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# The Uneasy Case Against the Uniform Commercial Code

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The last decade has not been kind to the Uniform Commercial Code ("U.C.C."). Prior to the last ten years, the U.C.C. was long regarded as one of the more, if not the most, successful projects in American lawmaking. Its self-stated goal of uniformity was achieved to a remarkable extent. All American jurisdictions, including Louisiana, have adopted the U.C.C.<sup>1</sup> Only acts of Congress could challenge the U.C.C. when it came to ensuring that the same legal rules would be found in every state. While there was a smattering of other uniform laws that had achieved widespread adoption, the areas of law covered by these statutes do not approach the depth and scope of the areas covered by the U.C.C. When it came to uniformity in an important area of state law, the U.C.C. had no serious contenders.

The U.C.C.'s success was more than simply achieving harmony among the various states. The substance of the U.C.C. was, by and large, considered a success as well. Perhaps the two most widely used portions of the Code in the life of a commercial lawyer, and a law student, are Article 2 and Article 9. Both were held in high esteem by the practicing bar and the professoriate. Article 2 was seen as the crowning achievement of perhaps the greatest legal academic of the 20th Century, Karl Llewellyn.<sup>2</sup> Its focus on commercial

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1. Information on the states' adoption of the various sections of the Uniform Commercial Code can be found on the website of the National Conference of Commissioners on Uniform State Law available at <http://www.nccusl.org>. Editor's Note: Louisiana has not adopted the uniform version of U.C.C. Article 2 in whole, but has revised the Louisiana Civil Code law of Sales to parallel U.C.C. Article 2. See James W. Bowers, *Incomplete Law*, 62 La. L. Rev. 1229, 1231 n.12 and n.13 (2002).

2. There is, not surprisingly, a large literature on Llewellyn, including William Twining, *Karl Llewellyn and the Realist Movement* (1973) [hereinafter "Twining"]; Douglas G. Baird, *Llewellyn's Heirs*, 62 La. L. Rev. 1287 (2002); Dennis M. Patterson, *Good Faith, Lender Liability, and Discretionary Acceleration: Of Llewellyn, Wittgenstein and the Uniform Commercial Code*, 68 Tex. L. Rev. 169 (1989); Alan Schwartz, *Karl Llewellyn and the Origins of Contract Theory*, in *The Jurisprudential Foundations of Corporate and Commercial Law* 12 (Jody S. Kraus & Steven D. Walt eds., 2002); Robert E. Scott, *The Rise and Fall of Article 2*, 62 La. L. Rev. 1009 (2002) [hereinafter "Scott, *Rise and Fall*"]; Zipporah B. Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant*

reasonableness was viewed as a triumph of realism over formalism.<sup>3</sup> Law adapted to business practice, rather than forcing businessmen to structure their transactions to adhere to the doctrinal niceties of times past.

Article 9 was viewed as an even more remarkable achievement. Article 2 had been built on its predecessor, the Uniform Sales Act. It was a successful offspring of a good, if somewhat worn, project.<sup>4</sup> Article 9, in contrast, had no such lineage. The drafters of Article 9 succeeded in melding together a welter of various state laws into a single, comprehensive statute governing the transfer of security interests in personal property.<sup>5</sup> With Article 9, the drafters succeeded in creating a law of general scope that was uniformly adopted. Few federal laws and virtually no state laws rivaled the U.C.C. in terms of its craftsmanship.

Other areas of the U.C.C. were held in similar high regard. In particular, Article 5 on letters of credit operated smoothly, as did Article 7 on warehouse receipts. Moreover, the U.C.C. process repeatedly demonstrated its flexibility, both by periodic updates of the extant articles and by the addition of new ones. After a six year gestation period, Article 2A was added in 1987 to handle issues relating to leases. Article 4A on wire fund transfers was added to the U.C.C. stable in 1989. Article 9 had been revised in 1972, and Articles 3 and 4 had been updated in 1990. The Permanent Editorial Board stood ready to provide guidance in between these major events. The U.C.C. was thus not only a remarkable achievement when first composed, but it also managed to keep pace with the times.

The success of the U.C.C., both in terms of its substance and its widespread adoption, was routinely attributed to its genesis. This was no partisan legislation written to secure immediate gain. Nor was it a hasty, ill thought-out response to a single problem. Rather,

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*Rules*, 100 Harv. L. Rev. 465 (1987). On how time has lessened Llewellyn's influence on current law, see Gregory E. Maggs, *Karl Llewellyn's Fading Imprint on the Jurisprudence of the Uniform Commercial Code*, 71 U. Colo. L. Rev. 541 (2000).

3. For example, see Homer Kripke, *The Principles Underlying the Drafting of the Uniform Commercial Code*, 1962 U. Ill. L. Forum 321, 330-32.

4. This is not to imply that Article 2 was simply a carrying forward of the Sales Act. Indeed, the principal drafter of the Sales Act, Samuel Williston, attacked Article 2 for not hewing to the Sales Act closely enough. See Samuel Williston, *The Law of Sales in the Proposed Uniform Commercial Code*, 63 Harv. L. Rev. 561 (1950). Rather, the point is simply that the drafters of Article 2 had the Sales Act as a point of departure.

5. See 1 Grant Gilmore *Security Interests in Personal Property* (1965); Edward L. Rubin, *Efficiency, Equity and the Proposed Revisions of Articles 3 and 4*, 42 Ala. L. Rev. 551, 557 (1991) [hereinafter "Rubin"].

the U.C.C. was the long, careful, systematic work of some of the country's leading scholars and attorneys.<sup>6</sup> It was drafted under the auspices of the National Conference of Commissioners on Uniform State Laws and the American Law Institute. Moreover, these groups kept a watchful eye on their handiwork to ensure that it remained current. In short, the U.C.C. was often seen as the exemplar of what could be done when experts were allowed to till the field.

To be sure, one could always pick nits. Section 2-207 on the battle of the forms was always good for a few laughs.<sup>7</sup> Article 3 recalled a somewhat mythical past in which negotiable instruments traversed the country as couriers without luggage.<sup>8</sup> The process by which Article 4 was drafted, notorious in commercial law circles for the high-handed lobbying by the American Bankers Association, was likened to "appointing a committee of dogs to draw up a protective ordinance for cats."<sup>9</sup> Article 4 has always been viewed as the price that had to be paid to ensure that the banking lobby would not derail the entire U.C.C. project. But these complaints were merely a side show. Indeed, what made them noteworthy was that they stood out from the rest of the project. The U.C.C. as a whole was universally seen as a praiseworthy achievement. In law school classrooms across the country, the U.C.C. was the gold standard. It was the exemplar of what a law should be. It may not have been perfect, but it was the best that we had.

What a difference a decade makes. The U.C.C. now finds itself under attack on various fronts. The few isolated snipings of the past became full broadside attacks. Some academics have gone so far as to argue that Article 2 and Article 9, the pillars of the U.C.C., should both be simply tossed away. Article 2 has been said to be inferior to

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6. On the genesis of the U.C.C., see Twining, *supra* note 2, chp. 11; Allen R. Kamp, *Uptown Act: A History of the Uniform Commercial Code: 1940-49*, 51 SMU L. Rev. 275 (1998); Allen R. Kamp, *Downtown Code: A History of the Uniform Commercial Code 1949-1954*, 49 Buff. L. Rev. 359 (2001).

7. For a summary of the current literature of U.C.C. § 2-207 (2000), see Daniel Keating, *Exploring the Battle of the Forms in Action*, 98 Mich. L. Rev. 2678, 2679-87 (2000); see also, James J. White & Robert S. Summers, *Uniform Commercial Code* 6 (4th ed. 1995) ("[T]he section is like an amphibious tank that was originally designed to fight in the swamps, but was sent to fight in the desert." *Id.*).

8. See Grant Gilmore, *Formalism and the Law of Negotiable Instruments*, 13 Creighton L. Rev. 441 (1979).

9. See letter from Grant Gilmore to Donald J. Raspon (Oct. 8, 1980) quoted in Donald J. Rapson, *Review of the Law of Modern Payment Systems and Notes*, 41 Bus. Law. 675, 677 (1986) (book review); see also Frederick K. Beutel, *The Proposed Uniform [?] Commercial Code Should Not Be Adopted*, 61 Yale L.J. 334, 362-63 (1952) (arguing that Article 4 was drafted by banks and represented "a deliberate sell-out." *Id.* at 362.).

both common law made by judges<sup>10</sup> and to private law crafted by trade organizations.<sup>11</sup> The basic complaint is that Article 2's focus on commercial reasonableness and trade usage asks more than the litigation process can deliver. Judges and lay jurors operating within the confines of the adversarial system cannot be expected to master industry practices. Even if they could, there is no guarantee that the parties would, before the fact, want to be legally committed to following those practices. Contracting parties may well have a norm of live-and-let-live when things are going well while at the same time expecting to be able to insist on rigid adherence to the terms of the contract if a dispute goes to litigation. Moreover, the vague standards of Article 2 leave so much room for differing judicial interpretations that Article 2 fails to provide similar results across jurisdictions. In light of these concerns over whether Article 2 is in fact normatively desirable, even if one wanted to keep Article 2 around, parties should be allowed to contract out of its coverage quickly and easily.<sup>12</sup>

The debates over Article 9 have been extensive and wide ranging. As an initial matter, many questioned whether secured creditor promoted economic efficiency at all.<sup>13</sup> Still others asserted that Article 9 encouraged inefficient investment because it allowed the debtor and the secured creditor to externalize costs onto nonadjusting

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10. See Robert E. Scott, *The Uniformity Norm in Commercial Law*, in *The Jurisprudential Foundations of Corporate and Commercial Law* 147 (Jody S. Kraus & Steven D. Walt eds., 2000) [hereinafter "Scott, *Uniformity Norm*"]; Scott, *Rise and Fall*, *supra* note 2, at 1017.

11. See Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. Pa. L. Rev. 1765 (1995); Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Value Creation Through Rules, Norms, and Institutions*, 99 Mich. L. Rev. 1724 (2001); Lisa Bernstein, *Formalism in Commercial Law: The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. Chi. L. Rev. 710 (1999).

12. As an example of the ease of contracting out of the U.C.C., the current version of Article 5 allows parties to contract for the rules set forth in the Uniform Customs and Practice for Documentary Credits by a simple statement to that effect. See U.C.C. § 5-116(c) (2000).

13. The literature here is extensive. For early work on why secured credit poses an efficiency problem, see Thomas H. Jackson & Anthony T. Kronman, *Secured Financing and Priorities Among Creditors*, 88 Yale L.J. 1143, 1147-61 (1979); Saul Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 Yale L.J. 49 (1982); Alan Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. Legal Stud. 1 (1981); F.H. Buckley, *The Bankruptcy Priority Puzzle*, 72 Va. L. Rev. 1393 (1986). Rather than extending this citation string for pages, I simply refer the curious to two excellent symposiums on the topic of secured credit, one in the Virginia Law Review, see 80 Va. L. Rev. No. 8 (1994), and the other in Cornell Law Review, see 82 Cornell L. Rev. 1279-1576 (1997) [hereinafter "Cornell Symposium"].

unsecured creditors.<sup>14</sup> We still lack an academic consensus on the appropriate scope of secured credit. There is widespread agreement that we lack sufficient data to resolve many of the key questions.

In a somewhat different vein, Alan Schwartz argued that even if contractual priority produces a net benefit for society, this benefit could be generated without the current Article 9. Article 9 sets forth a system by which a debtor can, via contract, grant priority rights in its various assets to various lenders. Each state is responsible for maintaining a registry in which each secured creditor can file notice of its security interest. Even if this institution of secured credit is efficient, according to Schwartz, it can be generated more easily. A simple rule of enforcing negative pledge clauses against third parties would work better.<sup>15</sup> To be sure, Article 9 may be better than its predecessors in terms of its ease of use, but it is by no means the best that can be done.

Perhaps even more dramatic than the questioning of the substance of the U.C.C. has been the attack on the U.C.C. drafting process itself. The vision of the drafting process as being conducted by high-minded experts simply trying to improve the law has been replaced by a more realistic, less flattering one. The U.C.C. is now viewed as the output of a private legislature.<sup>16</sup> Like all legislatures, this legislature is comprised of individuals who have their own biases and goals. Moreover, the drafting process is susceptible to interest group pressures, which rather than producing the best law possible, may generate a law that serves the need of the interest group. Indeed, this private legislature is worse in some respects than a public one. In those cases where competing interest groups exist, the private legislature lacks the institutional structure to resolve these competing claims, thus yielding either vague statutory provisions or even gridlock.

This reconception of the way in which the text of the U.C.C. comes into being has led to a new, more jaded view of most of the U.C.C. provisions. Article 9 is now seen as the output of attorneys

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14. See Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 Yale L.J. 857 (1996) [hereinafter "Bebchuk & Fried"], and the Cornell Symposium, *supra* note 13.

15. See Alan Schwartz, *A Theory of Loan Priorities*, 18 J. Legal Stud. 209 (1989); Alan Schwartz, *Priority Contracts and Priority in Bankruptcy*, 82 Cornell L. Rev. 1396 (1997).

16. See Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. Pa. L. Rev. 595 (1995) [hereinafter "Schwartz & Scott"]; Larry E. Ribstein & Bruce H. Kobayshi, *An Economic Analysis of Uniform State Laws*, 25 J. Legal Stud. 131 (1996). See also Nicholas S. Zeppos, *Reforming a Private Legislature: The Maturation of the American Law Institute as a Legislative Body*, 23 Law & Soc. Inquiry 657 (1998).

for lenders who write the rules so as to favor their clients.<sup>17</sup> Banks and their attorneys likewise dominate the formulation of Articles 3, 4 and 4A; here, they use their influence to ensure that they owe little, if any, duties to their customers.<sup>18</sup> By and large, most rights that a customer has against its bank come from her contract with the bank and not from Articles 3 and 4.<sup>19</sup> Article 2 is the inconclusive struggle between business interests and consumer interests.<sup>20</sup> The academics who often carry a large load in the drafting process are seen as trying to advance their own agenda. This agenda may include their own normative vision of the law, the desire for cultivating prestige with the practicing bar, or even procuring consulting opportunities. Any overlap between the public interest and the U.C.C. is one of circumstance, not inevitability.

The U.C.C.'s problems do not exist only in the scholarly milieu. The revision of the hallowed Article 2 has become something of a farce. Various drafts have come and gone.<sup>21</sup> Reporters resigned in protest.<sup>22</sup> A newspaper ad was purchased in an attempt to influence the vote of one of the proposed revisions. Attempts to bring other areas of commerce with Article 2's orbit, most notably information technology, have failed miserably and visibly. Year after year has passed, and still the ALI has not submitted a single draft of the revised Article 2 to the states. Courts have struggled with addressing the problems of the information age with the tools created decades ago.<sup>23</sup> What began as an attempt to modernize and broaden the scope of Article 2 now has the more modest goal of simply cleaning up

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17. See Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom*, 83 Iowa L. Rev. 569 (1998) [hereinafter "Janger"]; Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Law Process: Some Lessons from the Uniform Commercial Code*, 78 Minn. L. Rev. 83 (1993); Robert E. Scott, *The Politics of Article 9*, 80 Va. L. Rev. 1783 (1994) [hereinafter "Scott, Politics"].

18. See Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising Articles 3 and 4*, 26 Loy. L.A. L. Rev. 743 (1993); Rubin, *supra* note 5.

19. To be sure, Article 4 grants a customer the right to stop payment on a check. See U.C.C. § 4-403 (2000). Technological developments that have sped up the check collection process have eroded much of the value of this right. See Ronald Mann, *Information Technology and Non-Legal Sanctions in Financing Transactions*, 54 Vand. L. Rev. 1627 (2001).

20. See Schwartz & Scott, *supra* note 16; Scott, *Politics*, *supra* note 17; Scott, *Rise and Fall*, *supra* note 2.

21. For a summary of the process up to 2001, see Richard E. Speidel, *Revising U.C.C. Article 2: A View from the Trenches*, 52 Hastings L.J. 607 (2001) [hereinafter "Speidel"].

22. See *id.* at 611.

23. One prominent example is the treatment of shrinkwrap and click through license agreements, see *Pro CD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

some of the language. Indeed, the current effort has been downgraded from a full-scale revision of Article 2 to isolated amendments of the existing statute. Even this modest goal is not assured of success. Not much to show for over a decade's worth of work.

While the Article 2 revision process was suffering through this imbroglio, Article 9's most recent facelift had problems of its own. Whereas the Article 2 process resembles full-scale war, the Article 9 process looks more like the circling of the wagons. As noted above, serious questions have been raised about the vigor with which secured credit should be respected. The closest thing to an academic consensus that we have on the issue is that the current system slights the interests of tort victims.<sup>24</sup> Law and economics scholars have pointed out that this system creates an incentive for firms to take excessive risk. Firms enjoy limited liability, but participate fully in the gains from any investment. In deciding whether or not to undertake an investment, the firm thus does not expect to bear the full cost of failure. In particular, to the extent that a project causes injuries and the firm lacks sufficient assets to compensate the victims, the victims will suffer the loss. In a similar vein, some scholars drew on philosophy to question why it is appropriate to compensate voluntary creditors of a firm before compensating involuntary creditors. Voluntary creditors pick whom to deal with and on what terms; tort victims do not. Despite this agreement and repeated attempts to raise the issue in the drafting process, it appears that the Article 9 drafting process did not consider the issue seriously.<sup>25</sup> The drafting committee, stocked with representatives of secured lenders, simply was not interested. For academics attempting to analogize the U.C.C. rough-and-tumble drafting process to the ordinary legislative process, these events could not have been more timely. The U.C.C. has unquestionably lost some of its luster.

The U.C.C. may not be what it was once held out to be. Conceding that, however, does not warrant jettisoning the process. The U.C.C., after all, began as an attempt to create a better law than what existed at the time.<sup>26</sup> It may in fact be far inferior to its academic competitors. Academics writing scholarship enjoy a number of comparative advantages over actual drafters of legislation. First, they rarely engage in the process of composing actual

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24. See Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy: Further Thoughts and a Reply to Critics*, 82 Cornell L. Rev. 1279, 1296-98 (1997), and the sources cited therein.

25. See Janger, *supra* note 17, at 611-12; William J. Woodward, Jr., *The Realist and Secured Credit: Grant Gilmore, Common-Law Courts, and the Article 9 Reform Process*, 82 Cornell L. Rev. 1511, 1511-12 (1997).

26. On the aims and methods of Llewellyn, see Baird, *supra* note 2.



legislation; rather, they simply set out the broad parameters that would be followed in a perfect world. Thus, they don't have to sweat the details and come to grips with areas where their theory may be difficult or impossible to implement in practice. Second, each author must convince no one but himself. Compromise is not the nature of the academic enterprise.

However, the U.C.C. competes not against academic visions of optimal regulation but against products of other flawed institutional processes. Bringing interest group analysis to the private legislature has not removed interest groups from public legislatures. With our new understanding of the drafting process of the U.C.C., the question becomes one of comparative political economy—which of the many imperfect institutions should have the primary authority for crafting commercial law.<sup>27</sup> Here, the U.C.C. does have advantages over public legislatures that have been under appreciated in the recent debate. Primarily, the structure of the U.C.C. drafting and revision process suggests that it will produce a more technically competent set of laws than would a public legislature. Much legislation produced by public legislatures is a slapdash affair.<sup>28</sup> On average, it is going to have more gaps and internal inconsistencies than legislation produced via the U.C.C. process. In addition, the U.C.C. may reduce rent extraction by public legislatures. The need to adhere to the U.C.C. constrains the ability of legislators to offer favors to interest groups. Finally, even in areas where interest group dynamics suggest that there will be predictable flaws in the rules generated by the U.C.C. drafting process, the current situation which allows selective intervention by the federal government may be preferable to one that lodged initial lawmaking responsibility either in the state legislatures or the federal government.<sup>29</sup> For at least some areas covered by the U.C.C., the current flawed process may be the best that we can hope for.

Part I reviews the history and scope of the U.C.C. Part II then engages in a comparative institutional analysis. Part II first reviews the now-standard critiques of the U.C.C. drafting process. It then compares the shortcomings of this process to the shortcomings inherent in all possible alternatives—federal law, either in the form of legislation passed by Congress or regulations promulgated by an administrative agency; state law absent input from a coordinating

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27. On the need for comparative institutional analysis, see Janger, *supra* note 17, at 626; Pachtel, *supra* note 17, at 136.

28. See Victoria F. Nourse & Jane S. Schacter, *The Politics of Legislative Drafting: A Congressional Case Study*, 77 N.Y.U. L. Rev. 575, 590-93 (2002).

29. Cf. Janger, *supra* note 17, at 628-31 (suggesting that the U.C.C. process continues in some areas, but "abstains" from action in others so that the federal government would set the rules in those areas).

body; and the common law. This Part also articulates the hidden benefits of the U.C.C. process. While the U.C.C. process should not be given unfettered dominion of all that it currently covers, a system for producing commercial law that includes the extant U.C.C. process is decidedly better than one that does not.

### I. THE CURRENT SCOPE OF THE U.C.C.

The Uniform Commercial Code strikes many a law student as something of a dog's breakfast. This description does not stem from a failure to achieve its self-stated goal of uniformity. The U.C.C. no doubt achieved uniformity in the areas that it covers. All American jurisdictions have enacted the U.C.C., usually without any significant local variations.<sup>30</sup> The most recent example of the hold that the U.C.C. has achieved over the areas that it covers was the speed by which the new version of Article 9 was passed.<sup>31</sup> Revised Article 9 received approval from the American Law Institute ("ALI") in May 1998 and from the National Conference of Commissioners on Uniform State Laws ("NCCUSL") in July 1998.<sup>32</sup> The revision had a proposed effective date of July 1, 2001. All states and the District of Columbia have enacted the new Article 9. The only difference among the states was that four of them inserted effective dates that were a few months later than the one proposed by the drafters. This success stands in marked contrast to most of the proposed model laws promulgated by NCCUSL. NCCUSL has proposed over a hundred uniform laws. None of them can rival the U.C.C. for both its uniformity and the scope of the areas covered.<sup>33</sup>

The U.C.C., however, falls short of its lofty goals in its scope. The phrase "Commercial Code" implies a set of laws covering all of commercial practice. It evokes an image of being comprehensive.<sup>34</sup> Prior to the U.C.C., there were various uniform laws—the Sales Act, the Negotiable Instruments Law, the Uniform Warehouse Receipts Act, the Uniform Stock Transfer Act, the Uniform Bills of Lading Act, the Uniform Conditional Sales Act, and the Uniform Trust Receipts Act—but there was no "Code." The U.C.C. was a conscious

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30. As Bob Scott has pointed out, however, in Article 2 the veneer of uniformity comes at the cost of vague standards that will lead to non-uniform results as court apply these standards in practice. See Scott, *Uniformity Norm*, *supra* note 10.

31. On the reasons for the speed of this adoption, see discussion below.

32. For a description of the respective roles of the ALI and NCCUSL in drafting changes to the U.C.C., see Schwartz & Scott, *supra* note 16.

33. If you doubt this statement, just visit the NCCUSL website, *supra* note 1.

34. On the implications of the word "Code," see William D. Hawland, *Uniform Commercial "Code" Methodology*, 1962 U. Ill. L. Forum 291.

attempt to systemize the area of commercial law.<sup>35</sup> Yet, if one looks at the general area of commercial law, there are surprises both in what the U.C.C. does not cover and what it does. Article 2, the first substantive article of the U.C.C., addresses perhaps the most ubiquitous of areas of commercial practice, contracts. Almost all commercial transactions involve voluntary exchanges. Yet Article 2's reach is limited. It only applies to the sale of goods. This leaves contracts for the sale of real estate and for personal services to the common law for their regulation. The recent attempt to expand Article 2 to expressly address many issues arising from information technology has failed.<sup>36</sup>

A somewhat related area of contract practice that is now outside the ambit of Article 2 is the validity of contracts formed over the internet. While one can make a respectable argument that electronic contracts satisfy Article 2's statute of frauds provision, significant pressure from those who sell goods over the internet spurred action to ensure this result. NCCUSL weighed in first with a non-U.C.C. uniform law, the Uniform Transactions Act. Congress then guaranteed uniform enforceability of electronic contracts by passing the Electronic Signatures in Global and National Commerce Act, which removes this area from state law regulation.<sup>37</sup>

Article 2 thus seems destined to be limited to the sale of goods. However, a normative justification for handling these contracts by a uniform statute and other contracts by an amalgam of common law and nonuniform state law is lacking. No one has put forward a case as to why sales of goods contracts need a body of law that is distinct from the body of law that governs land or services contracts. Nor has there been any argument pressed as to why there is a need for uniformity in the goods context that does not exist in other areas.

Article 9 likewise touches upon an important commercial practice, but like Article 2, only covers a subset of transactions that serve the same general purpose. Article 9 regulates the granting of security interests. Security interests, like contracts, are part of the staple of commercial lawyers. Many firms that borrow money give collateral to at least some of their lenders. Article 9, however, does

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35. *See id.*

36. Information goods were originally going to be brought into the Article 2 fold with the "hub and spoke" concept. When this failed, these transactions were going to be handled by a separate article, Article 2B. Unable to reach agreement on Article 2B, those in charge of the U.C.C. have abandoned the attempt. Such transactions are now covered by a non-U.C.C. project, the Uniform Computer Information Transactions Act ("UCITA"). *See* Speidel, *supra* note 21, at 612-14.

37. For a discussion of congressional involvement in this area, *see* Suzanna Sherry, *Haste Makes Waste: Congress and the Common Law in Cyberspace*, 55 Vand. L. Rev. 309 (2002).

not apply to all pledges of collateral. Notably missing from Article 9 are security interests in land, which are governed by state law, and in patents and copyrights, which are governed by federal law. This lack of completeness ensures that Article 9 will not cover a bulk of financing transactions. Real estate transactions, at least in terms of dollar amounts, currently dominate asset-based finance, and the importance of intellectual property rights as collateral is increasing.

While Articles 2 and 9 are the most notable of the U.C.C. provisions, other parts of the U.C.C. suffer from limitations as well. Article 8 has a somewhat different limitation than does Articles 2 and 9. It covers all securities, and securities no doubt are an important aspect of commercial practice. However, the U.C.C. fails to cover many of the important questions surrounding securities. Article 8 sets forth provisions detailing how the ownership interest of securities is assigned, which includes how one can pledge securities as collateral. Yet much of the action in securities law concerns the actions that a firm and its managers can take in connection with the issuance and purchase of securities. Here, both federal and state law impose important requirements, but they are not found in the U.C.C.

Additionally, there are areas of commercial practice that are entirely untouched by the Commercial Code. Most businesses have insurance to cover many of the risks that they face. Indeed, in contracts for various services, it is often an important issue as to which party is required to procure insurance. There is also the insurance agreement itself, which at bottom is a species of contract. Yet nothing in the U.C.C. purports to establish legal rules regarding insurance.<sup>38</sup>

Bankruptcy law also is generally considered part of commercial practice, but it cannot be found in the U.C.C.<sup>39</sup> To be sure, any bankruptcy case will likely involve U.C.C. issues. Contracts for goods may create either claims or assets for the debtor, and lenders with personal property as collateral need perfected security interests as required by Article 9 if they want a secured claim. However, the

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38. The closest one gets in U.C.C. § 2-320 (2000), which states that the term "C.I.F." means that the price includes the cost of insurance and freight.

39. Of course, bankruptcy law can equally be viewed as part of general corporate law. See, e.g., Barry E. Adler, *A Theory of Corporate Insolvency*, 72 N.Y.U. L. Rev. 343 (1997); Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 Stan. L. Rev. \_\_\_\_ (publication forthcoming 2002); Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 Tex. L. Rev. 51 (1992); David A. Skeel, Jr., *Rethinking the Line Between Corporate Law and Corporate Bankruptcy*, 72 Tex. L. Rev. 471 (1994).

substance of bankruptcy law is in the Bankruptcy Code, not the Uniform Commercial Code.

So much for the puzzling exclusions. On the other hand, the U.C.C. contains provisions that cover areas that seem to be of little relevance today. The heart of Article 3 as originally drafted—the holder in due course doctrine—is mostly of historical interest.<sup>40</sup> It has been decades since the economy hinged on ensuring the easy flow of negotiable instruments. Article 6 on bulk sales is quickly flickering out of existence.<sup>41</sup> Article 7 on warehouse receipts seems to be doing just fine, though warehouse receipts do not strike one as a growing aspect of commercial practice.

Other parts of the U.C.C. retain vitality, but only because they mimic other laws. Much of Article 4 ostensibly sets out the rules for the check collection process. Federal law, in the form of Regulation CC, has taken over that task.<sup>42</sup> Article 5 retains its influence because the drafters of the recent amendments to that provision decided to resolve all conflicts between the original Article 5 and its competitor—the Uniform Customs and Practice for Documentary Credits, promulgated by the International Chamber of Commerce—in favor of the competitor.<sup>43</sup>

To be sure, in addition to various revisions of extant articles, there have been two notable attempts to keep the U.C.C. current in the half century since its conception. In the early 1980s, Article 2A was added. Article 2A covers leases; like the rest of the U.C.C., it only extends to personal property. Article 4A, added in 1989, covers wire fund transfers. The Federal Reserve Board has adopted Article 4A as the provision that regulates all wire fund transfers over its system.

In short, if a commercial lawyer were to draft a list of topics that should be covered in a uniform commercial code, that list may bear some similarity to our current U.C.C., but the overlap would by no means be perfect. The U.C.C. does contain some staples of commercial law, but parts of the U.C.C. are never touched by a practicing lawyer. Moreover, such a lawyer often has to turn to other sources to resolve important issues of commercial law.

The import of the hodgepodge nature of the U.C.C., from anything other than an aesthetic point of view, is not readily apparent.

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40. See Gilmore, *supra* note 8; Ronald Mann, *Negotiability in Payment and Credit Systems*, 44 UCLA L. Rev. 951 (1997).

41. NCCUSL and the ALI have recommended that Article 6 be repealed. See Official Text of U.C.C. § 6, Alternative A.

42. Article 4 is currently being redrafted, and part of the goal had to been to ensure that Article 4 was congruent with Regulation CC. This part of the revision effort has been abandoned.

43. See Ronald J. Mann, *Payment Systems and Other Financial Transactions* 216 (Aspen 1999).

Indeed, one can discount the lack of comprehensive scope of the U.C.C. It might matter to the drafters of the U.C.C. how comprehensive their product is—we all like to see our work as important—but it may matter little to the practicing lawyer. All of the areas that are not covered by the U.C.C. are covered by some other law. It is not as if there is no law for contracts for services or pledges of real estate. Why should we care whether the law of sales can be found in the U.C.C. and the law of contracts for services in the common law? Does it really matter whether the bankruptcy attorney picks up a volume labeled “The Bankruptcy Code” rather than “Article 10 of the U.C.C.”? To be sure, one has to worry about consistency between Article 9 and the Bankruptcy Code, but such consistency would be an issue even if both were enacted by the same sovereign.<sup>44</sup> So what if Article 3 insists on carrying forward the tradition of the holder in due course? The FTC has tamed the more pernicious uses of the doctrine,<sup>45</sup> so we are left with provisions that may do little, if any, harm.

Put another way, what matters to practicing lawyers and academics is the substance of the law. Neither uniformity—which the U.C.C. has—nor comprehensiveness—which it does not—are ultimate goals. A uniform, comprehensive commercial code filled with cumbersome, inefficient and vague rules has little to commend it. What counts is the content of the law, not its cover.

What the tattered coverage of the U.C.C. does suggest, however, is that perhaps we do not need the current uniform law process at all. If some areas of the law can be handled on a state-by-state basis and other areas by federal legislation, one cannot posit a priori that commerce would grind to a halt were the ALI and NCCUSL to exit the field. To be sure, one also cannot assume that public lawmaking institutions would necessarily perform better than the private ones. The next part of this essay first explores how we have reached the patchwork system that we have. It then explores what advantages the uniform law process may have over its competitors.

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44. There have been repeated attempts to ensure consistency between Article 9 and the Bankruptcy Code. For example, as part of the reform process that led to the 1978 Bankruptcy Code, the National Bankruptcy Conference established a committee on the coordination of the Bankruptcy Act and the Uniform Commercial Code. Grant Gilmore was the committee's chair. See Steven L. Harris, *A Reply to Theodore Eisenberg's Bankruptcy Law in Perspective*, 30 UCLA L. Rev. 327, 331-34 (1982). See also Steven L. Harris & Charles W. Mooney, Jr., *Revised Article 9 and the Bankruptcy Code: Policy and Impact*, 9 Amer. Bankr. Inst. L. Rev. 85 (2001) (reporters for the revised Article 9 arguing that the new Article 9 comports with bankruptcy policy).

45. See 16 C.F.R. § 433.2(a) (2001).

## II. COMPARATIVE POLITICAL ECONOMY

Commercial law emanates from a variety of institutions. Courts, state legislatures acting on their own, state legislatures coordinating through the uniform law process, and Congress each have primary responsibility for different facets of commercial law. Moreover, there is a hierarchy in this process. These institutions are not coequal decision-makers. State legislative action can trump judicial decisions, and Congressional action beats both. Action by an institution higher up on the food chain precludes consideration by all institutions below it. This division of various institutions raises two distinct questions. The first question is what explains this patchwork system. Given the curious omissions and inclusions of the U.C.C., one needs a story as to how they developed. The second question is a normative one. Given that there are a number of institutions from which to pick, which institution does, on average, a better job?

*A. How Did We Get Here?*

The history of the drafting of the U.C.C. is a familiar one. Prior to the U.C.C. project, NCCUSL proposed a number of model laws on a variety of subjects, with mixed success.<sup>46</sup> NCCUSL has its most consistent success in the area of commercial law. It proposed numerous commercial acts, which had been adopted with varying degrees of uniformity. The oldest of these laws was the Negotiable Instruments Law, which was drafted in secret. Indeed, Dean Ames at Harvard, the foremost authority on negotiable instruments at the time, did not learn of the law until it was enacted in a number of states.<sup>47</sup> NCCUSL also promulgated the Uniform Sales Act, which was drafted by Samuel Williston, the Uniform Warehouse Receipts Act, the Uniform Stock Transfer Act, Uniform Bills of Lading Act, the Uniform Conditional Sales Act, and the Uniform Trust Receipts Act. Three of these acts—the ones covering negotiable instruments, warehouse receipts and stock transfers—were enacted in every state. This actually overstates the degree of uniformity a bit, in that NCCUSL proposed amendments to the warehouse receipts act in 1922, and only 16 states adopted these amendments. The next most adopted provision, the sales act, was adopted in 34 of the then 48 states.<sup>48</sup>

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46. See James J. White, *Ex Proprio Vigore*, 89 Mich. L. Rev. 2096, 2106-28 (1991) (describing efforts to draft and enact a uniform divorce law).

47. See Gilmore, *supra* note 8, at 457.

48. See Twining, *supra* note 2, at 273.

In the late 1930s, there was a push for a federal sales act.<sup>49</sup> This act, however, would not have achieved uniformity across the country. The proposed legislation did not cover intrastate sales of goods, and differed from the Uniform Sales Act. Indeed, the primary justification for the Act was to ensure that there was a single set of rules that foreign courts could look to when litigating disputes that implicated American law.<sup>50</sup> A second justification was that the current differences in the laws of the various states created difficult conflicts of laws problems that would be avoided by the adoption of a federal act that applied to all interstate shipment of goods.<sup>51</sup> At this point, William Schnader, the President of NCCUSL and Karl Llewellyn embarked on the project of creating a uniform commercial code.

They decided to craft a uniform commercial code built on the existing foundation of uniform laws. No effort was made to expand the reach of the extant proposed laws. From its earliest conception, Llewellyn viewed the scope of the code as covering "the movement of goods, the payment thereof, and the financing thereof."<sup>52</sup> Llewellyn ruled out the regulation of businesses generally on the grounds that "[w]e have too little experience with their regulation, and there is too much flux in regard to them."<sup>53</sup> The drafters thus took the existing uniform laws as the baseline for their subject. They did not attempt to examine, let alone reinvent, the wheel.<sup>54</sup> At this time, corporate bankruptcy law, which began as common law in federal court, was the province of the federal government.<sup>55</sup> As such, it was outside of NCCUSL's jurisdiction. Insurance law was never the subject of any unifying attempt by NCCUSL. Insurance was left off the table because "local insistence on state control . . . [is] too firmly established to make uniform legislation seem possible."<sup>56</sup>

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49. See Symposium: *The Proposed Federal Sales Act*, 26 Va. L. Rev. 537 (1940).

50. See Karl N. Llewellyn, *The Needed Federal Sales Act*, 26 Va. L. Rev. 558, 558 (1940).

51. *Id.* at 559-60.

52. See Twining, *supra* note 2, at 528 (memo from Karl Llewellyn to the Executive Committee of NCCUSL).

53. *Id.*

54. See *id.* ("In essence, then, the Code carries forward and supplements the fields already occupied by one or another of the widely adopted commercial statutes.").

55. On the development of bankruptcy law, see David A. Skeel, Jr., *Debt's Dominion: A History of Bankruptcy Law in America*, chap. 2 (Princeton Univ. Press 2001); Douglas G. Baird & Robert K. Rasmussen, *Boyd's Legacy and Blackstone's Ghost*, 1999 S.Ct. Rev. 393 (2000).

56. See Karl N. Llewellyn, *Why We Need the Uniform Commercial Code*, 10 Fla. L. Rev. 367, 378 (1957).



Similarly, NCCUSL did not attempt to unify real estate law across the varying states.

Thus, it appears that little thought was given to move the U.C.C. beyond goods to real estate and services. One can imagine a few possible reasons for this. Perhaps the most benign reason stems from the state of economic activity at the time. Manufacturing was the mainstay of the American economy in the first half of the past century. Most contracts that involved parties from more than one state were probably contracts for the sale of goods. Real estate, by and large, was probably purchased by a local, in-state entity. Service contracts may have rarely extended across state borders. With this state of affairs, only the sale of goods implicated the need for a single set of rules. It was the manufacturers and their distributors that contended with doctrinal variations across state lines. It was the buyers and sellers of goods who, absent uniformity, would have to contend with differing state laws.

To be sure, one could posit other reasons as why some areas of commercial law never fell within the purview of the uniform law movement. One reason may be that the local bar may actually preferred a lack of uniformity when it came to real property. Property law, like contract law, is basically a feature of state law. Unlike contract law, however, parties to a transaction involving real property do not have a choice over which law will apply. A state where property is located is going to set forth the legal rules governing that property. This is not so with contracts for goods. Here, transactions often cross state borders, and lawyers can select the appropriate law.

In this environment, local lawyers can generate rents by having the legal rules governing real property vary from those of other jurisdictions. One way they do this is by increasing the jurisdiction-specific aspect of the transactions costs that accompany any sale of property. A party buying land in one state, in addition to having its regular counsel, will often need to hire a local lawyer to assist with the transaction. Indeed, the more quirks that exist in a state's law regarding the transfer of real property, the more a client's regular counsel will feel compelled to hire local counsel to ensure that the deal goes through without a hitch.<sup>57</sup> Were property laws uniform throughout the nation, the less need there may be to consult with local attorneys.<sup>58</sup> Idiosyncratic state laws, to the extent that a party

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57. On the general tendency for transactional attorneys to avoid legal risks, see Donald C. Langevoort & Robert K. Rasmussen, *Skewing the Results: The Role of Lawyers in Transmitting Legal Rules*, 5 S. Cal. Interdisc. L.J. 375 (1997).

58. Louisiana is probably the best example of this tendency. Few would attempt to purchase land in Louisiana without the aid of a local attorney to navigate

has to use them, increase the market for those lawyers who know those laws. To be sure, there is a limit on the extent that a state can play this game. If transactions become too costly, parties will look for land elsewhere. Nevertheless, some diversity in local law probably raises the demand for in-state attorneys.

A lack of uniformity on real estate law may provide a second advantage to those attorneys within any given state. Variation in state laws may act as a barrier to entry into local legal markets. States license attorneys, and most states require attorneys wishing to practice there to sit for the bar exam. The more peculiar a state's law, the higher the cost to an attorney wishing to enter the jurisdiction. The attorney has to learn more law than she otherwise would and also runs a greater risk of not passing the bar exam. While these two effects may be minor, at least they suggest reasons as to why local attorneys may not rush to embrace a proposed uniform law covering contracts for the sale of land.

The same general line of reasoning can assist in explaining the persistent separation of systems for recording nonpossessory interests in land and nonpossessory interests in everything else. To be sure, recordation systems for land predate the ability to take a nonpossessory security in goods by a number of years. Yet, there is little or no movement to create a unified system for recordation of all security interests. Part of the reason for this lack of interest may be that local lawyers have little reason to make their real estate system congruent with those of every other state.

Perhaps the most curious division is that between contracts for the sales of goods and contracts for the sale of services. At first blush, one would think that services have more of an affinity to goods than to real property. In the real property setting, certainty exists as to which law will apply. The property is physically located in a particular jurisdiction, and that state will dictate which laws apply. This is not so in the sale of goods area and the service area. In both situations, any given transaction can cross state lines, and thus a state cannot be assured that its laws would govern.

Placing contracts for services with those for real estate may simply reflect the nature of the economy of the time. In the middle part of the 20th Century, manufacturing was more important relative to services than it is today.<sup>59</sup> Hence, one would think that sales of

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through the Louisiana legal system.

59. As an example of this trend, consider that in 1980, well after Article 2 had been adopted by every state, there were over almost 22 million employees in manufacturing, and roughly 29 million in the service industry. *See* Statistical Abstract of the United States, table 596, at 384 (2001). Twenty years later, the number of employees in the manufacturing sector had fallen to 20 million, while the number of those in the service industry had swelled to more than 49 million. *Id.*

goods would be on more people's minds. Also, and perhaps more importantly, it may be that there was a less perceived need for uniformity in the service area. A manufacturer selling goods across the country may encounter the law of all fifty states. The more divergent laws that a firm has to deal with, the higher its transactions costs will be. Thus, the manufacturing industry would have reason to throw its weight behind a uniform sales law.

The same is not true for a provider of services. Services contracts tend to be more individualized transactions. The same service is not usually provided to consumers in all fifty states. Also, at least when the U.C.C. was being conceived, service contracts by and large tended to be more local in nature than sales of goods contracts. Goods could come from any jurisdiction. Most contracts for services, on the other hand, probably involved a local buyer and a local seller. The fact that jurisdictions differed in their treatment of such contracts did not loom as a large problem. There is no readily identifiable group that would see a significant lowering in its costs of doing business were service contracts subject to a uniform law. In short, there simply was no benefit to be achieved through a uniform law governing either service or real estate contracts.

So much for contracts and security interests. What explains the confusing state of affairs regarding responsibility for regulating payment systems? Here, the divide is not between state-by-state regulation and uniform state regulation. This was the area of commerce that launched the uniform law movement. Indeed the drive toward a single set of laws in this area predates the existence of today's most prominent payment system regulator, the Federal Reserve Board.<sup>60</sup> Rather, the relevant divide is whether uniformity should be supplied by uniform state regulation or by federal law. As with the curious division of responsibility for contracts, history is telling. At the time of the original drafting of the U.C.C., the most prominent payment mechanisms were checks, notes and letters of credit. These were historically regulated by uniform state laws, beginning with the Negotiable Instruments Law in the late 19th Century. It was thus no surprise that they became part of the uniform law process.

Modern payment systems, especially on the consumer end, did not develop until after the U.C.C. process had begun. The universal credit card did not gain widespread use until the rise of the Bank America Card in the 1960s.<sup>61</sup> Federal legislation followed soon afterward. The Truth-in-Lending Act, which regulates the

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60. The NIL was first enacted in 1897; the federal reserve bank system was created over a decade later in 1913.

61. Edward L. Cooter & Robert Rubin, *The Payment System* 712-15 (2d ed. 1994).

cardholder/card issuer transaction, took effect in 1968. With the federal government regulating credit cards, it was no surprise that debit cards were viewed as an appropriate subject of federal regulation as well. While not as generous to the consumer as the Truth-in-Lending Act, the Electronic Fund Transfer Act went on the books in 1977. Thus, these two areas, in which banks by and large provide payment services to consumers, are the province of federal law.

The same is not true with the other primary payment system that banks offer to consumers, checks. The legal regulation of checks may be the most convoluted of all commercial law regulation. Checks are now governed by an amalgam of state law, federal law and federal regulation. The legal rights of the various parties to a check were, in the first instance, governed by the NIL. A check, after all, is nothing more than a draft drawn on a bank. The banks, however, wanted a set of rules to govern the check collection process. Eventually, Article 4 was added to the U.C.C. to specially handle checks.<sup>62</sup> Article 4, however, unlike all other Articles, was not self-contained. Rather, it supplemented the rules set forth for drafts in Article 3. Thus, as the U.C.C. was originally drafted, checks were governed by the general commercial paper provisions of Article 3 and by the check-specific provisions of Article 4.

The federal government got in on the action in the 1980s. Consumers long complained that banks were putting inordinately long holds on deposited checks. Nothing in Article 4 regulated when banks had to make funds available to their customers. Customers routinely had to wait more than a week in order to draw funds on deposited checks. Congress responded to consumer complaints by enacting the Expedited Funds Availability Act, which established a schedule by which banks made funds available.<sup>63</sup>

The EFAA was the hook that the Federal Reserve used to take substantial control over regulation of the check collection process. The law granted power to the Federal Reserve to ensure that banks complied with the statutory deadlines for making funds available. The Federal Reserve has used this power to issue Regulation CC, which regulates the check collection process, thereby displacing portions of Article 4. Neither Article 4 nor Article 3, however, are displaced in their entirety. The recent effort by the ALI to update Article 4 to make it congruent with Regulation CC has fizzled.<sup>64</sup> As

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62. The drafting of Article 4 was the most tumultuous of the Code, including the sacking of the original reporter for the project. For an in-depth history of this process, see Kamp, *supra* note 6, at 448-64.

63. See Edward L. Rubin, *Uniformity, Regulation, and the Federalization of State Law: Some Lessons from the Payment System*, 49 Ohio St. L.J. 1251, 1257-61 (1989).

64. See Memorandum from Ronald J. Mann & Edwin E. Smith, Apr. 3, 2002,

any teacher of Payment Systems knows, students are bewildered in trying to figure out which body of law they should turn to when faced with a problem involving a check.

To be sure, the remaining provisions of the U.C.C. have their own history as well. Rather than canvassing them in any detail, it is sufficient to make two points. The first is that one cannot explain the extant assignment of lawmaking authority among states, the uniform law process, and the federal government as the result of a conscious design to divvy up law making authority according to which institution is best suited to make the rules governing any particular area. The second point is that to the extent that commercial law contains provisions designed to protect the welfare of consumers, these provisions came from either the federal government or the state government acting alone. The banning of the holder in due course doctrine in consumer transactions, the protections for unauthorized use of credit cards and debit cards, the restrictions on deceptive advertising, and the availability of funds all came from the federal government. States often pass legislation designed to safeguard consumer interests. The drafters of the various provisions of the U.C.C., however, have not been interested in such measures.<sup>65</sup>

The extant assignment is thus both path dependent and relatively inhospitable to consumer lobbying efforts. Saying this, however, does not necessarily suggest that the U.C.C. should be consigned to the dustbin. The next part assesses the relative merits of the current uniform law process on the one hand, and nonuniform state lawmaking and federal lawmaking on the other.

#### *B. Where Should the Laws Be Made?*

The academic attack on the U.C.C. drafting process has centered on the identification of the interest groups that participate in the process and those that are excluded, and how the private lawmaking process reacts to these groups. The groups that have a comparative advantage in influencing NCCUSL and the ALI are then seen as attempting to mold the final product to suit their own ends as opposed to those of society at large. In particular, the Article 9 revision process has been characterized as being unduly influenced by commercial lenders who seek to promote a norm of secured credit

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*in* Tentative Draft of Proposed Revisions to Articles 3 and 4 (Apr. 15, 2002).

65. On the lack of consumer protection provisions in Articles 3 and 4, *see* Rubin, *supra* note 5; on the difficulties faced by consumer groups in the current Article 2 revision process, *see* Gail Hillebrand, *What's Wrong with the Uniform Law Process*, 52 *Hastings L.J.* 631 (2001). On the lack of consumer input into the revised Article 9, *see* Janger, *supra* note 17, at 572 ("[T]he Proposed Final Draft does nothing to make secured credit safer for consumers." *Id.*).

uber allies.<sup>66</sup> On this public choice view, the seemingly endless Article 2 revision process represents the inconclusive struggle between business groups seeking almost complete freedom of contract and consumer groups attempting to place limits, or at least impediments, on certain contracting practices.<sup>67</sup> Added to this, Articles 4 and 4A have always been seen as the result of heavy lobbying by banks seeking to curb any duties owed to their customers.

It is one thing to diagnose a problem; it is quite another to find a cure. Transferring responsibility for drafting commercial law from NCCUSL and the ALI to another institution or set of institutions will not remove the incentives of interest groups to procure legislation that they favor. Groups will seek to further their conception of appropriate public policy regardless of the arena in which the decision is made. If decisions are made by judges, interest groups will participate in the judicial selection process and try to influence judges through amicus briefs. If authority rests in the state legislatures, lobbying will take place there. If the federal government sets the rules, groups will travel to Gucci Gulch. This is not to say that interest groups will necessarily have the same influence in every venue; rather, the point is that one cannot eliminate the effect of interest groups on the subject matter covered by the Uniform Commercial Code by simply transferring rule making authority from NCCUSL and the ALI to another institution. The ultimate question is which institution will produce better laws.<sup>68</sup>

To decide which institution will produce better laws, one has to compare their respective flaws. In particular, one has to identify how interest group pressures play out in different institutional settings. Moreover, one needs to ascertain the goals of the laws in question. It is one thing to predict whether or not an interest will succeed in procuring legislation in one setting as opposed to another. It is a different matter to judge whether or not the law that is enacted is normatively desirable.

How these matters play out in the context of the subject matter currently governed by the U.C.C. is a complex matter. As noted above, the U.C.C. itself covers a variety of areas, with different interest groups interested in different areas. This essay continues the work on comparative political economy begun by others in large part

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66. See Janger, *supra* note 17, at 617-25; Robert E. Scott, *Is Article 2 the Best We Can Do?*, 52 *Hastings L.J.* 677, 681 (2001).

67. See Schwartz & Scott, *supra* note 16, at 645-47; Scott, *supra* note 2 ("The outcome of the Article revision process was predictable. Indeed, it was predicted." *Id.*).

68. See Janger, *supra* note 17, at 626.

by pointing out the benefits of the uniform law process that are too easily overlooked.

In assessing where responsibility for establishing the legal rules for commercial law should lie, it is first helpful to identify the relevant interest groups who can affect the legislative product. The next step is to identify the potential forums to which responsibility could be assigned for handling commercial law. Each forum has a different structure, and brings a different set of resources to bear on the problem. Next, an examination of the appropriate goals for commercial law is necessary. With the players, the forum, and the goals in mind, the costs and benefits of the current system can be compared to plausible alternatives.

### *1. The Players*

The most obvious interest groups who attempt to affect the content of commercial law are those groups directly affected by the law in the applicable area. In the case of the U.C.C., this differs Article by Article. Banks tend to be most concerned with Articles 3 and 4 to the extent that they govern checks and the check collection process, Article 4A on wire fund transfers, Article 5 on letters of credit, and Article 9 on secured transactions. Indeed, the influence of the banking industry has been widely noted in the drafting of each of these provisions.<sup>69</sup> Of course, banks themselves are not necessarily a homogenous lot. For example, national money center banks have a much greater interest in letter of credit rules than do smaller, more local banks. Moreover, banks are not coextensive with lenders. Many lenders, such as GE Capital, are not banks. Thus, Article 9 attracts the interest of asset-based lenders, only some of whom are banks.

Another potential interest group that may spend resources to shape the content of law is the business community. Sales of goods tend to involve either one or two businesses; letters of credit are generally procured by businesses as opposed to consumers; secured borrowing is a major source of financing for many firms. It is thus no surprise that business groups repeatedly appear in the past and current history of the U.C.C. Attorneys representing manufacturing

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69. See Frederick K. Beutel, *The Proposed Uniform [?] Commercial Code Should Not Be Adopted*, 61 Yale L.J. 334 (1952) (bank influence in drafting Articles 3 and 4); Rubin, *supra* note 5, at 558-59 (bank interest in Articles 3, 4 and 4A); James J. White, *The Influence of International Practice on the Revision of Article 5 of the U.C.C.*, 16 Nw. J.Int'l L. & Bus. 189 (1995) [hereinafter "White, *International Practice*"] (describing drafting of revised Article 5); sources in *supra* note 62 (role of lenders in Article 9 drafting process).

interests played crucial roles in the initial drafting of the U.C.C.<sup>70</sup> Today, business interests play a high profile role in the ongoing struggle over the amendment of Article 2.<sup>71</sup> Businesses routinely sell goods, and they have an interest in the extent to which Article 2 constrains their ability to write certain contracts.

A third group affected by at least some of the provisions of the U.C.C. is consumers. The extent to which the interests of consumers are implicated varies across the U.C.C. Consumers routinely buy goods and engage in checking relationships with banks. Consumers, however, are not affected by many of the provisions of the U.C.C. They are rarely involved with letters of credit or negotiable documents of title. Similarly, they tend to have little direct experience with Article 8. As to Article 9, the granting of a security interest does not account for a majority of asset-based consumer debt. Consumers grant security interests most often in their houses and their cars. House mortgages do not fall within the scope of Article 9, and car liens are handled primarily by state certificate of title laws rather than by Article 9. Moreover, when a consumer buys a product on which there is a security interest in the ordinary course of business, they take the item free from the security interest.<sup>72</sup>

At times, consumers do grant security interests in the goods that they purchase. For example, a purchaser who uses a Sears credit card gives Sears a purchase money security interest in the items bought.<sup>73</sup> Consumers thus have an interest in the regulation of collection activities by secured creditors.

While consumers obviously are affected by some of the U.C.C. provisions, it is far from clear as to who is an appropriate representative of their interests. Banks and businesses hire their own representatives and can monitor their performance. Consumers on the other hand, must rely on self-appointed agents to guard their interests. These agents no doubt view themselves as advancing consumer welfare. What benefits consumers, however, is far from clear.<sup>74</sup> There is no mechanism that ensures that consumer groups lobby for positions that, in the long run, increase consumer well-being.

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70. See Kamp, *supra* note 6, at 384-85.

71. Scott, *Rise and Fall*, *supra* note 2.

72. See U.C.C. § 9-320 (2000).

73. See *In re Carlos*, 215 B.R. 52 (Bankr. C.D. Cal. 1997).

74. Consider, for example, the debate over the enforcement of standard form contracts. Some view such contracts with deep suspicion, see, e.g., Todd D. Rakeoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 Harv. L. Rev. 1174 (1983), while others believe that they often provide benefits for consumers, see, e.g., Richard Craswell, *Property Rules and Liability Rules in Unconscionability and Related Doctrines*, 60 U. Chi. L. Rev. 1 (1993); Douglas G. Baird, *Commercial Norms and The Fine Art of The Small Con: Comments on Daniel Keating's 'Exploring the Battle of the Forms In Action'*, 98 Mich. L. Rev. 2716 (2000).



Putting aside the degree to which consumers suffer an agency cost in their representation by consumer groups, consumer groups tend to have a relatively modest impact on the U.C.C. drafting process. For example, while consumer groups pressed for what they perceived as consumer protection measures in the revised Article 9, the eventual compromise between consumer groups on the one hand and industry representatives on the other left matters essentially how they were in the old Article 9.<sup>75</sup>

To be sure, there is another way in which all persons, including consumers, can be affected by Article 9, specifically, Article 9's extant treatment of involuntary creditors. General state law treats involuntary creditors who have yet to record a judgment as unsecured creditors. Moreover, once an involuntary creditor records a judgment, her priority dates from that act. In a world of "first in time, first in right," the general upshot of this treatment is that involuntary creditors will take a back seat to any secured lender. A good bit of ink has been spilled in determining the ways in which this treatment is viewed as inefficient or unfair. These concerns, however, have not spurred on any interest group, save the one discussed next.

Perhaps the most interesting (at least to an academic) interest group in the law creation process is legal academics.<sup>76</sup> The attractiveness of having academics involved in the drafting process is twofold. First, drafting is a public good. Most legislative bodies at the state level do not have the resources to have a staff of experts to craft proposed legislation. Indeed, some states do not even have legislators who work full time. Much of the legislative product thus has to be produced by outsiders.<sup>77</sup> Even Congress and administrative agencies, which have staff available to draft legislation and administrative rules, respectively, do not have the time to devote to drafting and redrafting proposed provisions so that they are user friendly.<sup>78</sup> Legislation is put together by multiple drafters at

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75. See Janger, *supra* note 17, at 612-14.

76. Schwartz and Scott divide the world a bit differently, noting that law reformers participate in the uniform law making process, and such reformers are often academics. See Schwartz & Scott, *supra* note 16, at 607. While there certainly have been reform minded law professors involved in the U.C.C. process, it is far from clear that all academics involved have pushed for reform. See also Clayton P. Gillette, *Politics and Revision: A Comment on Scott*, 80 Va. L. Rev. 1853, 1860 n.18 [hereinafter "Gillette"] (noting that academics may be concerned more with getting the U.C.C. adopted than with reform).

77. Ribstein and Kobayashi find that part-time legislatures are more likely to adopt uniform laws proposed by NCCUSL than are full-time legislatures. See Ribstein & Kobayashi, *supra* note 16, at 187.

78. Indeed, it is a common practice for Congress to pass "technical amendments" shortly after legislation has been enacted. These amendments correct

multiple stages.<sup>79</sup> Legislation is often amended on the floor of the House or Senate. Political compromises are often struck behind closed doors at House-Senate conferences. The press of time and the need for ambiguity to produce a passable bill often results in vague statutory language.<sup>80</sup>

Producing first-class legislation, or a statute that is technically sound, is an expensive and time-consuming process. The U.C.C. drafting process relies to a large extent on volunteers to compose the various provisions of the U.C.C. This lack of direct remuneration may lead one to expect the quality of the work will be less than optimal. Certainly, practicing lawyers often participate in the drafting process, but they have a relatively high opportunity cost. Time spent on drafting projects lessens the time spent on projects for which attorneys and their firms receive direct compensation. Lawyer salaries are more often based on the amount of business they bring in and the amount of billable hours they produce. The ability of top-flight attorneys to participate in the laborious details of drafting legislation is thus fairly constrained.

The opportunity costs for academics of participating in the drafting process, however, are much less than those of practicing lawyers. Typically, academics receive a fixed salary. Tenure ensures that the nominal amount of a law professor's salary generally cannot be reduced. Moreover, law reform work can fall within the stated obligations of an academic. Most law schools view efforts at law reform as fulfilling an academic's obligation of either service to the legal community or scholarship that advances our understanding of law. It is thus possible for academics to receive some tangible rewards from their law school for their participation in the drafting process. At a minimum, they will not be penalized for such efforts. Thus, relative to other potential contributors, it is cheaper for academics to participate in the drafting process than it is for practicing attorneys.

Academics also have non-pecuniary incentives to work on law reform projects. Law professors by their nature tend to enjoy thinking systematically about the areas of law that they teach. Indeed, it is often this desire to examine law from a comprehensive

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such oversights as misspelled words, duplicate words and omitted words. The existence of this practice, which we do not see in the U.C.C. process, suggests that Congress is less than thorough in crafting its legislation.

79. For an excellent and detailed description of legislative drafting in Congress, see Victoria F. Nourse & Jane S. Schacter, *The Politics of Legislative Drafting: A Congressional Case Study*, 77 NYU L. Rev. 575, 583-93 (2002).

80. See *id.*, at 594-97; Joseph Grundfest & A.C. Pritchard, *Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation*, 54 Stan. L. Rev. 627, 640-42 (2002).

perspective that induces a lawyer to leave practice for the academy. Working on law reform projects is thus enjoyable for many. Moreover, law professors who engage in effective law reform undoubtedly garner accolades for their work. They can point out their handiwork to their students over the years, and they gain a certain amount of recognition and prestige with the practicing bar. For many academics, a little recognition and praise go a long way.

Of course, there is a risk that these incentives will produce less than desirable outcomes. Academics may view the uniform law process as an opportunity to foist their views on an unsuspecting world.<sup>81</sup> Yet, they do not have a free hand in the process to translate to the statute books of the various states. Most of the law reform work of NCCUSL is relatively harmless in that there is little chance that the proposals will see widespread enactment by the states. Commercial law is different. Under the current state of affairs, it is highly likely that a proposed revision to the U.C.C. of which the ALI and NCCUSL approve will in fact become the law in most jurisdictions.

This likelihood of enactment constrains the ability of even the most adventurous academic.<sup>82</sup> Commercial law affects businesses to a large extent, and they ensure that their interests are represented in the drafting process. They can thus cabin any impulses that academics may have toward remaking the world. Indeed, while it is easy to find criticism of the ALI Restatement projects for departing too far from extant law,<sup>83</sup> the complaint tends not to be leveled at the U.C.C. revision process. If anything, the complaints of the recent work on the U.C.C. suggests that it is too conservative and too beholden to financial interests. Academics simply do not have the freedom to bend commercial law to their vision of the good.

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81. See Schwartz & Scott, *supra* note 16, at 610-11; Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. Chi. L. Rev. 1151, 1183 (2000) ("Law professors stand to gain fame and fortune by advocating sweeping new theories, and need not bear the costs when these theories go awry." *Id.*); Larry E. Ribstein, *The Mandatory Nature of the ALI Code*, 61 Geo. Wash. L. Rev. 984, 1024-30 (1993).

82. The recent efforts to overhaul the Bankruptcy Code provide a vivid illustration. Congress appointed a commission to propose changes. A number of prominent bankruptcy scholars spent countless hours drafting what they viewed as a marked improvement over current law. The commissioners' proposals, especially in the area of consumer bankruptcy, were far out of step from what Congress was willing to enact, and the proposals never received serious attention. See also Gillette, *supra* note 77.

83. For example, see the following articles criticizing the ALI's ongoing Restatement of Torts project, John C.P. Goldberg & Benjamin C. Zipursky, *The Restatement (Third) and the Place of Duty in Negligence Law*, 54 Vand. L. Rev. 657 (2001); Steven Hetcher, *Non-Utilitarian Negligence Norms and the Reasonable Person Standard*, 54 Vand. L. Rev. 863 (2001).

Academics, however, are attractive partners to others involved in the law creation process. One attractive feature is that they are likely to produce a high-quality product, when measured from a technical standpoint. Good statutes cover a myriad of hypothetical situations. They resolve both the pressing problems of the moment and yet do not create mischief in other areas. In short, they are not myopic. The testing of statutory language through a barrage of hypotheticals is the academics' stock and trade. They tend to instruct law students by creating new hypotheticals that force the students to test the limits of the extant legal materials. Thus, one would expect that academics would be able to provide a relatively high level of technical expertise. Another attraction of academics is that they can add a patina of respectability to the process. Academics, while they undoubtedly have their own normative biases, do not come shackled to any client. Indeed, they often care deeply about the law at issue rather than advancing the interests of any particular party that may be affected by the law. They truly want to get it right. They may well be seen as public-spirited individuals who are not beholden to any interest group. It is thus not surprising that academics have in the past played major parts in drafting the extant versions of the U.C.C. All U.C.C. revision projects have an academic that serves as the reporter.<sup>84</sup>

## 2. *The Competitors*

Most simply, lawmaking in the United States can take place either at the state or national level. At both levels, the process of producing legal rules can take on of two forms. At the state level, each state may enact what it views as the best law. Perhaps the most prominent private law area where this occurs is legislation that sets the parameters for the internal governance of firms. States are seen as competing against each other for incorporations, and there is substantial literature on whether this competition promotes efficiency.<sup>85</sup> One possibility is to create a market for regulatory

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84. The attraction of academics is not limited to the U.C.C. Twice in the last 30 years Congress has created a commission to propose substantial revisions of the then current bankruptcy law. Both times, an academic was selected as reporter for the commission, with Frank Kennedy of the Michigan Law School serving as reporter in the 1970s and Elizabeth Warren of the Harvard Law School serving as the reporter in the 1990s.

85. Standard cites in this literature include William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 88 Yale L.J. 663 (1974) (setting forth the "race to the bottom" thesis); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. Legal Stud. 251 (1977) (setting forth the "race to the top" thesis); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 Harv. L. Rev. 1435 (1992) (arguing that on some aspects of corporate law race will

competition for all or some of the areas currently covered by the U.C.C.<sup>86</sup>

A second way in which states can enact commercial legislation is through the current process.<sup>87</sup> The Permanent Editorial Board for the Uniform Commercial Code is made up of members of both the ALI and the NCCUSL. When it believes that a revision of the U.C.C. is needed, the Permanent Editorial Board forwards such a recommendation to the ALI and the NCCUSL, who then consider the recommendation. If the leadership of the ALI and the NCCUSL decide to go forward, they then form a drafting committee. The committee produces a draft, which is then submitted to the NCCUSL and the ALI for separate approval. If both organizations approve the draft, it goes to the states. In between drafts, the Permanent Editorial Board is charged with issuing commentary on interpretative issues that arise. For example, when the Tenth Circuit sent fear into the hearts of the securitization industry with its decision in *Octagon Gas*,<sup>88</sup> the Permanent Editorial Board quickly issued a commentary condemning the decision.<sup>89</sup>

The federal level also has two methods by which legal rules can be promulgated. Congress, of course, is one potential candidate for making commercial law. Indeed, it currently enacts the law that governs corporate reorganizations in bankruptcy.<sup>90</sup> Given its lack of activity in other areas of commercial law, it is something of a guess as to how Congress would go about producing a federal commercial code. In the bankruptcy area, the practice has been to establish a commission to draft proposed legislation. The work of the

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tend toward the top, while on others it will tend toward the bottom); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. Econ. & Org. 225 (1985) (trying to answer the question of whether Delaware law is efficient through an event study); Robert Daines, *Does Delaware Law Improve Firm Value?*, J. Fin. Econ. (2001) (using Tobin's Q to see whether Delaware law adds value). Recent work questions just how vigorously the states compete, see Lucian Ayre Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Debate on State Competition over Corporate Charters*, \_\_\_ Yale L.J. \_\_\_ (forthcoming 2002); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, \_\_\_ Stan. L. Rev. \_\_\_ (forthcoming 2002).

86. See Janger, *supra* note 17, at 588-93.

87. For a more detailed description of this process, see Patchel, *supra* note 17, at 88-93, Scott, *supra* note 17, at 1803-06.

88. *Octagon Gas Systems, Inc. v. Rimmer*, 995 F.2d 948 (10th Cir. 1993).

89. See PEB Commentary No. 14.

90. David Skeel has questioned whether Congress should retain the primary responsibility for enacting corporate bankruptcy law or whether this task should be devolved to the states. See David A. Skeel, Jr. *Rethinking the Line Between Corporate Law and Corporate Bankruptcy*, 72 Tex. L. Rev. 471 (1994). Skeel believes that, as with corporate law generally, states should formulate bankruptcy law outside of the uniform law process.

Bankruptcy Commission of the 1970s heavily influenced the final legislation that became the Bankruptcy Code in 1978.<sup>91</sup> The most recent Bankruptcy Commission, however, had little effect on the current debate over changing federal law. Its proposed revisions of the Code, especially as they related to consumer bankruptcies, were pretty much ignored by Congress. The bills that Congress has considered in the last few legislative sessions were seemingly drafted by creditor groups. Indeed, much has been written on the extensive lobbying of the credit card industry in favor of making it more difficult for individuals to discharge their debts in bankruptcy.

Congress, of course, is not the only actor at the federal level. Administrative agencies often exercise considerable sway over a number of areas. In the commercial law context, the Federal Reserve Board basically removed the check collection process from the domain of the U.C.C.<sup>92</sup> The Federal Trade Commission enacted provisions to regulate practices that would otherwise be allowed by the U.C.C. Perhaps the two most prominent restrictions are the FTC's elimination of the holder in due course concept from consumer transactions,<sup>93</sup> and its ban on taking a security interests in household goods that the lender did not finance.<sup>94</sup> Given this extant administrative regulation in the commercial law area, one could imagine assigning even a greater jurisdiction to the appropriate administrative agencies.

Each of these four primary ways to produce legislation differs in its available tools.<sup>95</sup> For example, legislatures have the ability to solve conflicts through log rolling. A legislator can propose a solution where her view of desirable legislation prevails on one piece of legislation in exchange for her supporting a different piece of legislation. While there certainly can be compromises in the U.C.C. drafting process, they do not cut across subject areas. Indeed, they are not even trades across U.C.C. articles. Consumer groups cannot offer banks greater leeway in Article 9 in order to garner their support for more consumer protections in Article 2. Thus, in order to get agreement, the drafters can either pass vague rules that do not resolve the issue,<sup>96</sup> or, when they are revising an extant article, they can stay with the status quo.<sup>97</sup>

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91. See Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 Mich. L. Rev. 47 (1997).

92. See *supra* notes 62-64.

93. See 16 C.F.R. § 433.2(a) (2001).

94. See 16 C.F.R. § 444.2(a)(4) (2001).

95. Some of these differences are referred to in Schwartz & Scott, *supra* note 16; Alan Schwartz suggested others when commenting on an earlier version of this essay.

96. This is Bob Scott's and Alan Schwartz's explanation for the vagueness of Article 2.

97. As happened with consumer protection initiatives and the recent Article 9 revision process. See Janger, *supra* note 17, at 612-15; see also Edward J. Janger,

The inability of the uniform law process to resolve conflicts is exacerbated by the nature of the "legislators."<sup>98</sup> Final decision—making authority rests with the membership of the NCCUSL and the ALI. Whereas the members of the NCCUSL are drawn for their interest in uniform laws, of which the U.C.C. is the most successful, the general members of the ALI have little reason to spend a good deal of time considering the U.C.C. The ALI attracts members from a variety of backgrounds, many of which are far removed from the intricacies of commercial law.<sup>99</sup> When confronted with the demands of conflicting interest groups, as they were in the case of the revised Article 2, these members are likely to opt for the status quo. They have no institutional resources that can assist them in evaluating the competing assertions of the interest groups, and they receive little benefit from taking sides in a contentious dispute. As Bob Scott and Alan Schwartz have pointed out, one may thus expect that a status quo bias may exist in such a legislature.

An additional difference between public and private lawmaking is that public legislatures and administrative agencies have the potential to gather more information than does the private reform process.<sup>100</sup> Both legislatures and agencies have staff that can provide an independent assessment of the factual claims of competing proposals. For example, both the Federal Reserve Board and the Federal Trade Commission employ a number of economists. They can thus provide information to the actual decision-maker that would simply be unavailable to the members of the ALI and the NCCUSL who actually vote on the final version of the U.C.C. This lack of information by which they can resolve competing factual assertions as to the effect of a given proposal is yet another reason as to why the members of the ALI and the NCCUSL may have a preference for the status quo more so than would a public legislature.<sup>101</sup>

The inability of the uniform law process to resolve conflicting claims may or may not be a detriment. Much will depend on how one views the competing claims at issue, the desirability of the status quo, and how one expects both private actors and courts to act without additional guidance. That said, there are some clear advantages that the private law process has over its competitors. The

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*The Locus of Lawmaking: Uniform State Law, Federal Law and Bankruptcy Reform*, 74 Am. Bank. L.J. 97 (2000) (pointing out structural reasons in U.C.C. process for status quo bias).

98. See Schwartz & Scott, *supra* note 16, at 596-98.

99. For example, colleagues on my faculty who are members of the ALI include prominent constitutional, tort, tax and corporate law scholars. None have any significant interest in commercial law.

100. Whether they actually use these sources is, of course, another matter.

101. See Schwartz & Scott, *supra* note 16, at 621-37.

products of the uniform law process tend to be more complete than the products produced either by state legislatures or Congress. Both are likely to cover many of the problems in the area and are done at a high level of technical expertise. There are a few reasons for this. One, discussed above, is that drafters in the uniform law process probably take more time with their handiwork. Moreover, federal legislation tends to take place against a backdrop of extant state regulation. If the federal regulation is not comprehensive, the state will fill in the gaps.

The uniform law process also has the potential to reduce the payments made to public legislators by the various interest groups. Getting on the agenda of a public legislature requires effort. Legislatures have budget constraints, and legislators cannot address all of the problems that some interest groups believe should be attended to. To be sure, some issues are so salient to the public that they will undoubtedly receive the attention of lawmakers. However, for other matters, interest groups may have to grab the attention of the lawmaker in order to garner consideration. One can get a legislator's attention either through the campaign process—contributions—or through the ability to deliver votes. For areas covered by the U.C.C., amendments by and large will receive consideration by the legislature. Moreover, there will be a natural reluctance on the part of state legislatures to deviate from the proposed text of the U.C.C. at the behest of an interest group.

In situations where there are reasons to believe that the uniform law process will produce a resolution of legal issues at least as consistent with the public interest as would a public legislature, responsibility should be assigned to the private legislature. First, doing so allows the public legislature to devote its limited time to consider other areas. Second, such an assignment reduces the cost of having the law enacted.

Perhaps most importantly, state lawmaking in a private legislature does not preclude targeted federal intervention. Administrative agencies can, and indeed have, modified the results of the U.C.C. when they concluded that it was necessary to do so. Thus, the relevant question is not private legislators versus federal lawmakers. Rather, the question is private legislatures subject to federal oversight as opposed to federal action alone. Given that the extant U.C.C. process can produce some benefits, one needs to do more than saying that federal law making may be superior along some dimensions. Retaining primary authority in the states allows for the creation of superior technical statutory language, and allows for the federal government, especially administrative agencies, to intercede in a narrow fashion once they conclude that such intervention is warranted.



*C. Preliminary Thoughts on What Should Go Where*

In assessing the attraction of the extant U.C.C. process as compared with its potential replacements, the threshold issue is the importance of uniformity. To the extent that uniformity is a normatively attractive goal, this would lead one to shy away from having law produced on a state-by-state basis without some coordinating mechanism. It seems unlikely that one could achieve uniform state law absent a coordinating mechanism. There is no reason to think that legislators in North Dakota would happen upon the same set of rules governing secured transactions as would legislators in New York. The very creation of an organization designed to serve this coordinating function suggests that, at least in the past, laws among the various states have diverged.

The experience in corporate law bears this out. While Delaware achieved a clear victory in the market for corporate charters, this victory has not led to uniformity in corporate governance.<sup>102</sup> Presently, roughly half of the nation's public corporations are not incorporated in Delaware. Regulatory competition is thus not likely to create a uniform system of laws. Uniformity is more likely to arise from either federal legislation or private legislatures designated to draft a uniform law than it is from ad hoc state enactments.

The current arrangement prizes uniformity. Perhaps the biggest normative commitment of the U.C.C. is the need for uniformity.<sup>103</sup> This desire for uniformity has pervaded the drafting process. Indeed, that it is the point of the entire project.

This commitment raises at least two questions. The first is when should our legal system aspire to ensure that the same law applies in all fifty states. As we saw in Part II, some areas of commercial law, notably land contracts, service contracts, and real estate mortgages, remain nonuniform. Are these areas of law suffering from an immense flaw, or is there a theory to explain which laws require uniformity and which work best via state-by-state variation? Second, once one concludes that a certain area of law should be uniform, when should this uniformity be provided at the state level via the

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102. See Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate* (Jan. 2002 working paper) available at <http://www.law.harvard.edu/faculty/bebchuk/papers.shtml> (last visited Nov. 11, 2002).

103. Indeed, the recent enactment of the revised Article 9 shows the sway the concerns for uniformity have. The drafters of the Revised Article 9 issued a statement with a parade of horrors that would result were the country to have old Article 9 in force in some states and the new Article 9 in others. Whether or not this struck fear in the hearts of legislators across the country, the fact is that the new Article 9 went into effect across the nation virtually simultaneously.

uniform law process rather than at the national level via legislation or agency action?

Uniformity is not necessarily an obvious goal. One has to distinguish between uniformity and certainty. Certainty has long been a primary goal of commercial law. Commercial law professors for years have been telling their students that businesses prefer a clear rule to a correct rule. The basic intuition here is that parties to a transaction want to know where they stand. They want to be able to predict exactly what may happen if they engage in a certain course of conduct. Moreover, if a dispute arises regarding a transaction, the more certain the law, the less likely we will need litigation to resolve that dispute.<sup>104</sup> When the law is uncertain, parties are more likely to have differing views on the outcome of litigation, and these differences may prevent the parties from settling the dispute without recourse to the judicial process. Certainty thus seems to have a clear value, but its link with uniformity is tenuous.

In exploring the relationship between certainty and uniformity, one must look at each area of law covered by the U.C.C. As discussed earlier, the U.C.C. is more a collection of related statutes than it is a comprehensive code. Moreover, once one moves beyond the theme of uniformity which unites the Code project, one finds different substantive goals for each area of law covered by the U.C.C. There is no reason to expect that the goals served by contract law are the same as those served by the check collection process.

### *1. Articles 4A, 5, 6, 7 and 8*

Perhaps the easiest set of provisions to discuss are those contained in Articles 4A, 5, 6, 7, and 8. These five articles have remained relatively immune from the recent wave of scholarship exploring the interest group dynamics of the Uniform Commercial Code law-making process.<sup>105</sup> The reason for this lack of scrutiny is easy to understand. Given the subject areas that these articles cover, one would not expect the uniform law process to deviate from the public interest any more than would a public legislature. In these settings the extant process works well and should be retained.

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104. Not everyone agrees that certainty induces more efficient bargains. See Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 Yale L.J. 1027 (1995); Jason Scott Johnston, *Bargaining Under Rules Versus Standards*, 11 J.L. Econ. & Org. 256 (1995).

105. But see Francis J. Facciolo, *Father Knows Best: Revised Article 8 and the Individual Investor*, 27 Fla. St. U. L. Rev. 615 (2000) (arguing that the securities industry dominated the drafting process for revised Article 8 to the detriment of the individual investor).

The key to understanding the lack of controversy that these articles have generated is the fact that all affected parties are capable of participating in the law revision process, and that process is able to accommodate all of their views. Three of these articles involve payment mechanisms operated by commercial banks and used almost exclusively by sophisticated commercial parties. Article 4A covers wire fund transfers, Article 5 handles letters of credit, and Article 7 deals with warehouse receipts, which are often part of a financing transaction where the buyer's bank lends against a negotiable document of title.<sup>106</sup> These transactions, at least from the perspective of the drafting process, have two salient features for our purposes. The first is that all of the parties tend to be sophisticated market actors; these are the type of entities that can ensure that their interests are brought to the attention of the commercial law drafting process. To the extent that one is concerned that the drafting process may produce rules that deviate from the public interest because the affected parties have unequal input into the process, that concern does not exist here.

The second feature of these transactions is that many businesses will find themselves playing different roles in different transactions. A business could send or receive a wire fund transfer, it could be the applicant for or beneficiary of a letter of credit, and it could be a consignor or a consignee for goods covered by a negotiable document of title. Given that many businesses repeatedly find themselves on both ends of the transaction, they may tend to be more concerned with the responsibility of banks than with rules that attempted to skew matters in favor of one of the non-bank parties to the transaction.

Most importantly, from the standpoint of public policy, there is no reason to conjecture that the rules produced by the U.C.C. drafting process would deviate more from the public interest than would rules drafted by a public legislature. All the affected parties are repeat players that, if they wish, can have input into the legislative process. The rules that are ultimately decided upon will be known to those who use them. To the extent that a rule imposes costs on one party, it can effectively take this rule into account via the price of the transaction. Thus, the parties will lean toward rules that keep the price of the payment system down.

Rather than plod through the history of these five articles one by one, Article 5 will be offered as an example. Article 5 covers letters of credit. A letter of credit transaction typically involves three parties—the issuing bank; the applicant, which is generally the

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106. See Ronald J. Mann, *Payment Systems and Other Financial Transactions* Assignment 26 (1999).

customer of the issuing bank; and the beneficiary.<sup>107</sup> The applicant and the beneficiary typically are sophisticated commercial actors. These are precisely the type of entities that fare well in the uniform law process.

One would expect all affected parties to participate in the drafting of rules for letters of credit. However, one would not expect excessive rancor among the participants in letter of credit transactions over the substance of those rules. A letter of credit transaction is one in which there are few externalities. Increasing the risk that a letter of credit will be dishonored, and the beneficiary will not receive the funds on which it counted, is the type of risk that can be priced in the underlying deal between the customer and the beneficiary. Moreover, any commercial actor is likely to find itself being an applicant in some cases, and a beneficiary in others. Thus, the commercial actors are more concerned with the overall efficacy of the letter of credit rules than any redistribution between applicant and beneficiary. Indeed, it appears that commercial actors, other than banks, played little active role in the most recent revision of Article 5.<sup>108</sup>

Banks, however, care deeply about Article 5. The motivation for this does not seem to be that they cannot price any risk that they bear. Increasing the risk that the bank will have to pay on a letter and not receive reimbursement from its customer is a risk that can be priced into the letter of credit transaction. Rather, the concern of American banks is that they have to compete with banks across the world for business. Most major commercial banks outside of the United States follow the Uniform Customs and Practices for Documentary Credits, which is published by the International Chamber of Commerce. American bankers believed that forcing them to adhere to old Article 5 would put them at a competitive disadvantage. In the revision process, American banks heavily lobbied the drafting committee to move the U.C.C. closer to the UCP. Indeed, the final product was a new Article 5 that was much closer in substance to the UCP than was its predecessor.

As a result, the banks got their way. This result is consistent with the prediction of Schwartz and Scott that when there is a single interest group involved in the U.C.C. revision process, the result will be a relatively clear set of rules amenable to the wishes of that group. While one may pause to endorse such a result where a party, who will be affected by the rules and who was also shut out of the drafting

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107. For an overview of a letter of credit transaction, see Mann, *supra* note 107, at Assignment 13.

108. For a history of the revision process of Article 5, see James G. Barnes, *Internationalization of Revised U.C.C. Article 5 (Letters of Credit)*, 16 NW J. Int'l L. & Bus. 215 (1995); White, *supra* note 70.

process, such caution is not warranted when the single group bears the costs and benefits of the legislation. In the case of Article 5, the American banks wanted to adhere to the same rules as their competitors. The U.C.C. process generated this result.

There are minor differences in the drafting histories of some of the other articles. For example, bank customers were more active in the Article 4A process. They were concerned that the original proposal placed too little responsibility on the banks. These concerns were eventually ameliorated through a compromise between the representatives of the banks and the representatives of the customers. Nevertheless, the basic pattern remains the same. All of the affected parties had access to the drafting process, and, in the commercial setting where these rules had to operate, no one party had a strategic advantage over another. In these circumstances, one would expect little divergence between the outcome of the U.C.C. drafting process and the public interest. Given that, as discussed above, the private law process both conserves public legislative resources and relieves the affected groups from having to get on the legislative agenda. Responsibility for handling the subject matter covered by these articles should continue to reside in the ALI and NCCUSL.

Article 6 is a much more interesting situation. The most recent revision of Article 6 engendered a clash among three different interest groups—unsecured lenders, secured lenders and auctioneers.<sup>109</sup> The uniform law process was unable to resolve this conflict. It did not, however, do nothing. Rather, it drafted two versions of a revised Article 6, one that would repeal the statute in its entirety and one that would update the statute. As it turned out, most states took the former option. The process added value, however, in that it clearly framed the issue for the states—repeal or no repeal. To be sure, a state could always repeal Article 6 on its own. But the official sanctioning of that option by the ALI and NCCUSL probably made the state legislatures more alert that they were faced with a policy choice in this area.

In sum, there are areas where the uniform law process for promulgating commercial law adds value to the overall lawmaking system. The remainder of this essay examines the extent to which this conclusion is obtainable for those other areas of the U.C.C. that have come under attack, Articles 2, 3, 4 and 9.

## 2. Article 2

Article 2 has always been central to the Uniform Commercial Code. Llewellyn deemed it the “heart and soul” of the project.<sup>110</sup> Yet,

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109. See Peter Winship, *Lawmaking and Article 6 of the Uniform Commercial Code*, 41 Ala. L. Rev. 673 (1990).

110. Karl Llewellyn, *Why We Need the Uniform Commercial Code*, 10 Fla. L.

whereas it is easy to see why the law benefits from uniformity in areas such as the check collection system and secured transactions, perhaps the area of the law where the connection between certainty and uniformity is the most opaque is the sale of goods. After all, the rest of contract law seems to survive by adhering to the common law. Indeed, in a series of recent articles, including one in this Symposium, Bob Scott has made a powerful argument that the Article 2 project should be abandoned, and sales be reunited with the rest of contract law and administered through the common law.

Common law, of course, varies across jurisdictions. It is not uniform. Even if one can conclude what the majority of common law courts do with an issue, there will often be divergence among the jurisdictions.<sup>111</sup> When one talks about "the common law rule" or, better still, "the traditional common law approach," there is a tacit understanding that one is speaking about what most courts would do rather than speaking about how every court would approach the problem. Thus, the choice here is not between the U.C.C. rule and the common rule; rather, the choice is between the U.C.C. rule and a variety of common law rules.

In this setting, the connection between uniformity and certainty, at least in the case of parties who are well informed about the law,<sup>112</sup> depends in large measure on the enforceability of choice of law clauses. To the extent that law permits broad enforcement of such clauses, it is easy for firms to procure certainty even though states differ in their substantive law.

To see this point, assume that a firm does business in many states. The firm is located in New York and sells goods in all fifty states. Assume further that each state were responsible for its sales of goods

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Rev. 367, 378 (1957).

111. For example, Bob Scott finds the traditional common law approach to interpretation to be one that focuses intensively on the written contract itself. See Scott, *supra* note 17, at 162-63. It is not hard, of course, to find courts that depart from this method. For example, see *Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 442 P.2d 641 (Cal. 1968); *Masterson v. Sine*, 436 P.2d 561 (Cal. 1968); *Hatley v. Stafford*, 588 P.2d 603 (Or. 1978). The Restatement (Second) of Contracts generally endorses this approach. See Restatement (Second) of Contracts §§ 209-216.

112. The question about the extent to which parties are well informed about the law is one on which there is much disagreement. Compare William J. Woodward, *Contractual Choice of Law: Legislative Choice in the Era of Party Autonomy*, 54 SMU L. Rev. 697, 760-62 (2001) (many parties are not well informed) with Paul B. Stephan, *Regulatory Cooperation and Competition: The Search for Virtue*, in *Transatlantic Regulatory Cooperation: Legal Problems and Political Prospects* 191-192 (George A. Berman, et al., eds., 2000). Of course, not everyone has to be well informed to support a competitive market for contract terms. See Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. Pa. L. Rev. 630 (1979).

law; in other words, there were no efforts made at achieving uniformity across the states. This situation seemingly has the potential to subject the New York firm to fifty different sets of contract law. Such a possibility could well lead one to conclude that a uniform sales act is necessary. The firm faces two distinct costs. One is the cost of uncertainty. Conflict-of-law rules are notoriously vague.<sup>113</sup> It is often not possible to say in advance of litigation which state's law will apply. Thus, were the CEO of the New York firm to ask her general counsel as to which law would govern in the case of dispute over a sale that was completed in California and the dispute arose in Oregon, perhaps the most accurate answer she could give would be "Your guess is as good as mine." Even if this situation were improved by crafting a clear set of conflict of law rules,<sup>114</sup> a cost is still associated with multiple laws, the cost of learning the various laws that apply to different states. Even if the hypothetical firm could ascertain exactly, quickly, and cheaply which state's laws governed which contract, it would still incur the cost of learning the ins and outs of each state's laws. Thus, the case of the single firm dealing in multiple jurisdictions seems to be the strongest case for needing a uniform sales law.

Things are not necessarily as bad as it seems, however. Those who make contracts on behalf of the firm can foresee the uncertainty engendered by the choice of law rules and attempt to settle the matter by contract. As Coase taught us long ago, the cost of any legal rule is capped by the cost of contracting around it. The firm in this case has the ability to avoid being subject to myriad contract laws via a choice of law clause in all of its contracts. The New York firm could insert in each of its contracts a provision that any dispute will be governed by the laws of New York. To the extent that such a clause would be enforced, the firm would achieve the desired certainty even in the absence of a uniform law. It would know which law applied and could limit the cost of having to learn multiple sets of laws.

To be sure, the potential use of choice of law clauses will not eliminate all costs associated with varying state laws. Not all contracting parties may recognize that they need to include a choice of law clause. Here, the lack of uniformity may create ex post uncertainty when a dispute arises. Moreover, reliance on choice of

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113. The classic quote describes the field as "a dismal swamp, filled with quaking quagmires, and inhabited by learned but eccentric professors who theorize about mysterious matters in strange and incomprehensible jargon." William Prosser, *Interstate Publication*, 51 Mich. L. Rev. 959, 971 (1953).

114. Recent attempts to add clarity include Larry Kramer, *Rethinking Choice of Law*, 90 Colum. L. Rev. 277 (1990); Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. Chi. L. Rev. 1151 (2000); Andrew Guzman, *Choice of Law: New Foundations*, 90 Georgetown L.J. 883 (2002).

law clauses may raise contracting costs as compared to a system that has a uniform law. The parties may spend resources bargaining over which law should apply.

There also are limits placed on choice of law clauses. Historically, parties could only choose from those states that had a relationship with the transaction. Thus, if a New York firm decided that Nevada had the best law for the sale of goods, it could only select Nevada if some aspect of the transaction touched Nevada. This is an obvious limit on competition, a limit that does not exist in the corporate arena, where a firm is free to incorporate in any state, regardless of where its assets are located.

To be sure, there has been a recent movement on this front. The new draft of Article 1 contains a broad choice of law provision in sales between businesses.<sup>115</sup> If the new Article 1 is enacted by the states,<sup>116</sup> firms falling under its purview are free to adopt the law they conclude best meets their needs. Were such freedom of contract generally followed, it would undoubtedly reduce the potential costs of the uncertainty created by nonuniform laws.<sup>117</sup> It is still the case under the new Article 1, however, that in transactions involving consumers, choice of law is constrained.<sup>118</sup>

Finally, it may be impossible to achieve certainty cheaply and quickly for all firms by employing choice of law clauses. The hypothetical New York firm achieves certainty for itself via a choice of law clause. However, what about its contracting opposites? Every contract has at least two parties. A buyer in California may buy from firms all over the country, just as the New York seller ships goods nationwide. Like the New York firm, it only wants to deal with one set of laws. It thus insists that all of its contracts have a choice of law clause establishing California law as governing any future disputes. It simply is not the case that every firm through adroit use of choice of law clauses can establish a single jurisdiction to govern its contracts.

The magnitude of this cost depends on one's assumptions as to how readily all firms will agree on which state's law provides the

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115. See U.C.C. § 1-301(b)(1) (2001).

116. New Article 1 has been approved by the ALI and NCCUSL in 2001. As of November 2002, it had been enacted only in the U.S. Virgin Islands. See [www.NCCUSL.org/uniformact/factsheets/uniformacts\\_fs\\_ucc1.asp](http://www.NCCUSL.org/uniformact/factsheets/uniformacts_fs_ucc1.asp) (last visited Nov. 2, 2002). Some law professors have objected to the new Article 1 on the grounds that small businesses should be treated like consumers. See William J. Woodward, Jr., "Sale" of Law and Forum and the Widening Gulf Between "Consumer" and "Nonconsumer" Contracts in the U.C.C., 75 Wash. U.L.Q. 243 (1997).

117. It is a bit ironic that we could end in a world where there is more freedom in choice of law clauses in an area governed by a uniform law than in an area governed by disparate laws.

118. See U.C.C. § 1-301(d) (2001).



best contract rules. To the extent that all firms scour the country in search of the state that offers the laws that best enhance the contracting surplus, one would predict little disagreement over which state a choice of law clause should point. On the other hand, if firms have a preference for the law of the state in which they are located,<sup>119</sup> the contracting costs loom larger. Which result is more likely depends in large part on whether any state has the incentive to create a legal system that attracts those drafting contracts. The argument here tracks the now decades old debate in corporate law over the corporate charter market. The proponents of regulatory competition in that field note that an American firm can incorporate in any jurisdiction, and that jurisdiction receives tax benefits from the firm. Thus, at least some states will attempt to implement a legal regime attractive to corporations.<sup>120</sup> The divide is over whether the winner of the competition will enact laws that promote efficiency or only enhance managerial prerogatives.

Transplanting the regulatory competition argument to the contract area is relatively straightforward. To the extent that parties can choose which law will govern their contract, they will choose the law that maximizes the total surplus of the contract. Jurisdictions will thus compete to supply better laws. The problem with the U.C.C. from this perspective is that it dampens regulatory competition. Uniformity comes at a cost. All states may have the same law; it simply may not be a terribly good one.

To assess this argument, it is necessary to understand the best case where the argument works, the case of the corporation. Delaware, so the story goes, is in a competition with other states to provide the law that corporations want. Delaware needs to supply a better product to win this competition.

Even if one accepts the Delaware competition story,<sup>121</sup> it is unclear that it can be transplanted to the U.C.C. context. There are crucial aspects to the Delaware story that are absent in the commercial law situation. One aspect is that firms have the ability to cheaply select jurisdictions. Due to the internal affairs doctrine, firms can simply choose from any of the fifty jurisdictions. They do

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119. Certainly the lawyers for the firm may prefer the home state given that they are more familiar with that state's law.

120. The extent of actual competition has been questioned. See sources cited in *supra* note 86.

121. And many do not. In addition to the work questioning the level of state competition, other work posits that there is a competition, but it is the please managers rather than promote firm value. See, e.g., Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Takeover Law: The Race to Protect Managers from Takeovers*, 99 Colum. L. Rev. 1168 (1999) reprinted in, *Regulatory Competition and Economic Integration*, (D. Esty & D. Geradin eds., Oxford Univ. Press 2001).

not need any party's agreement. The firm's managers can select the jurisdiction that they think best serves their needs.

This easy ability to specify governing law does not translate into the commercial law setting. To be sure, courts will generally respect choice of law clauses. But there are three important ways in which the contract setting differs from the incorporation setting. The first difference is the legal ability of firms to select governing law. Current law limits the ability of contracting parties to select the law of a jurisdiction that has some relation to the contract. Absent legal reform, this limitation means that a state cannot compete for all contracts. It can only compete for that subset that has some relation to the state. To the extent that a state cannot capture the full benefits from crafting attractive legal rules, this will lessen the incentive to create such rules in the first place. In a world where the state cannot capture the benefit of its efforts, the ability to opt out of a given state's legal regime is better seen as a limit on the state's ability to extract rents from the parties rather than regulatory competition toward a better set of legal rules.<sup>122</sup>

This inability to freely select the law governing the contract means that if sales law returned to the states, some parties could be left with a set of unattractive jurisdictions from which to choose. Many legislatures are part time, and are unlikely to produce any detailed legislation on contract law. For them, the current U.C.C. process is a way to enact legislation cheaply. They can simply adopt the work of others. Returning the law of sales to them would probably put that responsibility on the state judiciary. To be sure, if one believes that common law judges will always produce better legal rules than a legislature,<sup>123</sup> one would applaud this state of affairs. To the extent, however, that one concludes that Article 2 represents an improvement over the common law in these states, jettisoning the current system would be a cost.

A second way in which the contract setting differs from the corporate one is that there are two parties involved in the contract. The parties to the contract have to agree on which law is applicable. This entails costs both in learning the various set of choices and in selecting the applicable law in every contract. In corporate law, firms

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122. Cf. Bruce H. Kobayashi & Larry E. Ribstein, *Contract and Jurisdictional Freedom*, in *The Fall and Rise of Freedom of Contract* 325 (F.H. Buckley ed., 1999) (arguing that the ability of parties to use choice of law clause limits attempts to extract rents from those parties).

123. This implicates the oft-debated question of whether the common law is efficient. The efficiency-of-common-law doctrine was first put forth by Judge Posner, see Richard A. Posner, *The Economic Analysis of Law* 98-102 (1st ed. 1972). For a recent discussion of this issue, see Oona A. Hathaway, *Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System*, 86 Iowa L. Rev. 601 (2001).

only have to compare two jurisdictions. Most firms incorporate either in the jurisdiction in which they conduct most of their business or in Delaware. They do not have to examine the law of all fifty states. The same would not be true in the contract setting. A contracting opposite may come from any of the fifty states, and may propose its law as the one to govern disputes. To ascertain which law maximizes the joint surplus, the firm will continually be assessing the quality of law of various jurisdictions.

The third, and potentially most important, reason as why the corporate analogy does not easily transfer to the contract setting has to do with the incentives of the states to produce laws. Delaware has institutional forces that affect the quality of both its legislative and judicial products. It is a well-known fact that the Delaware state government derives a significant portion of its operating budget from the franchise tax that it charges to corporations incorporated in that state.<sup>124</sup> The threat of losing this source of revenue ensures that the legislature is attentive to the needs of those firms incorporated in Delaware. To the extent that one believes that a firm's managers pick a state of incorporation with an eye toward maximizing the value of the firm, this pressure tends to induce the Delaware legislature to enact efficient laws.

Central to this story is the ability of states to charge for the laws that they provide to every firm. States levy franchise fees on all firms that are incorporated in the jurisdiction. A state can thus extract the value of its corporate law through its taxing structure. It can price its product. Indeed, for publicly held firms, Delaware has a franchise tax that exceeds that of most other states.<sup>125</sup> Each firm that avails itself of Delaware law thus has to pay for it.

In addition to the interests of the legislators in Delaware in filling the fisc is the interest of Delaware attorneys. By all accounts, the Delaware bar derives significant benefit from the fact that Delaware is the jurisdiction of choice for most major publicly held firms. These lawyers thus have the incentive to ensure both that the legislature does not enact laws that drive corporations away, and that the Delaware judiciary is stocked with judges that attend to corporate law. Indeed, the Delaware bench has a norm of providing "service" to the corporations that bring disputes before it. Delaware's geography makes it easier for the bar to exercise this influence. Delaware is a small state, and Wilmington, its capital, is not a very large town. Thus, to the extent that the legal community has a norm of being sensitive to the needs of firms in its corporate law, the

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124. See Roberta Romano, *The Genius of American Corporate Law* (American Enterprise Institute ed., 1993).

125. See Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 Cornell L. Rev. 1205 (2001).

geography of the state makes it easier to support that norm than would the geography of many other states.

It is unclear whether regulatory competition could induce states to compete over contract law. It is hard to see how a state could institute a pricing structure to collect revenue from each entity that uses its contract law. A state derives no revenue from firms that include a choice of law clause in a contract that uses that state's law. A firm incorporated in Delaware can insert a choice of law clause in a contract for the sale of goods that specifies that the law of New York will govern all disputes. New York receives no compensation for this use of its law. Thus, whereas the Delaware fisc benefits directly from the legislature's production of corporate laws that please the managers of publicly held firms, no state increases its revenues by producing contract law that beats other states' contract law.

The one interest group that may benefit from competition over contract law is local attorneys. Just as Delaware attorneys derive significant rents from Delaware corporate law,<sup>126</sup> one could posit that commercial lawyers gain extra business were their state to become the jurisdiction of choice for contract law. The obvious state with a bar that may expend resources to attempt to become viewed as the jurisdiction of choice is New York. New York is generally regarded as the commercial law capital of the country. Indeed, the New York bar played a pivotal role in the original drafting and enactment of the U.C.C.<sup>127</sup>

There is some evidence that New York lawyers would be eager to compete for business. New York law contains a provision that authorizes its use for any contract whose value exceeds \$250,000.<sup>128</sup> The statute does not require that the transaction out of which the contract arose bear any relationship to New York. Of course, the statute by itself has little affect. A party to the contract who subsequently decides to avoid New York law could file suit in a state that, absent the choice of law provision in the contract, would apply its own law to the contract. Assuming that that state still follows the traditional rule that for a choice of law clause to be effective it must specify the law of a state that has a reasonable relationship to the transaction, that state would then follow its own law rather than the law of New York. This provision can thus be viewed more as a signal that New York is willing to have its law used widely. In other words, it is willing to compete for business, than be viewed as competition itself.

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126. See Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 Tex. L. Rev. 469 (1987).

127. See Kamp, *supra* note 6.

128. See N.Y. General Obligation Laws § 5-1401 (2001).

Yet even if the New York bar were willing to lobby to ensure that New York contained value-enhancing rules for contracts, it remains unclear how effective such lobbying would be in actually spurring competition among the states. The problem is the potential agency cost between a lawyer outside of New York and that lawyer's client. That lawyer may be a specialist in the law of her own jurisdiction. Specifying that the law of a different jurisdiction would apply to any subsequent dispute would reduce the chance that the original lawyer would handle that dispute. The lawsuit would more likely be handled by a lawyer specializing in New York law. The desire to handle future contractual disputes provides the lawyer with an incentive to pick the law where she practices rather than the law of New York. Thus, it is far from clear that elimination of Article 2 would precipitate a competition among the states to produce better contract law.

Another possible advantage of Article 2 is that it can reduce the ability of any given state to extract rents from contractual parties. States respond to pressure from those inside the state to expropriate benefits from those outside of the state. Consider, for example, the case of franchising. Franchisees tend to be located inside a state, whereas franchisors are likely to reside outside of the state. Legislatures can then pass laws that transfer benefits from the franchisors to the franchisees. Indeed, to the extent that they allow future parties to opt out of this law via a choice of law clause, they do not run the risks of either encouraging franchisors to avoid their state or passing along the cost of a new rule to future franchisees.<sup>129</sup> The uniform law process can act as a constraint on this impulse. By committing to regulate contracts for the sale of goods through the U.C.C., a state can commit to forego attempts to pass legislation that would tilt the contracting process in favor of instate interests.

The alternative to remitting the law of sales to the states is to lodge legislative responsibility with the federal government. After all, the one recurrent criticism hurdled at the Article 2 revision process is that it slights the interests of consumers. Consumer groups, by and large, have had much more success at the federal level than they have had in the U.C.C. drafting process. In terms of legislation, their perceived ability to deliver votes gain the ear of the legislator. In terms of administrative action, the Federal Trade Commission for years enacted regulations targeted at protecting consumer interests.

It is important, to note the limits of the argument that consumers have been shut out of the U.C.C. drafting process. Not all contracts

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129. See Erin Ann O'Hara, *Opting Out of Regulation: A Public Choice Analysis of Contractual Choice of Law*, 53 Vand. L. Rev. 1551 (2000).

involve consumers. Many contracts are between sophisticated entities. For them, they either like the default rules that Article 2 provides or they contract around them. For these entities, the primary concern is that the provisions governing their contracts be default rules. The ability to specify in the contract the term that the parties want is more important than ensuring that the correct rule is on the statute books. Moreover, this is a world where the cost of contracting is declining. Information technology has made it cheaper to enter into tailored contracts, and there is no reason to suggest that this trend will reverse itself. The risk of transferring authority to the federal government is the risk that the government will enact a mandatory law of sales. While people may have differing intuitions on how large this risk is, it is a risk nonetheless. For well-informed entities, state regulation is preferable to federal law.

As to consumers, the FTC is better able to ferret out objectionable practices than is the Article 2 process. Yet the FTC is not currently set up to draft a commercial law code. Rather, it operates in a more episodic fashion. It identifies problems with extant law, and then passes regulations designed for those problems. In looking at these problems, the FTC has advantages over the U.C.C. process. Primarily, it has a staff of economists that can investigate competing claims about the effects of current law. In short, the lack of responsiveness in the U.C.C. process to consumer interest is at best an argument for federal intervention limited to the consumer area. It is not an argument for turning over primary responsibility for all of sales law to the federal government.

### *3. Articles 3 and 4*

If Article 2 is the "heart and soul" of the U.C.C., Articles 3 and 4 are its Achilles heel. They have, since their inception, been viewed as the price that had to be paid in order to induce the banking lobby not to block the entire U.C.C. project. In today's economy, the most important commercial practice covered by these provisions is the check system. This system has two distinct aspects. One is the check collection process; the other is the relationship between the customer and her bank.

Checks crisscross the country. No one seems to have contemplated, let alone advocated, a nonuniform system for check collection. The choice here is between federal law and the uniform law process. Indeed, as recounted above, federal law has already displaced large segments of Article 4. Federal law now regulates the check collection process. Indeed, the ongoing effort to revise Articles 3 and 4 was initiated in large part to bring these provisions into line with Regulation CC. This goal has proven to be elusive.

There was little interest on the part of the Federal Reserve Board and the banking industry to redraft Articles 3 and 4 to comport with Regulation CC. After it became evident that there was no industry support for this harmonization effort, the NCCUSL approved a "sharply truncated agenda for the project," consisting of uncontroversial matters.<sup>130</sup> In short, Articles 3 and 4 seem to do little work in this area.

State law in general and the U.C.C. in particular still regulate many aspects of the consumer-bank relationship. For example, Articles 3 and 4 specify which party bears the loss when a bank pays on a forged check. Here, a customer may be held liable for the loss to the extent that her negligence contributed to the loss. This contrasts noticeably with the federal rules governing loss for unauthorized use of a credit card or a debit card. In those situations, the customer's liability is set at a specific amount; negligence is simply not a relevant issue. Similarly, a customer using a credit card has a much greater ability to undo the credit card payment than does a customer using a check.<sup>131</sup>

One proposal is that this remaining area of state control be shifted to the federal government.<sup>132</sup> Ed Rubin has argued that even conceding that the U.C.C. is better drafted than the federal laws on payment systems, Congress should be assigned responsibility for lawmaking here because it will do a better job than the current uniform law process. The federal laws produce better outcomes for two reasons. First, Congress draws on the expertise of the Federal Reserve Board, which is generally thought of as one of the better functioning administrative agencies. Second, the federal arena is better suited for all interest groups to be heard than is the U.C.C. drafting process.

Consider, for example, the issue of disclosure to consumers. Articles 3 and 4 are silent on the issue of disclosure. Credit card issuers, by contrast, are required to disclose certain facts to their customers.<sup>133</sup> The tricky part in designing disclosure rules is ensuring that the disclosure remains meaningful. At some point, adding

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130. See April 3, 2002 memo. The revision addresses six issues, four of the proposed changes are designed to bring Articles 3 and 4 into conformity with other laws, a fifth change has the effect of protecting the FDIC when it is a receiver for a bank that has lost an instrument that it was entitled to enforce (a district court had held that even though the bank itself could have enforced the lost instrument, the FDIC as receiver for the bank could not), and a final change that addresses the liability between banks for losses resulting from a check generated from a telephone conversation. See *id.*

131. See Mann, *supra* note 107.

132. See Rubin, *supra* note 5, at 579-86.

133. These obligations are set forth in the Truth in Lending Act and Regulation Z promulgated by the Federal Reserve Board.

additional information will decrease the amount of information that the consumer actually reads. Too much disclosure can be as uninformative as too little disclosure. Thus, the institution setting disclosure standards needs to be able to balance the potential gain from requiring a piece of information from being disclosed against the cost that this disclosure imposes.<sup>134</sup> The process that produces the U.C.C. provides no means by which this tradeoff can be answered. The question of optimal disclosure is probably best left to an administrative agency.

The final piece of Article 3 is the concept of negotiability of notes. There is no need to repeat at length the argument that negotiable instruments play no role in the modern economy.<sup>135</sup> Indeed, this was the case when Article 3 was first enacted.<sup>136</sup> In short, there is little to be said for retaining Articles 3 and 4.

#### 4. Article 9

Perhaps the area of law covered by the U.C.C. where the case for uniformity is the most compelling is secured transactions.<sup>137</sup> The key to all recordation systems is that third parties be able to ascertain which filing system to consult when it wants to verify whether there exists a senior claim on a debtor's assets. A filing system that no one can find is of little value. With real estate, the answer of where to look is relatively easy. The location of the land is fixed, and the searcher merely has to learn at which level, state or local, the records are kept. Things are not so simple, however, when the assets at issue are movable, or even intangible, property. As an initial matter, one can imagine at least three potential ways to determine which jurisdiction in which one should look—the jurisdiction where the assets are located (with, of course, rules determining where intangible assets are to be found); the jurisdiction in which the debtor is physically located; and, in the case of a corporate debtor, the jurisdiction in which the debtor is incorporated.

The potential for problems with a nonuniform state-by-state recordation system is readily apparent. Consider a debtor incorporated in one state, the laws of which bases recordation on state

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134. See Howard Beales, et al, *The Efficient Regulation of Consumer Information*, 24 J.L. & Econ. 491, 524-26 (1981).

135. For an excellent examination of this issue, see Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. Rev. 951 (1997).

136. See Gilmore, *supra* note 9.

137. See Janger, *supra* note 17, at 626-30 (arguing that the uniform law process is better than state-by-state regulation of secured transactions, but that federal legislation would be better than uniform state regulation in terms of setting out the priorities of creditors).



of incorporation, but which has assets in another state, the laws of which bases recordation on the location of assets. Indeed, it was a concern with choice of law problems such as this that the drafters of new Article 9 pointed to in their statement as to why all jurisdictions should adopt their handiwork.<sup>138</sup> Whether these concerns motivated states or not, the actual results are that all states quickly adopted the new article on secured transactions.

The real question is the extent to which one should choose between the current U.C.C. process and one that lodges rulemaking authority in the federal government. Both the benefits and the shortcomings of the U.C.C. drafting process can be vividly highlighted by the recent Article 9 revision. As to the benefits, Article 9 is a very complex statute that took a good deal of expertise to put together. While one can find fault with any statute, it is fair to say that revised Article 9 is a better-drafted statute than almost any statute produced at the federal level. One need only compare revised Article 9 to the those portions of federal law covering the assignment of rights in intellectual property to quickly ascertain the differences in levels of technical expertise.<sup>139</sup>

Were secured transactions included in the general jurisdiction of Congress, it would be a tempting source of lobbying efforts. Secured transactions involve a good deal of money. Recent experience with bankruptcy reform legislation suggests that creditors, mainly credit card companies, are willing to spend significant amounts of money to press their views on Congress as to the appropriate social policy.

While one can admire the technical elegance of Article 9 and the purity of motives of those who drafted it, one also must be cognizant of the fact that consumer groups had little input in the process. As described by both Bob Scott and Ted Janger, consumer groups had more difficulty in pressing their interests than did secured lenders. The most that they were able to secure, at least from their perspective, was that things did not get worse. Also, the drafters of the new Article 9 had little interest in considering the extent to which secured credit imposes unjustifiable costs on tort victims and other non-adjusting creditors.<sup>140</sup> All agree that banks played a dominant role in the drafting of the revised Article 9.

The question then becomes whether assignment of legislative authority should be switched to the federal level. On balance, it should not. To see why this is so, recall that the federal government can react against the backdrop of laws passed by the states. Indeed,

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138. See memo, *supra* note 131.

139. See White & Summers, *supra* note 7, at 751 ("Most of these acts are fragmentary and typically do not deal coherently with perfection of security interests." *Id.*).

140. See Janger, *supra* note 17, at 611.

in the area of secured transactions, the FTC banned cross-collateralization clauses in consumer goods. Similarly, Congress in the Fair Labor Standards Act made it impossible to sell "hot goods," goods produced in violation of the Act.<sup>141</sup> This provision has the effect of ensuring that workers are paid the wages that they are owed, even ahead of a secured creditor with a security interest in the goods. So, the question is not whether the federal government should act in the secured transactions area; rather, the question is whether the federal government should act against a backdrop of laws crafted by the U.C.C. lawmaking process or whether it should act on its own.

Leaving the matter to be decided in the first instance by states via the U.C.C. has a number of advantages. One is the line drawing problem. If Congress were to have initial responsibility for some subset of secured transactions and the states were to have responsibility for others, we would need to articulate the basis on which one decided that a transaction is governed by state law or by federal law. This may not be an easy matter. For example, if one were concerned that consumer interests are systematically slighted in the U.C.C. drafting process, one may be tempted to suggest that secured transactions involving consumers be regulated by federal law. However, this requires a definition by which one could readily identify which transactions are consumer ones and also raises the concern that perhaps the category assigned to the federal government is too narrow. After all, tort victims have few friends in the Article 9 drafting process. Moreover, some unsecured creditors may be ill-equipped to participate in that arena as well.

There is also the problem of the unanticipated case. While Article 9 undoubtedly has not addressed every conceivable situation, it has addressed many. New federal law is likely to have more unaddressed problems. For example, federal law currently governs security interests in intellectual property. All agree that those laws answer far fewer questions than does Article 9.<sup>142</sup> It is reasonable to suppose that were the federal government to assert primary responsibility for crafting a law of secured transactions for a limited set of cases, this law would be less complete than current Article 9.

While the observation that certain groups are underrepresented in the Article 9 drafting process is correct, the better solution to this problem is to have the federal government act on a targeted basis against the background of this law rather than to cede primary responsibility for secured transactions to Congress.

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141. See *Citicorp v. Brock*, 483 U.S. 27, 107 S.Ct. 2694 (1987).

142. See *White & Summers*, *supra* note 7.

## CONCLUSION

The last ten years taught us to be skeptical of the U.C.C. drafting process. The laws produced no doubt reflect the input of interest groups. Moreover, these interest groups do not necessarily reflect the interests of society as a whole. In this regard, our conception of the ALI-NCCUSL effort simply caught up with our conception of lawmaking generally. There is no law crafting institution to which we can assign responsibility for commercial law, nor can we complacently assume that the output will advance the public good. To be sure, the public legislative process operates differently from the private one. Nevertheless, these advantages do not justify the wholesale abandonment of the U.C.C. project. We could easily live without Articles 3 and 4. But as to the rest of the extant Code, we are better off with it than without it. When viewed against the ideal, the U.C.C. comes up short; when viewed against its competitors, it still comes out ahead.