

**Proposal to Amend Official Text of § 1-301
(Territorial Applicability; Parties' Power to
Choose Applicable Law) of Revised Article 1 of the UCC**

To: Institute Members

From: Director Lance Liebman, with assistance from Amelia H. Boss, member of ALI's Council and Executive Committee, the Permanent Editorial Board for the Uniform Commercial Code (PEB), and the former Drafting Committee to Revise Uniform Commercial Code (UCC) Article 1, and Neil B. Cohen, PEB Research Director and Reporter for the former Drafting Committee to Revise UCC Article 1

The Executive Committee of The American Law Institute recommends that the Council and membership of the Institute approve an amendment to Revised Article 1 of the UCC replacing the choice-of-law rule in current § 1-301 with the choice-of-law rule contained in former UCC § 1-105.¹

History. Revised Article 1 of the UCC, promulgated in 2001 by the Institute and the Uniform Law Commission (ULC),² contains a new choice-of-law rule for transactions within the scope of the UCC. The new rule (§ 1-301) provides somewhat more party autonomy in business-to-business transactions and somewhat greater consumer protection against overreaching than the prior rule (former § 1-105). The new choice-of-law rule was one of the most hotly debated provisions in revised Article 1; while other portions of Revised Article 1 achieved consensus within the Institute, dissenting views about § 1-301 were expressed within the Drafting Committee to Revise UCC Article 1 and within the ALI Council. Section 1-301 was the subject of four motions at the Institute's Annual Meeting in 2001 but was ultimately approved.

To date, however, while Revised Article 1 has been enacted in 30 jurisdictions,³ all except the U.S. Virgin Islands have retained

¹ Proposed § 1-301, current § 1-301, and former § 1-105 are set out in the attached Annexes.

² The National Conference of Commissioners on Uniform State Laws adopted this new name in 2007.

³ As of March 3, 2008, Revised Article 1 has been adopted by Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida,

the choice-of-law rule from former § 1-105 (renumbering it, in most cases, as § 1-301) rather than enacting the revised rule in the Official Text of § 1-301. This has led to an unfortunate situation: the “uniform” version of the UCC as promulgated by the Institute and the ULC is not the version that has been “uniformly” adopted. In fact, in all 50 states the substance of former § 1-105 is the law; it is only in the U.S. Virgin Islands that the “uniform” version is followed.⁴

At its November 3, 2007 meeting, the Permanent Editorial Board for the Uniform Commercial Code (PEB) recommended that the Official Text of UCC § 1-301 be amended by reverting to the choice-of-law rule of former UCC § 1-105. Acting under the ULC constitution,⁵ the Executive Committee of the ULC accepted that recommendation and, at its meeting on January 12, 2008, approved the proposed § 1-301 set out in the attached Annex 1. Since no objection was filed by any ULC commissioner within the objection period, that amendment is deemed approved by the ULC as a whole.

The Executive Committee of the Institute considered the proposed amendment at its meeting on February 27, 2007. With all members in attendance and without dissent, the Committee recommended the amendment. It will be before the Council at its meeting on May 19 and, if then approved, will go to the Annual

Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, North Dakota, Oklahoma, Rhode Island, Texas, U.S. Virgin Islands, Utah, Virginia, and West Virginia.

⁴To encourage enactment of Article 1 even in states that are not inclined to adopt the Official Text of § 1-301, the ULC has been supplying the legislatures of such states a version of § 1-301 essentially identical to the amendment recommended in this proposal as a “hip pocket” amendment to the Official Text.

⁵Section 4.3(b)(3) of the ULC constitution permits the Executive Committee to approve amendments to uniform acts between Annual Meetings of the ULC if the amendments are “desirable to remove an ambiguity, . . . to meet an unanticipated objection, to conform the Act to a trend of judicial decisions, or to achieve a similar objective.” The ULC’s Executive Committee concluded that adopting the proposed amendment to Article 1 was appropriate under that provision. The Institute does not have a comparable procedure; substantive changes to Institute products require concurrence of the Council and the membership.

Meeting for the membership's consideration and approval on May 21.

Issues raised by Revised § 1-301. Section 1-301 represented a significant rethinking of choice-of-law issues for transactions within the scope of the UCC, changing both the rules governing the power of parties to select the jurisdiction whose law will govern their transaction and the rules determining the governing law in the absence of such selection by the parties. With respect to the power to select governing law, § 1-301 affords somewhat greater party autonomy than does former § 1-105 but with important safeguards protecting consumer interests and fundamental public policies.

While former § 1-105 allows the parties to a transaction to designate a jurisdiction whose law governs a transaction only if the transaction bears a "reasonable relation" to that jurisdiction, more recent examinations of this issue have moved in the direction of greater party autonomy to designate the governing law within certain limits. Section 187(2) of the Restatement Second of Conflict of Laws (1971, amended 1988) provides more party autonomy than does former § 1-105 (by allowing designation of a jurisdiction's law not only if the transaction bears a reasonable relation to the jurisdiction but also if there is a reasonable basis for the parties' choice); however, it explicitly limits that autonomy when the designated law would offend a fundamental policy of the jurisdiction whose law would govern in the absence of the designation. Subsequently emerging international norms foster even more party autonomy than provided in the Restatement while adding additional protections for consumer transactions. Following the international trend, § 1-301 goes further than the Restatement in its basic principles of party autonomy but accompanies that development with both the Restatement's limitations relating to public policy and additional protections for consumer transactions.

In the context of business-to-business transactions, § 1-301 generally provides the parties with greater autonomy to designate a jurisdiction whose law will govern than does former § 1-105 by deleting that section's requirement that the transaction bear a "reasonable relation" to the chosen jurisdiction but following the lead of the Restatement by providing that the designation of a jurisdiction's law is not effective (even if the transaction bears a reasonable relation to that jurisdiction) if application of that

law would be contrary to a fundamental policy of the jurisdiction whose law would otherwise govern.

In the context of consumer transactions, the language of § 1-301, unlike that of former § 1-105, explicitly protects consumers against the possibility of losing the protection of consumer-protection rules, a result often achieved in practice under former § 1-105.

Section 1-301(d) also addresses another issue arising under former § 1-105. In the absence of an effective contractual designation of governing law, former § 1-105(1) directs the forum to apply its own law to a transaction if it bears “an appropriate relation to this state.” In this situation, though, many courts simply apply the forum’s general choice-of-law principles, either ignoring the language of § 1-105 or interpreting its requirement of an “appropriate” relation as invoking the forum’s general principles. Section 1-301 follows the approach adopted by these courts and provides that, in the absence of an effective contractual designation, the forum should apply the forum’s general choice-of-law principles, subject to certain special rules in consumer transactions.

Reasons for recommended change. As noted above, during the process that led to approval of Revised Article 1 by the Institute and the ULC, § 1-301 proved to be somewhat controversial. Concerns were raised that the expanded party autonomy to choose applicable law was at variance with the formulation in the Restatement Second of Conflict of Laws,⁶ was overbroad,⁷ and might be unconstitutional.⁸ Moreover, some argued that the expanded consumer-protection provisions and the “fundamental policy” limitation on the designation of governing law could place excessive limits on party autonomy. This controversy continued during the first several enactments, with large commercial interests (primarily bankers’ associations) lobbying against § 1-301, sometimes joined by those who were concerned that the section might validate choice-of-law clauses that would result in

⁶ Restatement Second, Conflict of Laws § 187(2) (1969).

⁷ William J. Woodward, Jr., *Contractual Choice of Law: Legislative Choice in an Era of Party Autonomy*, 54 SMU L. Rev. 697, 740 (2001).

⁸ See generally Richard K. Greenstein, *Is the Proposed U.C.C. Choice of Law Provision Unconstitutional?*, 73 Temp. L. Rev. 1159 (2000).

application of UCITA as enacted in Virginia or Maryland.⁹ The result was that all of the early enactments of Revised Article 1 (except in the U.S. Virgin Islands) rejected § 1-301 in favor of former § 1-105. The decisions of these early enacting states set a pattern that other enacting states have been unwilling to break. The result, as noted earlier, is that all 29 enacting states have retained the substance of former § 1-105.

In the context of the drafting of Restatements and Principles of the Law, the Institute takes pride in articulating what it considers to be the “better” proposition of law. The drafting of the UCC, however, implicates issues not present in the preparation of Restatements and Principles. First, the preparation of a uniform act requires that considerations of enactability, while not determinative, be taken into account. Second, the UCC is a joint enterprise, undertaken with the ULC, the entity with the responsibility for promoting UCC enactments in the states. Consequently, while it would not be appropriate to seek revision of a Restatement provision merely because it has been rejected by some courts, it is important to the integrity of the UCC process that both the Institute and the ULC concur in proposing and promoting a product that is capable of achieving broad enactment. Failure to meet that standard has led to UCC revisions in the past.¹⁰ Unfortunately, we now know that § 1-301 has not met that standard. This is the basis for the recommendation by the Institute’s Executive Committee that the Council and the membership adopt the revision to § 1-301 as proposed by the PEB.

If, as expected, the Council approves the Executive Committee’s recommendation when it meets on May 19, the proposal to amend § 1-301 will be presented for consideration and action at the Annual Meeting at 2:00 p.m. on Wednesday, May 21. Professor Neil Cohen, the Research Director for the PEB and the

⁹ See, e.g., Keith A. Rowley, *The Often Imitated, But Not Yet Duplicated, Revised Uniform Commercial Code Article 1*, 38 UCC L.J. 195 (2006).

¹⁰ The original 1952 Official Text of the UCC achieved only one enactment in the five years after its promulgation. This state of affairs, augmented by calls for revision, resulted in the promulgation of a substantially revised 1958 draft that garnered much more support. The UCC was amended still further in 1962. Similarly, Article 2A, the first new Article of the UCC since its original promulgation, had been enacted in only a few states when the 1987 text was replaced with a new 1990 text that rewrote some problematic provisions.

Reporter for the Drafting Committee to Revise UCC Article 1, will be on the dais to help present the matter to the membership and to address any questions.

Annex 1

Proposed UCC § 1-301

§ 1-301. Territorial Applicability; Parties' Power to Choose Applicable Law.

(a) Except as otherwise provided in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties.

(b) In the absence of an agreement effective under subsection (a), and except as provided in subsection (c), [the Uniform Commercial Code] applies to transactions bearing an appropriate relation to this state.

(c) If one of the following provisions of [the Uniform Commercial Code] specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law so specified:

- (1) Section 2-402;
- (2) Sections 2A-105 and 2A-106;
- (3) Section 4-102;
- (4) Section 4A-507;
- (5) Section 5-116;
- [(6) Section 6-103;]
- (7) Section 8-110;
- (8) Sections 9-301 through 9-307.

Official Comment

Source: Former Section 1-105

Changes from former law: This section is substantively identical to former Section 1-105. Changes in language are stylistic only.

This section is subject to Section 1-102, which states the scope of Article 1. As that section indicates, the rules of Article 1, including this section, apply to a transaction to the extent that

transaction is governed by one of the other Articles of the Uniform Commercial Code.

Annex 2

Current UCC § 1-301

§ 1-301. Territorial Applicability; Parties' Power to Choose Applicable Law.

- (a) In this section:
 - (1) “Domestic transaction” means a transaction other than an international transaction.
 - (2) “International transaction” means a transaction that bears a reasonable relation to a country other than the United States.
- (b) This section applies to a transaction to the extent that it is governed by another article of the [Uniform Commercial Code].
- (c) Except as otherwise provided in this section:
 - (1) an agreement by parties to a domestic transaction that any or all of their rights and obligations are to be determined by the law of this State or of another State is effective, whether or not the transaction bears a relation to the State designated; and
 - (2) an agreement by parties to an international transaction that any or all of their rights and obligations are to be determined by the law of this State or of another State or country is effective, whether or not the transaction bears a relation to the State or country designated.
- (d) In the absence of an agreement effective under subsection (c), and except as provided in subsections (e) and (g), the rights and obligations of the parties are determined by the law that would be selected by application of this State’s conflict of laws principles.
- (e) If one of the parties to a transaction is a consumer, the following rules apply:

- (1) An agreement referred to in subsection (c) is not effective unless the transaction bears a reasonable relation to the State or country designated.
- (2) Application of the law of the State or country determined pursuant to subsection (c) or (d) may not deprive the consumer of the protection of any rule of law governing a matter within the scope of this section, which both is protective of consumers and may not be varied by agreement:

(A) of the State or country in which the consumer principally resides, unless subparagraph (B) applies; or

(B) if the transaction is a sale of goods, of the State or country in which the consumer both makes the contract and takes delivery of those goods, if such State or country is not the State or country in which the consumer principally resides.

(f) An agreement otherwise effective under subsection (c) is not effective to the extent that application of the law of the State or country designated would be contrary to a fundamental policy of the State or country whose law would govern in the absence of agreement under subsection (d).

(g) To the extent that [the Uniform Commercial Code] governs a transaction, if one of the following provisions of [the Uniform Commercial Code] specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law so specified:

- (1) Section 2-402;
- (2) Sections 2A-105 and 2A-106;
- (3) Section 4-102;
- (4) Section 4A-507;
- (5) Section 5-116;
- [(6) Section 6-103;]
- (7) Section 8-110;
- (8) Sections 9-301 through 9-307.

Official Comment

[intentionally omitted]

Annex 3

Former UCC § 1-105

§ 1-105. Territorial Applicability of the Act; Parties' Power to Choose Applicable Law.

(1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement this Act applies to transactions bearing an appropriate relation to this state.

(2) Where one of the following provisions of this Act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. Section 2-402.

Applicability of the Article on Leases. Sections 2A-105 and 2A-106.

Applicability of the Article on Bank Deposits and Collections. Section 4-102.

Governing law in the Article on Funds Transfers. Section 4A-507.

Letters of Credit. Section 5-116.

[Bulk sales subject to the Article on Bulk Sales. Section 6-103.]

Applicability of the Article on Investment Securities. Section 8-110.

Law governing perfection, the effect of perfection or nonperfection, and the priority of security interests and agricultural liens. Sections 9-301 through 9-307.

Official Comment

[intentionally omitted]