Legal Backgrounder

Washington Legal Foundation
Advocate for freedom and justice®
2009 Massachusetts Ave., NW
Washington, D.C. 20036
202.588.0302

Vol. 18 No. 16 May 7, 2003

REVISED UCC ARTICLES ERECT NEW HURDLES FOR E-COMMERCE

by

Holly K. Towle

Not every well-intended project works out. That is the case with revisions proposed for Uniform Commercial Code (UCC) Article 2, the statute explaining how to make contracts to buy or sell goods from toasters to airplanes. It has been the hallmark of state contract law for the goods economy. For over a decade, the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL) have labored to modernize it. UCC Article 1, containing generic rules, was also included in this "modernization" ride.

The ride has been rocky, with flame-outs along the way, but the final versions of both Articles 1 and 2 do not improve the law.

The UCC's goal is to simplify clarify and modernize commercial law, and to permit the continued expansion of commerce based on reality. *See* Existing UCC Article 1-102 (1998 Official Text). It is a true commercial code encouraging freedom of contract and flexibility, which has supported the U.S. economy for over fifty years.

Few would dispute that it could use updating or that NCCUSL typically does excellent work. But the final product is intentionally ambiguous, decreases the ability of parties to rely on their contracts, and encourages litigation. It also creates problems for U.S. businesses engaged in global electronic commerce.

No one governed by the UCC has supported the proposed revisions, and there has been a blizzard of letters and comments explaining concerns.[1] In 1999, revised Article 2 was in such trouble that it was rejected

[1]Groups writing to oppose as late as 2002 at least include: National Association of Manufacturers, National Electrical Manufacturers Association, U.S. Chamber of Commerce, International Mass Retail Association, American Boiler Manufacturers Association, Colorado Association of Commerce and Industry, Delaware State Chamber of Commerce, Indiana Manufacturers Association, Manufacturers Association of Mid Eastern Pennsylvania, Michigan Manufacturers Association, Nevada Manufacturers Association, Oklahoma State Chamber of Commerce, Utah Manufacturers Association, American Electronics

---

Holly K. Towle is a partner with Preston Gates & Ellis LLP, a full-service law firm providing legal services from strategic locations in the United States and abroad. She is a member of the firm's Technology and Intellectual Property Department and chairs its Electronic Commerce Practice Group. She is included in *An International Who's Who Of E-Commerce Lawyers* and in the Cyberspace and Banking law sections of *The Best Lawyers in America*. For almost a decade, Ms. Towle has commented on behalf of trade organizations on proposed revisions to UCC Article 2 and other NCCUSL projects.

and the drafting committee reconstituted. While the current version eliminates some of the 1999 problems, many remain. Nevertheless, a final version which is reflected in ALI Council Draft No. 2 dated October 2, 2002 is expected to be approved by ALI in spring, 2003. Thus, by fall, 2004, a proposed revision of UCC Article 2 and a revised Article 1 (adopted in 1999), should be all dressed up with, hopefully, nowhere to go. A few of the problems created for e-commerce are discussed below.

UCC Article 1-301 — Choice of Law Rules. Choice of law jurisprudence has been aptly described as a quiet game of Russian Roulette. *See* T. Quinn, QUINN'S UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST at 1-16 and 1-17 (Warren, Gorham & Lamont, Inc. 1991). But when all is said and done, existing law generally allows parties to make a choice in commercial and consumer contracts as long there is no violation of a truly fundamental public policy. But the "said and done" rules are chaotic.

Proposed Article 1 makes them worse for commerce with consumers. Proposed Article 1-301 proposes a choice-of-law rule which will reverse the vast majority of modern U.S. court decisions.

Under the new rule, even if applicable law originally can be found, it can change constantly during the contract as the consumer moves about the U.S. or the world. The Official Comment explains that one generally can look to the law of the place where the consumer "principally resides," and most U.S. practitioners would assume that is where the consumer resided at the time of contracting. Instead, the Comment provides this unusual explanation:

> The jurisdiction in which the consumer principally resides *is determined* at the time relevant to the particular issue involved ... [I]f the issue is one related to *formation of a contract*, the relevant consumer protective rules are rules of the jurisdiction in which the consumer principally resided at ... formation .... *If, on the other hand, the issue is one relating to enforcement of obligations*, then the relevant consumer protective rules are those of the jurisdiction in which the consumer principally resides *at the time enforcement is sought*, *even if* the consumer did not principally reside in that jurisdiction at the time the transaction was entered into.

See Proposed Article 1-301, Cmt. 3 (emphasis added). With this kind of rule it is not necessary to play Russian Roulette — this is a direct shot at the heart of commerce.

But that is merely one aspect of the proposed rule. The basic rule looks to where the consumer resides, and that is both a significant change and serious problem. Under existing law, a consumer contract may state what law applies, such as the law of the state where the vendor is located. That creates certainty and allows the vendor to comply with that law, including its consumer protection rules. Although states differ in consumer protection, the chance of residing in a state with "less" is as great as residing in one with "more" protection, and all state protections are supplemented by federal consumer protections such as the Magnuson Moss Warranty Act, the FTC's power to regulate unfair or deceptive acts and practices, the Truth in Lending Act, the FTC Telephone/Mail Order Rule, the FTC Telemarketing Sales Rule, the FTC Preservations of Consumer Claims and Defenses Rule and so on.

Proposed Article 1 eliminates that compliance alternative. It requires the vendor to comply with the non-uniform and hard-to-find consumer "protective" laws of all fifty states and every country in the world. The rule's details take ten single-spaced pages of Official Comments to explain which go beyond the plain language of the Code. In essence, the vendor must determine law in an overwhelming number of jurisdictions and then keep doing so as millions of its customers randomly move about the world. Consumer privacy is shattered because consumers will have to initially and continually supply location information. Vendor compliance is

---

Association, Association of International Automobile Manufacturers, Marine Retailers Association of America, National Lumber and Building Material Dealers Association, UMB Bank, Consumer Electronics Association, Associated Equipment Distributors, Electronics Industries Alliance Gateway, Frost Brown Todd LLC, attorneys for General Electric, the Salt Institute, USAA, American Council of Life Insurers, and Americans for Fair Electronic Commerce.

  ISBN 1056 3059

also harmed.[2]

No business, small or large, can comply. Even with unlimited budgets, it is not possible to find all of that law, determine which is "protective of consumers," harmonize it to allow any reasonable administration of contracts, or establish a monitoring system to track customer migration. The promise of the Internet is lost for small businesses who will, necessarily, be replaced by those large enough to bear the forced risk of noncompliance. Choices for consumers among multiple vendors will also be eliminated.

Proposed UCC Article 2 Makes It Impossible for Some Participants in the Information Economy to Protect Themselves. E-Commerce is electronic. Although toasters can be ordered electronically, an explosive segment of e-commerce will continue to be the digital delivery of information. But under proposed Article 2, sellers are affirmatively denied rights to consequential damages in consumer contracts.

Consider a transaction where information is involved with goods such as the sale of a cellular phone containing a database of one million telephone numbers. Because the U.S. Copyright Act largely does not protect data, assume that the information provider's willingness to collect and make that information available at an affordable consumer price is subject to a promise that the consumer will not copy the database. But the consumer does and then posts it on the Internet for everyone else to copy. Under proposed Article 2, the seller cannot recover consequential damages — the major damage it will suffer — even though the consumer breached the contract and destroyed the value of the database. *See* Proposed Article 2-710(3) (ALI Draft No. 2, 10/2/02) ("In a consumer contract, a seller may not recover consequential damages from a consumer"). Article 2 should not even apply to the database in the first place, and this is clarified in proposed Article 2 which expressly excludes "information." However, the Official Comment attempts to legislate by re-describing the exclusion as only for information "not associated with goods."

Under the common law traditionally covering information, consumers and all other parties who breach a contract are required or allowed to pay consequential damages unless they contract otherwise. This creates an incentive to comply with contracts, even if consumers are not "deep pocket" sources of damages. And it is that compliance that is critical to information providers. Proposed Article 2 eliminates that incentive to comply for "consumers" and makes it impossible for the information provider to protect itself (short of moving to the European Union, which does protect consumers). Normally, parties may alter UCC rules, but the Official Comments forbid alteration of this one. *See* proposed Article 2-710, Official Cmt. 2 ("Subsection (3) precludes seller's from recovering consequential damages from consumers. *This provision is nonwaivable*") (emphasis added). This is bad public policy inviting consumers to breach their contracts. As the Copyright Office has said, "The recent phenomenon of the popularity of using Napster to obtain unauthorized copies of works strongly suggests that some members of the public will infringe copyright when the likelihood of detection and punishment is low." *See* DMCA Section 104 Report U.S. Copyright Office at 98 (Aug. 2001), *A Report of the Register of Copyrights Pursuant to § 104 of the Digital Millennium Copyright Act.*

Proposed UCC Article 2 Creates New, Tort-Like Liability for Public Communications in E-Commerce. Proposed Article 2 creates a new liability for sellers who "in advertising or a similar communication to the public" describe a product or say something that looks factual. *See* Proposed Article 2-313B. The rule is a bad solution in search of a problem already treated by false advertising and express warranty laws, and its inevitable effect will be endless litigation and a chill on the provision of information.

The proposed rule makes any speaker describing a good liable to a "remote purchaser" if the good does not conform to the description. The purchaser need not have a contract with the speaker — the rule eliminates the traditional separation between contract law and tort. Although the rule includes a traditional exception for "puffery," it is rewritten in a way that may undermine other traditional protections and will promote class actions. Nor can the speaker realistically control the new liability, because the rules allowing qualification will

[2]For example, some countries require deletion of data a period of time after consummation of a transaction. But under the new rule, data will have to be retained to explain why certain performances were made (or not) as the consumer moved about the world triggering new laws.

  ISBN 1056 3059

not work in actual commerce.[3]

The proposed rule seems only to create a new, ambiguous liability making all statements on the Internet fodder for class actions without demonstrated need: express warranty and advertising laws still exist. No purpose is served by adding a new "warranty/tort-like" rule and much is lost for commerce and the free flow of information.

Proposed UCC Articles 1 and 2 Eliminate Any Uniformity in Consumer Commerce. An express purpose of the UCC was to eliminate the need to research court-made (common law) rules of multiple jurisdictions within and among states. The UCC's uniform rules for consumers entitled parties to confine their legal research for additional consumer rules to "findable" consumer *statutes* (and regulations flowing from them) and judicial decisions annotating those statutes. *See* existing Article 2-102. This is even more important in global e-commerce.

But in a double punch, proposed Articles 1 and 2 restore the chaos the UCC originally eliminated. The first punch comes in proposed Article 1, which states that the UCC defers to certain laws, using a new, undefined term, "rule of law," and then attempts to legislate in the comments by defining it. That definition includes all *case law* as well as statutes and regulations, even common law decisions that are not tied to statutes. *See* Proposed Article 1-301(c)(2), Official Cmt. 3 (proposed 1999 Official Text) ("The phrase 'rule of law' is *intended to refer to case law as well as* statutes and administrative regulations") (emphasis added). Accordingly, common law rules may be pulled back into the Code when there is a requirement to comply with a "rule of law."

The second punch comes in proposed UCC Article 2-108(b) which provides in a new rule that any Article 2 transaction *is also subject to a rule of law that establishes a different rule for consumers*. Again, the comments do not preclude common law.[4] Thus, courts may be free to fashion random, court-made rules notwithstanding legislative decisions made in the UCC and in other provisions of Article 2.[5] In short, proposed Articles 1 and 2 may eliminate the base uniformity that is created by existing Articles 1 and 2. One hopes this is not a correct interpretation; if so, then these provisions illustrate the kind of ambiguity and litigation that is certain to result from the proposals.

Conclusion. This paper treats only a few of the problems created for e-commerce by proposed Articles 1 and 2. That is not to say that valiant efforts were not made by NCCUSL and observers, including industry observers. But the result is not an improvement over existing Article 2, which is more appropriate for its subject matter: transactions in goods. Neither existing nor proposed Articles 1 and 2 work for e-commerce or information, and those topics are not adequately addressed in the revisions. To the contrary, affirmative harm is done. For example, the impact of each provision of UCC Article 2 on information was deliberately ignored during the revision process, yet an official comment in the final draft purports to invite courts to apply Article 2 when information is "associated" with goods.

Thus, one is left with choosing between the status quo, with its time-worn but known defects, and proposed Articles 1 and 2, which heap more on top. There is only one commercially reasonable choice: forego adoption of both articles until they actually improve the law.

---

[3] *See* Proposed Article 2-313B(4) (a), which says, in part, that "The seller may modify or limit the remedies available to the remote purchaser if the modification or limitation is furnished to the remote purchaser *no later than the time of purchase*." The problem is that the best and most cost-effective way to ensure that disclosures and disclaimers are delivered is to include them in the box. But those will not be seen until *after* purchase has been made and the box is opened, i.e., the same time that an express warranty may appear. Proposed Article 2 alters existing law by allowing that express warranty to become part of the contract (*see* proposed Article 2-313A) but not the qualifications or disclaimers of the public communication.

[4] Proposed Article 2-108(b), Official Cmt. 4 ("'Rule of law' *includes* a statute, an administrative rule properly promulgated under the statute, *and final court decision*") (emphasis added).

[5] Existing Article 2-102 only preserves consumer "statutes" and intentionally eliminates court-made rules. That rule has not been changed; proposed Article 2-108 is, ambiguously, added.

  ISBN 1056 3059