Loyola of Los Angeles Law Review

Volume 26
Number 3 *Is the UCC Dead, or Alive and Well?*

Article 13

4-1-1993

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Recommended Citation

Julian B. McDonnell, *The Code Project Confronts Fundamental Dilemmas*, 26 Loy. L.A. L. Rev. 683 (1993).
Available at: https://digitalcommons.lmu.edu/llr/vol26/iss3/13

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THE CODE PROJECT CONFRONTS FUNDAMENTAL DILEMMAS

Julian B. McDonnell *

The Uniform Commercial Code has not produced nirvana. We cannot be satisfied with the text of the Code: Regular revisions and additions are required. And even during recent Republican administrations which were philosophically committed to enhancing the authority of the states, the federal government has insisted on chipping away at the Code's domain. It takes a chunk of check collection law here, provides special rules for farm financers there, while steadily expounding rules of super-negotiability to benefit its own besieged deposit insurance funds.

These federal intrusions may be distressing to true believers in uniform laws. But if the Code project is viewed from a realistic perspective, the intrusions are not surprising at all. The Code attempts to express only *part* of our commercial law. It is a special—some might say weird—type of codification effort: a proposed uniform law to be adopted not by one Congress but by over fifty legislative bodies. As with our commercial law in general, this uniform-law approach confronts certain fundamental American dilemmas. These are the dilemmas presented by federalism, by change and by the need to protect consumers. These dilemmas are by no means unique to American society, but at times they are felt with particular severity. These dilemmas do not lend themselves to definitive solutions. We must always struggle with them. In this Essay, I hope to provide a perspective for evaluating the current vitality of the Uniform Commercial Code by exploring the strengths and weaknesses of the uniform-law method of codification in confronting these fundamental dilemmas.

I. THE CODE AS A PARTIAL CODIFICATION

The UCC attempts to express only part of our commercial law. Its focus was defined by its time of origin. Its purpose was to make accessible and uniform the law relating to the movement of goods in the economy. How would goods be sold and paid for and shipped and stored and financed? These were the fundamental questions to be addressed. To be

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sure, the resulting codification extends beyond transactions in goods in very significant ways. The treatment of payments—originally Articles 3 and 4, and now Article 4A as well—covers payments made by check or certain electronic means for all types of assets. Article 5 is able to accommodate the standby letter of credit. Article 8 deals with transfers of investment securities. Article 9 covers financing on the security of accounts, including accounts generated from sales of services, and intangibles.

Important areas of commercial law, however, are not covered by the UCC. At the state law level, sales of real estate, services and intangibles fall outside the domain of the UCC. Creditors' rights, statutory liens and suretyship are addressed only in relation to other topics that have been codified. Real estate finance is entirely excluded from the Code. Security interests in deposit accounts and insurance are not covered, except as proceeds of other collateral. In addition, important areas of securities regulation and bankruptcy are dealt with outside the Code at the federal level.

The drafters have disclaimed any intent to be exhaustive, even within the Code's area of focus, declaring instead that the principles of common law and equity supplement the Code, except as displaced by its provisions.[1] The UCC is a partial rather than comprehensive or exhaustive codification of commercial law. But those who launched the Code project did not think of these limitations on coverage as a major defect because they realized that the uniform-law vehicle was only one means of struggling with the dilemma that inspired the Code project in the first place.

II. THE DILEMMA OF FEDERALISM

To state the obvious, this country is a big nation populated by diverse and often contentious people. Americans do not want everything to be run from the center. Recent experience confirms that the policy of total centralization is not a winner. We value our federal system that leaves some important measure of political power at the state level. Thus, our standing assumption has been that the law of contracts, sales and secured transactions are matters to be dealt with at the state level by state legislators and state judges.

At the same time, however, we realize that our prosperity was built on the American common market. Enterprises must be able to operate nationally, unhindered by widely variant or oppressive state measures.

1. U.C.C. § 1-103 (1990).

How are we to develop a unified, national law of commerce within the context of a federal system that leaves critical areas of policy formulation to fifty legislative bodies and courts of last resort? That is the dilemma of federalism.

At one point in American history, lawyers confronted with an outpouring of statutory pronouncements and judicial opinions in the area of commercial law relied principally on the great commentators to order their legal universe. In commercial matters the lawyer of 1893 looked to Justice Joseph Story,[2] Theophilus Parsons[3] or Judah Benjamin[4] to find the "correct" rule to govern a particular transaction or dispute.[5] The uniform laws movement did not arrive until the turn of the century. Later still, the Restatements were designed to deal with the same problem of federalism. As the reporter for the first *Restatement of Contracts*, Samuel W. Williston, wrote: "The prodigious material from which our law must be sought should be summarized as effectively and as soon as possible."[6]

The UCC is not the only way of working toward uniformity. Commentary, restatement, and—from time to time—federal legislation and regulation are also means to that end. Is there more uniformity in our law of warranty today under Article 2 of the UCC than in the law of strict products liability, which is so heavily influenced by section 402A of the *Restatement (Second) of Torts*? I doubt it. In warranty litigation, there is no uniformity at all as to such basic issues as whether reliance must be proved to establish an express warranty claim, whether privity of contract is required, or whether consequential damages should be al-

2. Justice Story authored a number of commentaries including: JOSEPH STORY, COMMENTARIES ON THE LAW OF BAILMENTS (5th ed. Boston, Little, Brown & Co. 1851); JOSEPH STORY, COMMENTARIES ON THE LAW OF BILLS OF EXCHANGE (4th ed. Boston, Little, Brown & Co. 1860); JOSEPH STORY, COMMENTARIES ON THE LAW OF PROMISSORY NOTES AND GUARANTIES OF NOTES AND CHECKS ON BANKS AND BANKERS (5th ed. Boston, Little, Brown & Co. 1859).

3. The sixth edition of Theophilus Parson's *Law of Contracts* was published in 1873. *See* THEOPHILUS PARSONS, THE LAW OF CONTRACTS (6th ed. Boston, Little, Brown & Co. 1873).

4. *See* JUDAH P. BENJAMIN, BENJAMIN'S TREATISE ON THE LAW OF SALE OF PERSONAL PROPERTY (Charles L. Corbin ed., 6th Am. ed., Jersey City, Frederick D. Linn & Co. 1889).

5. Commentators are still an important force for uniformity even under the Code. Consider, for example, the influence of Grant Gilmore and Peter F. Coogan (both no longer with us) on the interpretation of Article 9. *See, e.g.*, Peter F. Coogan, *A Suggested Analytical Approach to Article 9 of the Uniform Commercial Code*, 63 COLUM. L. REV. 1 (1963). It may, however, be best to keep quiet about the work of living commentators. In some contemporary academic circles, writings addressed to practitioners are not considered legitimate scholarship.

6. Samuel W. Williston, *Restatement of Contracts Is Published by the American Law Institute*, 18 A.B.A. J. 775, 776 (1932).

lowed when a limited remedy of repair or replacement fails of its essential purpose.

Ultimately, it will be the business community in the United States that will decide whether the uniform laws approach to achieving uniformity is satisfactory. It is unlikely that the UCC will be entirely federalized. Instead, it is more likely that we will continue to rely on a variety of tools to grapple with the dilemma of federalism. The piece-by-piece enactment of federal measures when the UCC solution does not produce the best outcome is not really a defeat for the Code. It merely confirms that the Code is a partial codification of our commercial law.

III. THE DILEMMA OF CHANGE

Before his death, Grant Gilmore himself had grown disillusioned with the Code project. Professor Gilmore feared that "[i]n the detail and rigid precision of much of its drafting the Code will cause us all much grief."[7] But more fundamentally he had grave doubts about the codification process in general. He had become convinced that codes end up codifying the practices of the past.[8]

The risk of statutory obsolescence is real; the pace of economic, technical and legal change is very rapid in American society. Specific rules formulated in light of recurring commercial situations may produce very surprising outcomes when economic, technical or legal changes cause enterprises to operate in a different manner. Moreover, the drafting process itself is extremely difficult. As the history of the development of the original UCC proves, good codes, like good wine, take time.[9] And the process of securing adoptions by the states can be protracted.

All of these factors combine to create the risk that provisions will be dated by the time of their enactment or shortly thereafter. Look what happened to Article 3. Drafting at a time of rather stable interest rates, the authors of Article 3 confidently specified that negotiable notes must be for a sum certain in money and that the holder should be "able to determine the amount then payable from the instrument itself with any necessary computation."[10] Very volatile market conditions subsequently

7. Grant Gilmore, *The Storrs Lectures: The Age of Anxiety*, 84 YALE L.J. 1022, 1038 (1975).

8. Grant Gilmore, *The Good Faith Purchase Idea and the Uniform Code: Confessions of a Repentant Draftsman*, 15 GA. L. REV. 605 (1981).

9. The need to revise the Code does not show that it is sick, but the haste of recent revision efforts is a matter of concern. The dilemma of change suggests that we will never produce a final version of the Code. Perhaps it would be better to try to institutionalize a slower and more thoughtful revision process.

10. U.C.C. § 3-106 cmt. 1 (1987) (amended 1990).

forced financers to employ floating interest rates tied to a prime rate or some other market index. As a result, most courts felt compelled to hold that the notes evidencing almost all commercial loans—and many consumer loans as well—were not negotiable and not subject to Article 3. Moreover, in consumer transactions for the sale of goods or services, the Federal Trade Commission rule requiring a legend on notes reserving to the consumer all claims and defenses has operated to remove these notes from Article 3.[11] Article 3 was on the books, but did not apply to the notes commonly being used by financers. The new Article 3 cures these specific problems. But the problems illustrate the circumstances that will make it very unlikely that any version of the UCC will become "a semipermanent piece of legislation" envisioned by the original drafters.[12]

In grappling with the dilemma of change, the uniform-law method of codification suffers from the disadvantage of being difficult to amend. True, it is also difficult to move Congress to act, but the federal option has the advantage of allowing Congress to articulate policy goals and leave much of the implementation to administrative regulations. Of course, there are other disadvantages with the regulatory option. But the question remains whether the uniform-law approach will prove adequate, as commercial problems increasingly require the very precise and technical solutions of computerized systems. For example, when, or if, prosperity returns and international economic activity continues to increase, it is not realistic to expect that state and local filings of security interests will be satisfactory in the long run. At some point a highly computerized, national filing system is likely to be demanded. Federal legislation and regulation not only will be required to implement such a scheme; they also will be required to implement inevitable technical changes and adjustments without drastic delay.

The more technical the problem, the less likely the uniform-law approach of the UCC will be the best solution. The strength of the UCC is in providing basic frameworks around which commercial activity can be planned and conducted. Articles 2, 5 and 9 of the original Code are examples of how successful the Code can be in providing a road map for commercial ventures. The Code has given even the small-town banker the confidence to issue letters of credit and engage in asset-based financing. The new Articles 2A and 4A play the same role. Commercial law-

11. The standard analysis was that the legend specifying that a holder takes subject to claims and defenses made the promise conditional and therefore destroyed its negotiability. *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 14-9, at 639 (3d ed. 1988).

12. U.C.C. § 1-102 cmt. 1 (1990).

yers and their clients simply feel more comfortable when the basic legal contours have been reduced to statutory form. In this role the Code is a catalyst for the expansion of commercial practices, rather than the slow hound trying to catch up.[13]

IV. THE DILEMMA OF CONSUMER PROTECTION

Uniform laws amount to legislation by consensus. The drafters must work for consensus within the sponsoring organizations and must produce a product that has a good chance of being sold to all of the state legislatures. Otherwise the goal of uniformity will be thwarted. Over the years the UCC has not provided a satisfactory vehicle for resolving issues of consumer protection because we have lacked a broad national consensus of how to deal with those issues. The American political soul is divided within itself. We are attached to the free market, with the efficiency and wealth that it brings. At the same time, however, we are concerned about abuses of economic power and are ready to relieve the hardship of those who bear heavy losses because transactions go wrong. When Congress decides where to draw the line between the free market and relief of hardship, it resolves the controversy based on principles of majority rule. When possible, the drafters of the UCC have chosen to avoid such confrontations. The end result is that much of the law of consumer protection is not to be found in the Code, but is scattered in a variety of federal and state statutes and regulations.

Avoidance of such issues, however, also produces a substantive policy position, and at times the Code is not merely silent on consumer questions. Rather, the business community knows that the sponsoring agencies for the Code provide a more congenial environment than the national Congress in which to design basic frameworks for commercial activity. Business leaders know that the end product—the UCC—will "tilt" in favor of commercial utility rather than consumer protection. The new versions of Articles 3 and 4, for example, attempt to protect bankers when they do not "sight review" checks[14] and when indorsements are forged by employees of firms that seek to shift their embezzlement losses to the banks.[15] Consumers and small businesses, however, will fight against UCC positions that are perceived as being unfair. They will urge the courts to use the principles of common law or equity to give them relief. They will seek specific corrective action from state legisla-

13. The original drafters hoped that the Code would "provide its own machinery for expansion of commercial practices," *id.*, as it has.

14. *See id.* § 3-103(7).

15. *See id.* § 3-405.

tures, from Congress or from friendly regulators. And sometimes they will succeed.

V. Conclusion

The end product of our multi-track system of commercial law is not neat. The results are unsettling to those who represent both business and consumer interests. There are costs incurred by working out the interface between the Code and varied consumer measures springing from other sources. Anyone who has struggled with the relationship between government regulations and the Code will attest to that. But the diffusion of policy-making embodied in the scheme is distinctively American. If our contemporary commercial law causes a "drag" on economic development or the building of a just society, the negative impact must be minuscule in comparison with the problems of our cities, schools and system of providing health care. In comparison with the results we achieve elsewhere, the results of our hodge-podge approach to commercial law appear to be a success story. Let's keep the Code for now, but recognize that it is only part of a larger commercial-law story.