TALKING POINTS ON REVISED UCC 1 CHOICE OF LAW PROVISIONS
(REVISED UCC 1-301)

1. There is no compelling reason for enacting the controversial Revised UCC 1-301 choice of law rules now. Although the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved Revised UCC 1 in 2001, our information indicates that as of September 6, 2005, no state has enacted the revised choice of law provisions. NCCUSL reports that fourteen states have adopted Revised UCC 1 in some form, but we understand that all of them retained the basic part of the pre-revision choice of law section. Many state bankers associations and other organizations are opposed to the Revised UCC 1 choice of law provisions. If a state were to adopt Revised UCC 1-301, its choice of law provisions would be significantly different from other states. This disparity would encourage litigation. To achieve uniformity and some form of commercial certainty, the state might be forced to “undo” what it had enacted.

2. The pre-revision Article 1 choice of law section is fairly simple. It generally allows the parties to a transaction to designate in their agreement a jurisdiction (e.g., a state law) whose law governs if the transaction bears a “reasonable relation” to that jurisdiction. The agreement’s designated law will generally be upheld if it meets the “reasonable relation” standard.

On the other hand, the Revision deviates from this unified approach by providing different rules for consumer transactions and “business-to-business” transactions and by imposing new consumer protection and fundamental policy “safeguards.” The NCCUSL Drafting Committee that developed Revised UCC 1 has not provided any evidence of abuse to justify imposing new consumer protection and fundamental policy “safeguards.” For many financial institutions, these provisions will be a compliance nightmare. Any perceived benefits of these new “safeguards” are outweighed by increased costs in compliance, administration, and litigation. As a practical matter, financial institutions will be forced to design their compliance programs around the worst-case scenario. Some otherwise deserving borrowers might not be able to obtain needed credit. The following example provided by a bank attorney highlights a few practical problems with the Revision’s choice of law provisions.

Consumer lives in state A which borders on state B. Consumer visits dealer in state B to purchase a manufactured home. Consumer signs a retail installment contract at the dealer’s place of business in state B. The retail installment contract was prepared by the Financial Institution to which dealer intends to assign the contract. The retail installment contract complies with the requirements of state B and contains a choice of law provision that selects state B’s laws. The dealer delivers the home to Consumer and Consumer accepts delivery in state A. The dealer then sells the retail installment contract to Financial Institution. The security interest is perfected in state A where Consumer lives and where the collateral will be located.

Typically, state A and state B will have retail installment sales and other consumer protection laws that may cover the transaction with disclosure or other rules. The rules may not be
consistent, and it may be impossible to comply with both. This would create serious practical problems if the choice of law in the retail installment contract should be unenforceable.

Why should acceptance of the goods in state A potentially invalidate the choice of law provision selecting state B’s laws? In this case, every other act material to the transaction would have taken place in state B. This is only one example. Bankers also discussed with the NCCUSL Drafting Committee Chair and Reporters other common situations highlighting practical problems for financial institutions under the Revision.

3. The recent experience with the states’ adoption of Revised Article 9 should be considered. Among the most common non-uniform amendments to Revised Article 9 are those aimed at eliminating Revised Article 9’s newly created distinctions between consumer and commercial transactions. The disparate treatment for consumer and commercial transactions, whether in Article 9 or Article 1, represents a change in substantive policy which is inappropriate. Many bankers and state bankers associations are opposed to this continued balkanization of the UCC and will seek appropriate amendments in the state legislatures.

4. Some proponents of Revised UCC 1-301 have argued that many of our objections are eliminated if the Section 1-102 “Scope” provision and the exceptions in Section 1-301(g) are properly interpreted.

On the other hand, several bankers say that in practice application of the Scope provision is not clear, that the Section 1-301(g) exceptions do not remove many concerns, and that application of Section 1-301 to mixed transactions will lead to unpredictable and inconsistent results. For example, many bankers are concerned about whether the consumer protection and fundamental policy “safeguards” apply to a negotiable note. They question whether the Section 4-102 exception is adequate. Where is a bank or branch “located” for purposes of Section 4-102? Do the consumer protection and fundamental policy “safeguards” apply to deposit account agreements? Must a bank comply with individual state laws when amending the terms of account agreements? Are the rules relating to stop payment, account closure, and availability of items in Sections 4-403 and 4-406 (particularly when individual states have enacted non-uniform amendments) mandatory consumer protection provisions? Do the choice of law provisions apply to a credit card account or an open-end credit line when a check is used to access the account or credit line? Will the Section 1-301 choice of law rules apply to the non-UCC aspects of a mixed transaction, or will the transaction be subject to multiple choice of law rules? In addition, some courts might incorrectly apply the Article 1 choice of law rules to a non-UCC transaction. The bottom line: Section 1-301’s uncertainty will result in needless litigation and endless questions regarding governing laws.

5. What are consumer protection rules that may not be varied by agreement [see Section 1-301(e)(2)]? The terminology is ambiguous. According to Official Comment #3, the rules are not limited to those in the UCC but can extend to protections in “other law” outside the UCC. This same Comment indicates such rules include not only statutory protections but also “safeguards” found in administrative regulations and case law. Whether a creditor has complied with such rules will be raised continually in consumer litigation. Does a consumer get the benefit of protections of both the agreement’s designated law and the law of his or
her principal residence? Is a consumer’s principal residence determined when the contract is
made or at another time (for example, if foreclosure is required)? The Official Comments
attempt to answer some questions by providing a few examples. However, in many cases
these examples raise more questions than they resolve. In addition, one Comment attempts
to sanction the ability of a consumer to unilaterally alter contractual terms by relocating to
another state.

6. The “fundamental policy” provision in Section 1-301(f) will be used to interfere with the
justified expectations of the parties. Under this section, the parties’ contractual designation
of governing law is ineffective to the extent it would be contrary to a fundamental policy of
the law that would otherwise govern. The provision is an open invitation to litigation. It is
an ambiguous standard. Is its scope limited to business-to-business transactions or does it
also apply in the consumer context?

7. The Revision makes it very difficult – if not impossible – for parties to various
agreements to foretell with accuracy what their rights and liabilities will be. One of the
prime objectives of contract law is to protect the justified expectations of the parties so that
certainty and predictability of result will follow [see Restatement (Second) Conflict of Laws,
Section 187, Comment e]. The Revision undermines this basic objective by including new
limits on the parties’ autonomy to select governing law.

8. The new limits on the parties’ autonomy to select governing law are inconsistent and
conflict with various provisions of federal banking law [e.g., 12 U.S.C. 85 and 12 U.S.C.
1831d(a)].

9. The new limits on parties’ ability to designate governing law are contrary to the stated
purposes of the UCC as reflected in Revised Section 1-103. Rather than achieving the
desired purposes, the new “safeguards” are unworkable, will breed uncertainty, and will
make banking transactions more complicated. These limits will inhibit innovation and
interfere with the expansion of commercial practices through agreement. As one bank
attorney noted, the choice of law revision is “ill-advised. It would promote market chaos,
instead of uniformity.”

10. In summation many bankers continue to be concerned that unintended consequences
will follow if Revised UCC 1-301 is enacted. In an effort to find a compromise, members of
an ABA group evaluating the Revision have suggested possible alternatives for consideration
to the NCCUSL Drafting Committee Chair and Reporters. Meaningful changes to the actual
statutory provisions are needed to overcome the fundamental objections of many financial
institutions and state bankers associations.