, demand assurance, or even suspend performance, upon reasonable grounds of insecurity.\textsuperscript{140} The comments to this section provide:

Clauses seeking to give the protected party exceedingly wide powers to cancel or readjust the contract when ground for insecurity arises must be read against the fact that good faith is a part of the obligation of the contract . . . and, in the case of the merchant, the reasonable observance of commercial standards of fair dealing in the trade.\textsuperscript{141}

Hence, the good faith performance of demanding assurance, or even halting performance, on a contract appears to be measured with an objective standard. Interestingly, the official comment to section 2-609 cross-references section 1-208 for interpretation and construction.\textsuperscript{142}

The language of the official comment to section 2-609 makes reference to "merchant" status. The question then becomes whether a creditor can hold "merchant" status.

\textit{a. Merchant}

Section 2-104 defines merchant as:

\textsuperscript{137} The official comment to U.C.C. § 1-208 provides:

This section is intended to make clear that despite language which can be so construed . . . void as against public policy . . . the clause means that the option is to be exercised only in the good faith belief that the prospect of payment or performance is impaired . . . [thus to clear up] some confusion in the cases as to the effect to be given to a clause which seeming grants the power of an acceleration at the whim and caprice of one party.

U.C.C. § 1-208 official comment (1988).


\textsuperscript{138} Brown v. AVEMCO Inv. Corp., 603 F.2d 1367, 1379 (9th Cir. 1979).

\textsuperscript{139} U.C.C. § 2-609 (1988).

\textsuperscript{140} U.C.C. § 2-609(1) (1988). "When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance. . . ." Id; see Richards Engineers, Inc. v. Spanel, 745 P.2d 1031 (Colo. Ct. App. 1987).

\textsuperscript{141} U.C.C. § 2-609 official comment 6 (1988).

\textsuperscript{142} Id.
[A] person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.\(^{143}\)

The official comment to section 2-104 suggests that there are three types of classifications of merchants:

1. those who . . . by their occupation hold themselves out as having special knowledge or skill peculiar to the practices . . . involved in the . . .
2. those who are sellers] . . . with respect to goods of that kind; and . . .
3. those] who are merchants under either the “practices” or the “goods” aspect of the definition of merchant.\(^{144}\)

The comments further suggest that section 2-609 falls under the third classification,\(^{145}\) thus qualifying under either subsection 2-104(1) or 2-104(2) (as shown above). Because section 2-609 does not concern the sale of goods, but rather a party's “practice” of determining insecurity, “merchant” status is found under the first classification:

[A]lmost every person in business would be deemed to be a “merchant” under this language who . . . by his occupation holds himself out as having knowledge or skill peculiar to the practices . . . involved in the transaction. . . . In this type of provision banks . . . well may be “merchants.”\(^{146}\)

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144. U.C.C. § 2-104 official comment 2 (1988). The first classification applies to §§ 2-201(2) (Statute of Frauds); 2-205 (firm offers); 2-207 (confirmatory memorandum) and 2-209 (modification). These aspects of commercial law are familiar to any person in the business. This category covers “almost every person in the business world” including banks. The second classification covers §§ 2-314, 2-402(2), and 2-403(2). Merchant status requires that professional status be held toward the particular kind of goods. The last classification specifically addresses §§ 2-103(1)(b), 2-327(1)(c), 2-603, 2-509, and 2-609. Merchant status can be acquired under either of the prior two classifications. Id.
145. Id. In fact, the official comment to U.C.C. § 2-609 uses the same language as § 2-103(1)(b) also included under the third classification of “merchant.” Compare U.C.C. § 2-609 official comment 6 (1988) (“[w]hen ground for insecurity arises [it] must be read against the fact that good faith is a part of the obligation of the contract and . . . in the case of a merchant, the reasonable observance of commercial standards of fair dealing in the trade”(emphasis added)) with U.C.C. § 2-103 (1)(b) (1988) (“‘Good faith’ in the case of merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.” (emphasis added)).
Yet the courts, in applying the good faith obligation to lenders,\textsuperscript{147} almost without exception\textsuperscript{148} misapply the general subsection 1-201(19) definition of good faith without discussion.\textsuperscript{149}

Assuming, arguendo, that creditor banks can hold "merchant" status under Article 2, the next issue is whether this objective standard can be applied outside of Article 2.\textsuperscript{150} One approach would be to apply by analogy the objective standard of good faith performance of sales contracts by merchants.\textsuperscript{151} Professor William H. Lawrence and Professor Robert D. Wilson\textsuperscript{152} suggest that a lender's performance and enforcement of a loan agreement, subject to the lender's discretion, is sufficiently analogous to a merchant's performance and enforcement of a sales contract to support the integration of the objective standard with the lender's obligation of good

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\textsuperscript{148} A student commentator found only one case that applied the observance of reasonable commercial standards of fair dealing in the trade to a bank. See, e.g., Branch Banking & Trust Co. v. Creasy, 44 N.C. App. 289, 293, 260 S.E.2d 782, 784 (1979), rev'd on other grounds, 301 N.C. 76 269 S.E.2d 117 (Iowa 1975); Black v. Peoples Bank & Trust Co., 437 So.2d 26 (Miss. 1983); McKay v. Farmers & Stockmens Bank, 92 N.M. 181, 585 P.2d 325 (Ct. App. 1978), cert. denied, 92 N.M. 79, 582 P.2d 1292 (1978); State Bank v. Woolsey, 565 P.2d 413 (Utah 1977).

\textsuperscript{149} Note, supra note 148, at 549 n.64 (citing Van Bibber v. Norris, 275 Ind. 555, 566, 419 N.E.2d 115, 122 (1981)) (lender not subject to "merchant" definition of good faith).

\textsuperscript{150} Many commentators argue that the observance of reasonable commercial practices applies only in Article 2 due to the language in U.C.C. § 2-103(1) which states: (1) "In this Article unless context otherwise requires . . . (b) 'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." U.C.C. § 2-103(1) (1988) (emphasis added).

\textsuperscript{151} But see, Lawrence & Wilson, supra note 112, at 841. The authors state: The words "argument by analogy" cannot magically dispense with the statutory language that limits the objective standard of good faith to Article 2 transactions involving merchants [citing U.C.C. § 2-103(1)(b) (1978)]. Proponents of analogies must formulate a rationale to demonstrate the appropriateness of the proposed analogy. In this case, the formulation is even more difficult because, rather than justifying the application of a Code concept to a transaction outside the scope of the Code, it applies a Code definition beyond its codified scope. Nevertheless, combined principles of analogy and statutory construction create persuasive arguments in this area.

\textsuperscript{152} William Lawrence is a Professor of Law at the University of Kansas. Robert Wilson is a 1988 graduate of the University of Kansas. Both commentators coauthored a law review article in 1988. Lawrence & Wilson, supra note 112.
The following decision illustrates the similarity in cases involving sales contracts and those involving loan agreements.

In *Ellis Manufacturing Co. v. Brant*, a breach of contract action was brought by Ellis Manufacturing Company (Ellis) for nonperformance by Brant, a general contractor. Ellis contracted to supply and install the cabinets in an apartment complex constructed by Brant. After both parties had substantially performed their obligations, Ellis demanded collection of all payments on the contract. When no payments were received, Ellis stopped performance. The Texas Appellate Court, relying solely on section 2-609, held that "[i]t cannot be said that Brant's failure to pay was, under the circumstances, as a matter of law, reasonable grounds for insecurity."  

Both installment sales agreements and loan agreements concern general contract principles. One party bargains for a payment of money, and the other bargains for the receipt of goods or services. In *Ellis*, Brant was to receive goods and services (the installation of cabinets) and Ellis was to receive money. This is no different from a loan transaction. A creditor bargains for payment of money (interest fee) and the debtor bargains for the use of that money. An insecurity acceleration clause can be contained in both.

The Alaska Supreme Court acknowledged the similarities between section 1-208 and section 2-609 in *Kupka v. Morey*. Kupka and his wife operated two corporations—National Aero Sales Corporation and Nasco Leasing Corporation. The former engaged in the purchase and sale of aircraft; the latter dealt with leasing aircraft. Morey, signing as a guarantor on one of the leases, made the initial payment of $3500. After a crash of the leased aircraft, the parties entered into a subsequent agreement. Morey leased and then subleased the plane for two months. An insurance policy had been taken out by Kupka naming the sublessee as an additional insured. This policy lapsed. Kupka then repossessed the airplane despite the fact the Morey had been paid in full. The Alaska Supreme Court held that "as a minimum requirement for the enforcement of such [insecurity clause] ... the party invoking the clause must reasonably and in good faith believe that the prospect of payment or performance has somehow been im-

153. See id. at 841.
155. Id. at 304.
156. Article 2 covers the sale and disposition of "goods." It is beyond the scope of this Comment to examine the controversy of determining whether mixed contracts of goods and services fall within the scope of Article 2.
paired. . . . Kupka's repossession of the plane was neither reasonable nor in good faith."

Transactions governed by Article 2 concern those within a trade context in which reasonable commercial standards exist. Consequently, the "observance of reasonable commercial standards of fair dealing within the trade" is an obvious standard. Lending and financial institutions also hold themselves out to be professionals in commercial transactions:

The proposition that they should not be held to observe reasonable commercial standards of fair dealing within the lending and financing trade is untenable. To the extent that such standards exist within the requisite trade, the same policies that support their required observance by merchants apply with equal force to lenders and other financing enterprises.\textsuperscript{159}

A recent First Circuit case suggests that the "merchant" definition of good faith may apply outside of Article 2.\textsuperscript{160} In \textit{Reid v. Key Bank of Southern Maine},\textsuperscript{161} Depositors Trust Company of Southern Maine (Key Bank's predecessor in interest) granted Reid an extensive line of credit in mid-1975. Less than four years later, Depositors halted any further advance on this line of credit. At trial, the judge gave a series of jury instructions containing both subjective and objective components.\textsuperscript{162} Yet the court held that "even if we agreed with [the] defendant [Key Bank] that the Maine courts would limit an objective standard for good faith to article 2 cases, we would not find a fatal error in the judge's instructions here."\textsuperscript{163} Section 2-609 addresses a party's grounds for insecurity in demanding performance under a contract which resembles the insecurity acceleration clauses governed by section 1-208. The major difference between sections 2-609 and 1-208 rests in the consequences after a party deems himself insecure — a written de-

\textsuperscript{158} Id. at 747 (footnotes omitted) (citing U.C.C. §§ 2-609, 1-208).
\textsuperscript{159} Lawrence & Wilson, \textit{supra} note 112, at 841.
\textsuperscript{160} See \textit{Reid v. Key Bank, Inc.}, 821 F.2d 9, 15 n.2 (1st Cir. 1987).
\textsuperscript{161} \textit{Contra} Van Bibber v. Norris, 275 Ind. 555, 556, 419 N.E.2d 115, 122 (1981) (The fact that lenders are under no burden to observe reasonable commercial standards "reflects the Code drafters' recognition that sales transactions are more amenable to establishment of 'reasonable commercial standards' than are the relations between secured parties and debtors"); Warren, \textit{Good Faith Under the Uniform Commercial Code}, 1 EMERGING THEORIES OF LENDER LIABILITY 58 (H. Chaitman ed. 1985) (sponsored by the American Bar Association Section of Corporation, Banking and Business Law and the Section of Litigation) (Indeed, a lender is not a merchant and is not generally bound to observe "reasonable commercial standards"). \textit{See also} Farnsworth, \textit{Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code}, 30 U. CHI. L. REV. 666, 765 (1963); Lawrence & Wilson, \textit{supra} note 112, at 834.
\textsuperscript{162} 821 F.2d 9 (1st Cir. 1987).
\textsuperscript{163} For an examination of the confusion presented by the jury instructions in \textit{Reid}, see \textit{supra} notes 82-83 and accompanying text.
mand of assurance versus the acceleration of an entire debt. Indeed, to hold a creditor to a less stringent standard under section 1-208, rather than what is afforded merchants under section 2-609, is inconsistent.

3. Section 1-203

The third source for support of an objective standard of good faith in section 1-208 is section 1-203. Section 1-203 states that “[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.” The official comments to section 1-203 provide particular sections of the Code to which this general principle applies: section 1-208 (option to accelerate at will); section 2-508 (right to cure a defective delivery of goods); section 2-603 (duty of merchant who has rejected goods to effect salvage operations); section 2-614 (substituted performance); and section 2-615 (failure of presupposed conditions). Each of the aforementioned sections, except section 1-208, expressly requires reasonable grounds for performance, thereby implicitly couching section 1-203’s standard in “reasonable” terms. Additionally, other Code comments sug-

164. U.C.C. § 1-203 (1988). The relationship between § 1-208 and § 1-203 remains uncertain. While some courts treat the two sections as distinct inquiries, a Texas appellate court concluded that § 1-208 is a specific application of § 1-203. Compare Fulton Nat'l Bank v. Willis Denney Ford, Inc., 154 Ga. App. 846, 269 S.E.2d 916 (1980) (holding that § 1-203 and § 1-208 are separate, unrelated inquiries), with Jack M. Finley v. Longview Bank & Trust Co., 705 S.W.2d 206 (Tex. Ct. App. 1985) (§ 1-203 held to include secured transactions which are governed by § 1-208).


167. Section 1-203 of the Code, like § 1-208, is applicable in every transaction subject to Code coverage. Hence, good faith is statutorily required in every secured transaction, in every sales action, and with the use of any negotiable instrument. The Official Comments to U.C.C. § 1-203 mention only a few sections of the Code:

U.C.C. § 2-508(2) provides:
Where the buyer rejects a nonconforming tender which the seller had reasonable grounds to believe would be acceptable . . . the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.


U.C.C. § 2-603 states:
(1) . . . [A] merchant buyer is under a duty after rejection of goods in his possession . . . to follow any reasonable instructions received from the seller . . . and in the absence of such instructions to make reasonable efforts to sell them . . . .

(2) [W]hen the buyer sells goods under subsection (1), he is entitled to reimbursement from the seller . . . for reasonable expenses of caring for and selling them.

(3) In complying with this section the buyer is held only to good faith . . .


U.C.C. § 2-614 requires that:
gest that the objective standard in observance of commercial practices applies to section 1-203.\textsuperscript{168} Although comments are not considered part of the statutory language of each Code section,\textsuperscript{169} the Code's chief draftsperson, Llewellyn, indicated:

I am ashamed of it in some ways; there are so many pieces that I could make a little better; there are so many beautiful ideas I tried to get in that would have been good for the law, but I was voted down.\ldots\textsuperscript{170} When we weren't allowed to put it in where we wanted to go,\ldots\textsuperscript{170} we at least got the thing set up so that we are allowed to state in accompanying comments where the particular sections are trying to go.

A recent bankruptcy case recognized the need for an objective standard utilizing section 1-103. In \textit{In re Martin Specialty Vehicles, Inc.},\textsuperscript{171} a bank representative simply appeared one day at the debtor's place of business, foreclosed on the collateral and proceeded to change the locks. This action came without notice to the debtor. In fact, the debtor believed that the bank was going to approve a pending loan application. No default was proven. The bank merely reacted to the existence of the involvement of a shareholder in organized crime.\textsuperscript{172} Without invoking section 1-208's inse-
curity acceleration law, the bankruptcy court found that the creditor had violated its obligation of good faith in its performance of the contract. The United States Bankruptcy Court held that Massachusetts courts, as established by precedent,\textsuperscript{173} recognize and apply an objective standard under general contract law.\textsuperscript{174} Therefore, if an objective standard can be applied to section 1-203 for general contract performance, it must also be required to satisfy section 1-208 — a particular application of section 1-203 by direct reference within the section's language.

VI. CONCLUSION

"Nature n'a cree' l'homme que preter of emprunter."\textsuperscript{175}

As long as there is lending and borrowing, laws are needed to govern such transactions. As one can readily see, there exists a tremendous need for a uniform standard of good faith in applying insecurity clauses if equity is to be achieved. That standard must be measured in objective terms. The distinction that developed between good faith performance and purchase mandates an objective application. What at first glance appeared as a fatal misjudgment by the drafters in defining the general standard of good faith in objective terms, can be rationalized in the application of equitable principles in section 1-103 and given reasonable meaning under Code construction of sections 2-609 and 1-203. As one judge stated: "Good faith in law . . . is not to be measured always by a man's own standard of right, but that which it has adopted and prescribed as a standard for the observance of all men in their dealings with each other."\textsuperscript{176}

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\textsuperscript{173} See Fortune v. Nat'l Cash Register Co., 373 Mass. 96, 102-05, 364 N.E.2d 1251, 1256-58 (1977) (The court's holding of bad faith was not based upon the employer's deceit or lack of candor when terminating the employee plaintiff under an "at will" contract, but rather was based upon the unfairness when the employee was on the edge of successful completion of a sale entitling him to full commission.); see also Gram v. Liberty Mut. Ins. Co., 834 Mass. 659, 667, 429 N.E.2d 21, 26 (1981), damages reconsidered, 391 Mass. 333, 461 N.E.2d 796 (1984); Zapatha v. Diary Mart, Inc., 381 Mass. 284, 291, 408 N.E.2d 1378, n.16 (1980).

\textsuperscript{174} Martin, 87 Bankr. at 776.

\textsuperscript{175} Nature has created man to no other end but to lend and borrow. RABELAIS, WORKS, book iii ch.4.

\textsuperscript{176} First Nat'l Bank v. F.C. Trebein Co., 59 Ohio St. 316, 325, 52 N.E. 834, 837 (1898).