

**PERMANENT EDITORIAL BOARD
FOR THE UNIFORM COMMERCIAL CODE**

REPORT

**EFFECT OF NON-UNIFORM SCOPE PROVISIONS IN
REVISED ARTICLE 9 OF THE
UNIFORM COMMERCIAL CODE**

I. Introduction

Revised Article 9 has now been enacted in all 50 states and in the District of Columbia. As has been the case with other Articles of the Uniform Commercial Code, the various state enactments contain a number of deviations from the Official Text of Revised Article 9.

While some deviations from the Official Text reflect accommodation of uniquely local issues, others represent substantive policy choices by the enacting legislatures to differ from the national model provided by the Official Text of Revised Article 9. While non-uniformities in the latter category are inconsistent with the ideal of a truly *Uniform* Commercial Code, they are, of course, inevitable in a democratic system that entrusts enactment to 51 different legislatures. Moreover, it must be recognized that the Uniform Commercial Code has never been enacted in a truly uniform way. There have been local variations ever since the widespread enactment of the Code, including variations in Article 9. The substantive non-uniformities in the enactment of Revised Article 9 are well-catalogued in two articles by Penelope L. Christophorou, Kenneth C. Kettering, Lynn A. Soukup, and Steven O. Weise: *Under the Surface of Revised Article 9: Selected Variations in State Enactments from the Official Text of Revised Article 9*¹, and *Analysis of State Variations*².

Such non-uniformities have the potential to be problematic in our national economy, where transactions frequently cross state lines and where more than one jurisdiction can be the forum in which litigation establishing the rights of parties can be instituted. Nonetheless, most of the deviations from the Official Text of Revised Article 9 will not cause serious transactional difficulties so long as the parties involved educate themselves as to the applicable law.

¹34 Uniform Commercial Code Law Journal 331 (2002).

²34 Uniform Commercial Code Law Journal 358 (2002) (hereinafter referred to as “State Variations”).

There is one group of non-uniformities, though, that has the potential to cause transactional difficulty and legal uncertainty, because these non-uniformities can create difficult conflict of laws issues. This group of non-uniform enactments relates to the scope provisions of Revised Article 9.

II. Uncertainties Arising from Non-uniformities as to Scope

Uniform Commercial Code Section 9-109(a)³ provides that, “[e]xcept as otherwise provided in subsections (c) and (d),” Revised Article 9 applies, *inter alia*, to all transactions, regardless of their form, that create a security interest in personal property or fixtures by contract and to sales of accounts, chattel paper, payment intangibles, or promissory notes. Section 9-109(c) excludes application of Revised Article 9 in certain situations *to the extent that* the transactions are governed by other law referred to in that subsection⁴. Section 9-109(d) excludes application of Revised Article 9 altogether to the transactions and interests listed in that subsection.⁵ While there are non-

³Unless otherwise noted, all references to Article 9 are to the Official Text of Revised Article 9.

⁴Section 9-109(c) provides:

This article does not apply to the extent that:

- (1) a statute, regulation, or treaty of the United States preempts this article;
- (2) another statute of this State expressly governs the creation, perfection, priority, or enforcement of a security interest created by this State or a governmental unit of this State;
- (3) a statute of another State, a foreign country, or a governmental unit of another State or a foreign country, other than a statute generally applicable to security interests, expressly governs creation, perfection, priority, or enforcement of a security interest created by the State, country, or governmental unit; or
- (4) the rights of a transferee beneficiary or nominated person under a letter of credit are independent and superior under Section 5-114.

⁵Section 9-109(d) provides:

This article does not apply to:

- (1) a landlord’s lien, other than an agricultural lien;
- (2) a lien, other than an agricultural lien, given by statute or other rule of law for services or materials, but Section 9-333 applies with respect to priority of the lien;
- (3) an assignment of a claim for wages, salary, or other compensation of an employee;
- (4) a sale of accounts, chattel paper, payment intangibles, or promissory notes as part of a sale of the business out of which they arose;
- (5) an assignment of accounts, chattel paper, payment intangibles, or promissory notes which is for the purpose of collection only;
- (6) an assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract;
- (7) an assignment of a single account, payment intangible, or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness;
- (8) a transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds;
- (9) an assignment of a right represented by a judgment, other than a judgment taken on a right to payment that was collateral;
- (10) a right of recoupment or set-off, but:
 - (A) Section 9-340 applies with respect to the effectiveness of rights of recoupment or

uniformities in enactment with respect to subsection (c), variations with respect to subsection (d) raise more difficult issues. In most cases, these non-uniform enactments add further exclusions to the 13 listed exclusions in the Official Text of the subsection. Thus, Article 9 as enacted in a state with such a non-uniform enactment does not govern some transactions that are governed by Article 9 in states that have followed the Official Text. In a few states, however, the non-uniform variations delete an exclusion that appears in subsection (d) of the Official Text, with the result that transactions not governed by Article 9 in states that have followed the Official Text are governed by Article 9 of such states.

A. Non-Uniform Exclusions

For purposes of this Report, attention is drawn particularly to the most common types of non-uniform enactments of Section 9-109(d) — those that exclude from the scope of Article 9 transactions that are otherwise within the scope of the Official Text of the Article: (i) 18 states exclude from Article 9 transfers by the government of any state⁶, (ii) 18 states exclude from Article 9 transfers of interests in workers compensation and similar programs⁷, and (iii) 13 states exclude from Article 9 transfers of interests in special needs trusts⁸. The relatively large number of states with these non-uniform exclusions makes it likely that conflict of laws issues will arise with some frequency.

If a transaction that is the subject of a non-uniform exclusion from Article 9 does not have a relationship to any state other than the state that has excluded that transaction from Article 9, and litigation takes place in a forum in that state, Revised Article 9 would not be applicable to the transaction. However, such a purely local transaction (accompanied by local litigation) may not be the norm. In many cases, the parties (or some other aspect of the transaction) may relate to a state that has not excluded the transaction from Article 9, or the litigation may take place in a state that

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- set-off against deposit accounts; and
 - (B) Section 9-404 applies with respect to defenses or claims of an account debtor;
 - (11) the creation or transfer of an interest in or lien on real property, including a lease or rents thereunder, except to the extent that provision is made for:
 - (A) liens on real property in Sections 9-203 and 9-308;
 - (B) fixtures in Section 9-334;
 - (C) fixture filings in Sections 9-501, 9-502, 9-512, 9-516, and 9-519; and
 - (D) security agreements covering personal and real property in Section 9-604;
 - (12) an assignment of a claim arising in tort, other than a commercial tort claim, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds; or
 - (13) an assignment of a deposit account in a consumer transaction, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds.

⁶See *State Variations* at 361-82. Thirteen other states exclude transfers only by “this state.” By their limited nature, these exclusions are likely to cause fewer choice of law problems. See *id.*

⁷See *id.*

⁸See *id.*

has not excluded the transaction from Article 9. Accordingly, conflict of laws issues must be addressed.

1. Litigation in non-excluding forum

What happens if litigation concerning a security interest excluded from the scope of Article 9 as enacted in State X is instituted in the courts of State Y, which has not excluded the transaction from the scope of Article 9? In such a case, the conflict of laws rules of State Y determine which state's law applies. The Uniform Commercial Code of State Y contains two sets of rules that determine the state whose law will govern secured transactions issues in the litigation. With respect to issues of perfection and priority, UCC Sections 9-301 through 9-307 of State Y provide the rules that determine which state's law governs⁹. With respect to issues of enforceability, attachment, and other rights and duties between debtor and secured party, though, the applicable law is determined by the conflict of laws rules in UCC Article 1 of State Y. Article 1's conflict of laws rules appear in Section 1-301 of Revised Article 1 and Section 1-105 of former Article 1. As the following analysis demonstrates, it is possible for a court in State Y to conclude, by application of that forum's conflict of laws rules, that the law of State Y (or another state that has not excluded the transaction from the scope of Article 9) is applicable, even if the transaction has significant contacts with State X.

a. Enforceability, attachment, and other rights between the parties

If litigation concerning a transaction that is excluded from the scope of Article 9 in State X takes place in the courts of State Y, which has not excluded the transaction from its Article 9, the law that governs enforceability, attachment, and other rights between the parties will be determined by application of Revised Section 1-301 or former Section 1-105, as enacted in the forum state. If application of Revised Section 1-301 or former Section 1-105 directs the State Y court to apply the law of State X, the court will apply that law — which, as a result of the exclusion in State X, will not be Article 9, but, rather, whatever other law of State X governs in light of the fact that the transaction has been excluded from State X's Article 9.¹⁰ It is possible, of course, for Revised Section 1-301 or former Section 1-105 to direct the State Y court to apply the law of State Y (or another state that has not excluded the transaction from Article 9) even though the transaction has some connection to State X. In this regard, it should be noted that both Revised Section 1-301 and former Section 1-105 provide the parties to a transaction with some autonomy as to selection of the governing law.¹¹

⁹More precisely, these sections govern issues of perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.

¹⁰It is important in this regard to recall that excluding a transaction from the scope of Article 9 is not the same thing as prohibiting that transaction. Exclusion from Article 9 merely means that other law governs the transaction. Only if other law prohibits the transaction is the transaction prohibited. As a practical matter, though, parties may be unwilling to enter into a transaction if the other law that would govern it is uncertain or antiquated.

¹¹Section 1-301 provides somewhat greater party autonomy in non-consumer transactions but is also explicitly limited by considerations of public policy. See Revised UCC Section 1-301(f).

b. Perfection and priority

If, under the law of the state determined to be applicable pursuant to State Y's enactment of Revised Section 1-301 or former Section 1-105 (whether the applicable law is the non-Article 9 law of State X or Article 9 of State Y), the security interest in question is enforceable and attached, issues of perfection of that security interest and the priority of that security interest are likely to arise. If the litigation concerning these issues takes place in the courts of State Y, those courts must apply the conflict of laws rules in UCC Sections 9-301 through 9-307 to determine which state's law governs issues of perfection and priority. Once again, depending on the situation, the State Y court might be directed by these sections to apply the non-Article 9 law of State X for either or both of these issues, or it might be directed to apply the law of State Y (or another state that has not excluded application of Article 9 to the transaction at hand)¹²; in the latter case, the rules in Article 9 of State Y or such other state would apply even though the transaction has some connection with State X.

2. Litigation in excluding forum

It is also possible for litigation concerning a security interest excluded from the scope of Article 9 in State X to be instituted in the courts of State X, even if the transaction has significant contacts with State Y, which has not excluded the transaction from its enactment of Article 9. In such a case, the conflict of laws rules of State X determine which state's law applies. If all aspects of the transaction relate to no state other than State X, the analysis is likely trivial, resulting in application of the law of State X to all aspects of the transaction; but, as noted above, such a purely local transaction may not be the norm. In cases in which the law of a state other than State X might conceivably apply, the analysis is made much more difficult by the fact that the conflict of laws rules that will determine the applicable law may not be the conflict of laws rules found in the Uniform Commercial Code.

a. Enforceability, attachment, and other rights between the parties

If litigation concerning a transaction that is excluded from the scope of Article 9 in State X takes place in a court of State X, it is not clear which conflict of laws rules the court must apply in order to determine the state whose law governs enforceability, attachment, and other rights between the parties. If no other aspect of the transaction is within the scope of Article 9 of State X or within the scope of another Article of the Uniform Commercial Code of State X, it is likely that the conflict of laws rules in UCC Article 1 do not apply. This result is stated explicitly in Revised UCC Section 1-301(b), and is implicit in former Section 1-105. Thus, the general conflict of laws principles of State X determine whether the non-Article 9 law of State X applies to these issues or, rather, whether the Article 9 of State Y (or another state that has not excluded the transaction from Article 9) applies. Because conflict of laws rules outside the UCC are not uniform in the various states, it may

¹²The conflict of laws rules in Sections 9-301 through 9-307, unlike those in Revised Section 1-301 and former Section 1-105, do not generally defer to choices made by the parties.

be difficult to predict which state's law would be applied by the courts of a state that has excluded a transaction from Article 9. *It is the view of the Permanent Editorial Board that a court in a state that has excluded from the scope of its Article 9 a transaction that would otherwise be within the scope of that Article should give serious consideration to applying to such a transaction the conflict of laws rules in that state's enactment of Article 1, even though those rules may not, strictly speaking, be binding on the court, on the theory that those rules represent a general statement of legislative policy as to conflict of laws issues in secured transactions.*

b. Perfection and priority

If litigation concerning a transaction that is excluded from the scope of Article 9 in State X takes place in a court of State X, and, under the law applied by that court (whether that law is the non-Article 9 law of State X or Article 9 of State Y), the security interest granted by the debtor to the secured party is enforceable and attached, issues of perfection of that security interest and the priority of that security interest are likely to arise. In such a case, it is also not clear which conflict of laws rules the court must apply in order to determine the state whose law governs issues of perfection and priority. In this situation, UCC Sections 9-301 through 9-307 of State X are not, strictly speaking, applicable to determine which state's law governs issues of perfection and priority.

This is because Sections 9-301 through 9-307 are part of Article 9, and, as a result of State X's non-uniform scope provision, Article 9 of State X (including Sections 9-301 through 9-307) does not apply to the transaction. As a result, a State X court will be required to determine (without the explicit legislative guidance in the Uniform Commercial Code) the nature of State X's conflict of laws rule for issues relating to perfection and priority of security interests that are outside the scope of State X's Article 9. A search for such conflict of laws rules might be quite difficult, and the search could conceivably lead to a rule directing the court to apply the law of a state other than the state whose law that would be applicable by virtue of UCC Sections 9-301 through 9-307. Such a result would be unfortunate, because it would necessitate parties to secured transactions that are excluded from the scope of Article 9 in *any* state to consider the possibility that litigation concerning the security interest might take place in such a state, and that the courts of that state might look to the law of a different state for perfection (and, thus, the location of any required filing) than would a state that has enacted the Official Text of Article 9. Requiring parties to perform such complex conflict of laws analyses not based on application of the conflict of laws rules of the Uniform Commercial Code, and to make protective filings in various states in order to be sure of perfection regardless of where litigation takes place, is wasteful. *Accordingly, it is the view of the Permanent Editorial Board that a court in a state that has excluded from the scope of its Article 9 a transaction that would otherwise be within the scope of that Article should give serious consideration to applying to such a transaction the conflict of laws rules in that state's enactment of Sections 9-301 through 9-307, even though those rules may not, strictly speaking, be binding on the court, on the theory that those rules represent a general statement of legislative policy as to conflict of laws issues in secured transactions.*

B. Non-uniform Inclusions

For purposes of this Report, attention is drawn to non-uniform enactments of UCC Section 9-109(d) which delete the exclusion in Section 9-109(d)(13) for “an assignment of a deposit account in a consumer transaction.”¹³ This exclusion is deleted in the enactment of Revised Article 9 in four states — Idaho, Illinois, Mississippi, and North Dakota. As in the case of non-uniform exclusions from the scope of Article 9, this leads to the possibility of differing determinations of applicable law depending on whether a dispute is litigated in a state that has enacted the Official Text of Article 9 or a state that has enacted this non-uniform inclusion with respect to Article 9.

The basic conflict of laws analysis for this non-uniform inclusion is the same as described in Part A of this Report. If an issue concerning a security interest in a deposit account in a consumer transaction is litigated in a state that has enacted the Official Text of Revised Article 9 and, thus, in which assignments of deposit accounts in consumer transactions are outside the scope of Article 9, neither the conflict of laws rules in Revised Section 1-301 or former Section 1-105 (governing attachment, enforceability, and other bilateral issues) nor the conflict of laws rules in Sections 9-301 through 9-307 (governing perfection and priority) are applicable. This can lead to uncertainty as to the applicability of Article 9 if the transaction also touches upon one of the states that has enacted the non-uniform inclusion of deposit accounts in consumer transactions. *As is the case with respect to non-uniform exclusions from the scope of Article 9, discussed in Part A, it is the view of the Permanent Editorial Board that a court in a state that has followed the Official Text of Revised Article 9 and, accordingly, has enacted the exclusion of assignments of deposit accounts in consumer transactions from the scope of Article 9, should consider its legislature’s enactment of the conflict of laws rules in that state’s enactment of Article 1 and Sections 9-301 through 9-307 as general statements of legislative policy as to conflict of laws issues in secured transactions and apply the principles of those sections to conflict of laws issues relating to assignments of such deposit accounts even though, strictly speaking, they may not be binding on the court.*

If, on the other hand, an issue concerning a security interest in a deposit account in a consumer transaction is litigated in a state that has enacted the non-uniform inclusion of these transactions in the scope of Article 9, the conflict of laws rules in Revised Section 1-301 and former Section 1-105 (governing attachment, enforceability, and other bilateral issues) and the conflict of laws rules in Sections 9-301 through 9-307 (governing perfection and priority) are applicable.

III. Conclusion

The non-uniform enactments of the scope provisions of Revised Article 9 leads to the possibility of non-uniform determinations of which state’s law governs legal issues arising from a

¹³Section 9-109(d)(13) provides, however, that “sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds.”

secured transaction. As a result, different rules could be applied to a secured transaction depending on the location of the court in which litigation takes place. This situation would impose significant costs and uncertainty on transactions that are the subject of non-uniform scope provisions. This difficulty can be avoided if courts in states with non-uniform scope provisions nonetheless consider their legislatures' enactments of Revised Section 1-301 or former Section 1-105 and Sections 9-301 through 9-307 as general statements of legislative policy as to conflict of laws issues in secured transactions and apply the principles of those sections even though, strictly speaking, they may not be binding on the court. If this practice is followed, all U.S. courts should make the same determination of which state's law governs issues arising under a secured transaction that is within the scope of Article 9 in some, but not all, states.