



2006

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Recommended Citation

Sarah Howard Jenkins, Contracting Out of the UCC, 40 Loy. L.A. L. Rev. 1 (2006).

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CONTRACTING OUT OF THE UCC

INTRODUCTION

*Sarah Howard Jenkins**

During the mid-forties and fifties, Karl Llewellyn and his coterie of drafters labored to produce a commercial code that would simplify and unify commercial law among the States. The effect of these two goals produces a tension with a historically strong competing public policy in our jurisprudence of freedom of contracting. The Code recognizes the expansion of commercial practices by agreement as an underlying purpose that drives a court's construction of the Uniform Commercial Code. However, it is the expansion of commercial practices that is to be fostered by the construction of the Code. Freedom of contracting is merely the methodology for expanding those practices. The freedom of contracting parties to define legal relations within the Code's ambit is restricted. The question of the degree of restriction on party autonomy and the ethical limitations on approaches to minimizing the effect of the Code on contractual relations was posed to UCC scholars and practitioners at several recent meetings of the Business Law Section of the American Bar Association. This scholarly discourse led to this compilation of manuscripts on *Contracting Out of the UCC*. This collection of articles and essays addresses the complications, limitations, and approaches to opting-out of or contracting out of the legal standards and norms articulated in the substantive Articles of the Uniform Commercial Code and the implications of such processes upon the general law of contract.

Focusing on mass marketing transactions, Professor William Woodward¹ in his thoughtful submission, *Constraining Opt-Outs: Shielding Local Law and Those It Protects from Adhesive Choice of*

* Charles C. Baum Distinguished Professor of Law, University of Arkansas at Little Rock, William H. Bowen School of Law.

1. William J. Woodward, Jr., Professor of Law, Temple University.

Law Clauses,² asks the essential question of whether the law “should permit parties to substitute for the ordinarily applicable law a different set of rules of their own choosing.” His concern is whether vendors, using adhesion contracts, impose a choice of law term or choice of forum clause or both and strip the non-drafting purchasers of protections designed by their legislatures to minimize abusive business tactics. Professor Woodward initially proposes an analytical framework to be utilized by the parties and the courts for determining the enforceability of such terms. He posits that the forum court must, in the first instance, determine the law applicable to the transaction by employing its choice of law rules; second, address the contract law question of the enforceability of the choice of law term pursuant to the predetermined applicable law insuring that contract law defenses such as unconscionability and the reasonable expectation test are applied; and, assuming the term survives the contract law scrutiny, the forum court must determine whether the transaction is reasonably related to the designated state and whether the application of the designated state’s laws violate a fundamental policy of the state whose law would otherwise be applicable. Despite his convincing rationale, Professor Woodward rejects this approach and calls for the adoption of a Federal Choice of Law rule to shield the “rich diversity of State protective law”³ and to prevent a perversion of our Constitutional system by vendors who designate one state’s law to govern citizens nationwide in mass marketing transactions.⁴ Until his proposal becomes a reality, he willingly accepts as the most immediate panacea the adoption of state shield laws to protect consumers and small businesses that lack the resources to negotiate or to acquire information on the value of the imposed choice of law provision.

In the same vein, Charles Knapp,⁵ an elder statesman of contract law and theory, in his essay *Opting Out or Copping Out: An Argument for Strict Scrutiny of Individual Contracts*⁶ sounds a clarion call for reevaluating the mechanical application of Modern

2. William J. Woodward, *Constraining Opt-Outs: Shielding Local Law and Those It Protects from Adhesive Choice of Law Clauses*, 40 Loy. L.A. L. Rev. 7, 92 (2007).

3. *Id.*

4. *Id.* at 83–84, 92.

5. Joseph W. Cotchett Distinguished Professor of Law, UC Hastings College of the Law.

6. 40 Loy. L.A. L. Rev. 95 (2007).

Contract Law, mid-Twentieth Century—“circa 1980,” doctrines and principles such as assent, the duty to read, and the parol evidence rule to Post Modern, Twentieth-first Century, contracting modes and processes of *individual contracts*, drafter-dominated contracts between commercial enterprises such as employers or mass market sellers and flesh and blood individuals.⁷ Given the depersonalization of the contractual relationship and the ability of the drafter to wield unrestrained bargaining power, he argues, the issue is not one of freedom of contract or freedom from contract but the legitimacy of the drafter’s ability to effectively negate the fundamental principles that inure to individual members of our democratic society without a bargain, as defined circa 1980. The fundamental principles that he desires to insure include the right to a jury trial, the availability of a class action, and the accessibility of a court of law. These rights may be negated through the union of a choice of law designation, choice of forum, and the imposition of an agreement to arbitrate. Professor Knapp concludes his impassioned essay positing as the remedy the judicial redefinition or reevaluation of the contract doctrine of assent and unconscionability based on context or the “strict scrutiny” of standardized individual contracts.

Addressing the same concerns raised by Professors Woodward and Knapp but using as her subject UCC Article 2A consumer leases, Professor Irma Russell⁸ engages in an economic assessment of both the policies underlying UCC default provisions in general and specifically those of Article 2A and the enforceability of mass marketed adherence contracts.⁹ Her thesis, that the system of restrained judicial oversight that insulates true bargains from governmental control should not be extended to standardized consumer contracts, is supported by her empirical research of the prevailing terms offered and enforced by the 10 major national consumer automobile rental agencies. Each of these agencies, she found, employs a form lease offering terms and conditions on a nationwide basis. Russell recognizes that 2A eliminates two of the

7. Charles L. Knapp, *Opting Out or Copping Out? An Argument for Strict Scrutiny of Individual Contracts*, 40 LOY. L.A. L. REV. 95 (2007).

8. Professor of Law and Director, National Energy-Environmental Law & Policy Institute (NELPI), University of Tulsa.

9. Irma S. Russell, *Got Wheels?: Article 2A, Standardized Rental Car Terms, Rational Inaction, and Unilateral Private Ordering*, 40 LOY. L.A. L. REV. 137 (2007).

three potentially offending terms, choice of law and choice of forum, that both Woodward and Knapp view as coalescing with arbitration for maximum impact of drafter domination and thus Article 2A provides greater protection than is available for sales or service agreements. However, the scrivener's ability to impose an arbitration term and to vary other default provisions support her conclusion for the need to moderate the prevailing tests for the enforceability of contract terms.

In his article, *Is Arbitration Lawless?*,¹⁰ Professor Christopher Drahozal¹¹ delves into available empirical data to determine if claims by leading commentators, including Professor Knapp, that arbitration is lawless are indeed valid. He begins his assessment with a focused definition of lawlessness; he then delineates the available data and contrasts the conduct of arbitrators with that of judges and juries before reaching his conclusion that arbitrator conduct and their resolution of disputes are indistinguishable from that of judges and juries.

Professor Emeritus Fred Miller,¹² immediate past president of the National Conference of Commissioners on Uniform State Laws, questions the wisdom of opting out of the UCC for a transaction within its scope given the confusion and complexity of the common law that codification of the UCC was designed to rectify.¹³ Concomitantly, he inquires whether it is wisdom to opt into the UCC if the statute was not designed for the transaction under consideration. Here, he specifically identifies software licensing. Although recognizing existing statutory and commentary support for opting into the various UCC articles, he advises caution in his article, *Writing Your Own Rules: Contracting Out of (and Into) the Uniform Commercial Code; Intrastate Choice of Law*.¹⁴ For transactions within the UCC, Professor Miller offers as an alternative to agreements varying non-mandatory provisions or agreements designating another jurisdiction's law, the designation of *intrastate* law,

10. 40 LOY. L.A. L. REV. 187 (2007).

11. John M. Rounds Professor of Law, University of Kansas School of Law.

12. George Lynn Cross Research Professor Emeritus, and former McAfee Chair in Law and Centennial Professor, University of Oklahoma College of Law; Of Counsel, Phillips, McFall, McCaffrey, McVay and Murrah, Oklahoma City, Oklahoma.

13. Fred H. Miller, *Writing Your Own Rules: Contracting Out Of (And Into) the Uniform Commercial Code; Intrastate Choice of Law*, 40 LOY. L.A. L. REV. 217 (2007).

14. *Id.*

other local codified or substantively relevant non-codified legal principles or regimes.

Raymond Nimmer¹⁵ and Jean Braucher¹⁶ both weigh in on the applicability of Article 2 to software licensing in their essays: *An Essay on Article 2's Irrelevance to Licensing Agreements*¹⁷ and *Contracting Out of Article 2 Using a "License" Label: A Strategy that Should Not Work for Software Products*, respectively.¹⁸ Dean Nimmer echoes and expounds on Professor Miller's expressed irrelevancy of Article 2 to licensing agreements arguing that information is not a good, that the rationale of Article 2 default rules is a property-based paradigm, and that the general themes of good faith, practical construction, and policing for unconscionable terms are an integral part of general contract law. Hence, these rules and doctrines as Article 2 themes are irrelevant. Professor Braucher, as part of the continuing debate, takes exception to the positions espoused by Nimmer and Miller and offers a functional approach to resolving the issue of the applicability of the Article 2 to software licensing.

Professors James E. Byrne¹⁹ and Sarah Howard Jenkins²⁰ and practitioners Meredith S. Jackson and Paul S. Turner²¹ focus on the theory and mechanics of contracting out of specific substantive articles. Meredith S. Jackson's²² essay, *Contracting Out of Article 9*,²³ presents a pithy assessment of the likely motives driving the desire to contract out of Revised Article 9, the planning paradigms available—including "morphing" the collateral, and the attendant

15. Dean, Leonard H. Childs Professor of Law, and Co-Director of the Intellectual Property and Information Law Program University of Houston Law Center.

16. Roger C. Henderson Professor of Law, James E. Rogers College of Law, University of Arizona.

17. 40 Loy. L.A. L. Rev. 235 (2007).

18. 40 Loy. L.A. L. Rev. 261 (2007).

19. Professor of Law, George Mason University School of Law; Director of the Institute of International Banking Law & Practice, Inc.

20. Charles C. Baum Distinguished Professor of Law, University of Arkansas at Little Rock, William H. Bowen School of Law.

21. Former Attorney at Law; author of numerous articles and books, including *Law of Payment Systems and EFT* and *Negotiating Wire Transfer Agreements: A Guide for Treasury Executives, Bankers & Attorneys*; and former Assistant General Counsel Occidental Petroleum Corporation, San Diego, California.

22. Ms. Jackson heads the debt finance practice of Irell & Manella LLP's debt finance and has been named California Super Lawyer from 2003 to the present.

23. 40 LOY. L.A. L. REV. 281 (2007) (emphasis added).

risks in completely contracting out of Revised Article 9 or merely varying its effect. She tersely concludes, however, that “[w]ithin the parameters of careful structuring and disclosure . . . parties *should* find Article 9 a flexible and responsive system of rules that facilitates commercial creativity.”²⁴ Impliedly she stresses, as other contributors, the need to be knowledgeable of not only the principles, policies, and goals of the applicable law but also those of the target regime. Byrne, Jenkins, and Turner separately provide comprehensive evaluations of the ability to contract out of or vary the terms of Article 5,²⁵ Article 2,²⁶ and Articles 3, 4, and 4A,²⁷ respectively.

Stephanie Heller, Counsel and Vice President of the Federal Reserve Bank of New York, echoes the general concern of relevancy and persuasively challenges the notion of the continued viability of Article 4 payments law as bank collection process shifts from paper check processing to electronic processing in her essay entitled: *An Endangered Species: The Increasing Irrelevancy of Article 4 of the UCC in an Electronics-Based Payments System*.²⁸ Heller provides a concise review of automatic clearing house check conversion products and the growing use of inter-bank electronic check exchange agreements for the collection of electronic check images, two separate and competing paradigms that are swiftly putting an end to the need for paper based rules. She concludes that agreements or consent to the use of a check as the source of collection information for check conversion products, opting out of Article 4, are motivated by a desire for faster payment and not necessarily a rejection of Article 4 rules. “Variation of the UCC rules is not the driver of the contracting out practice but rather an unexpected casualty of it.”²⁹ In her discussion of agreements for the collection of electronic images, Heller identifies the most troublesome issues raised by the process and the void in existing payments laws, including Article 4 and

24. *Id.* at 296 (2007).

25. James E. Byrne, *Contracting Out of Revised UCC Article 5 (Letters of Credit)*, 40 LOY. L.A. L. REV. 297 (2007).

26. Sarah Howard Jenkins, *Contracting Out of UCC Article 2*, 40 LOY. L.A. L. REV. 401 (2007).

27. Paul S. Turner, *Contracting Out of the UCC—Variation by Agreement under Articles 3, 4, 4A*, 40 LOY. L.A. L. REV. 443 (2007).

28. 40 Loy. L.A. L. Rev. 513 (2007).

29. Stephanie Heller, *An Endangered Species: The Increasing Irrelevance of Article 4 of the UCC in an Electronics-Based Payments System*, 40 LOY. L.A. L. REV. 513 (2007).

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Finally, Professor Christina L. Kunz³⁰ addresses the rarely considered ethical implications of efforts employed by lawyers to contract out of applicable legal regimes, triggering among other ethical duties those of competency and zealous representation within the bounds of the law.³¹ These ethical questions, she suggests, “apply to all contractual drafting” including discerning mandatory provisions, drafting on the edge of validity, proposing invalid contractual clauses, and making representations to clients, opposing counsel, or opposing parties.

We believe this symposium of articles and essays is only part of the dialogue on both the private ordering of contractual relations and the relevancy of the UCC as global commerce and electronic payments are increasing exponentially. We invite each reader not only to engage the substance of our individual contributions but also to participate in the discourse by way of critique or response.

30. Professor of Law, William Mitchell College of Law.

31. Christina L. Kunz, *The Ethics of “Iffy” and Invalid Contract Clauses*, 40 LOY. L.A. L. REV. 487 (2007).