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The N.Y. Uniform Commercial Code Comes of Age

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New York justifiably prides itself on being one of the world's major financial and commercial centers. In addition, very few would dispute that New York is a, if not *the*, preeminent commercial law jurisdiction. As such, it is the jurisdiction of choice for a vast majority of all commercial transactions, both domestic and international.[1] Parties in large non-consumer transactions with no connection whatsoever to New York often choose its law to govern their transactions, and New York statutes permit them to do so.[2] Jurists of state and federal courts located in New York City are among the world's most experienced in resolving complex commercial law disputes.

What most people don't know is that the New York Uniform Commercial Code is outdated. It is the *only* state that has not adopted the 1990 amendments to Articles 3 (Negotiable Instruments) and 4 (Bank Deposits and Collections). Its Article 1 (General Provisions) does not reflect the many changes recommended in 2001 by the National Commissioners on Uniform State Laws (NCCUSL)) and the American Law Institute (ALI), which changes are now in effect in all but five states and Puerto Rico.[3] New York UCC Article 7 (Documents of Title) does not contain any of the amendments proposed by NCCUSL and ALI in 2003 (RA 7). Although RA 7 has been enacted in 45 states and the District of Columbia, the New York State Legislature has yet to consider enactment of RA 7.[4] Last, but certainly not least, the significant revisions to Article 9 proposed by NCCUSL and ALI in July 2010 (the 2010 UCC amendments) are now effective in 45 states, plus the District of Columbia and Puerto Rico, but not in New York.[5]

This growing divergence between New York UCC law and the remainder of the states should be of enormous concern. As New York statutes lag further behind other states, the incidence and risk of erroneous UCC section cross-references in legal documents and memoranda rises. Further, the applicability of judicial decisions under other state UCC laws to New York statutes (and vice versa) is increasingly drawn into question. All of this presents a trap for the unwary practitioner.

The 2010 UCC amendments have prompted New York legislators and commercial law experts alike to take a closer look at this unfortunate state of affairs. That focus has given rise to an effort to bring the New York statutes into the 21st century through an aptly (and somewhat ambitiously) piece of legislation entitled the Omnibus Uniform Commercial Code Modernization Act (the Modernization Act).[6] The Modernization Act was introduced in the New York State Legislature in June 2013 and, as of submission of this article for publication, is undergoing review by the New York State Senate Judiciary Committee.[7]

The Modernization Act has the full support of the New York City Bar Association Committee on Commercial Law and Uniform State Laws (the NYC Bar Committee), which has closely monitored, reviewed, analyzed and issued a number of reports and recommendations on proposed revisions to the UCC.[8] Others following its progress have described the act as "necessary to modernize New York's commercial law, preserve New York law's relevance and usefulness for parties that wish to transact business in the state, and sustain New York as a jurisdiction of choice for conducting domestic and international business."[9]

The expectation is that this legislation will be passed during the current session of the New York State Legislature. Today we discuss what it will mean to practitioners.

The Amendments

Article 1. Article 1, entitled "General Provisions," contains definitions, underlying principles and fundamental concepts that apply throughout the different articles of the UCC.

As noted above, NCCUSL and ALI proposed a set of revisions to Article 1 (RA 1) in December 2001. In April 2004, the NYC Bar Committee issued a 30 page report analyzing RA 1.[10] Although the Committee found RA 1 to be in many respects an improvement on existing NY UCC Article 1, it was also troubled by an expanded definition of "good faith"[11] that added the objective test of "observance of reasonable commercial standards of fair dealing" to the subjective "honesty in fact." It was even more troubled by a revised choice of law provision (RA §1-301) that allowed parties almost complete autonomy in choosing the governing law for a transaction provided one of the parties was not a consumer and public policy would

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not be violated.[12] As a result, the committee refused to recommend adoption of RA 1 to the New York State Legislature.

Six years later it was a much different story. In July 2010, that same committee issued a second report again analyzing RA 1.[13] By that time, RA 1 had been adopted in 37 states and the Virgin Islands, and introduced in the legislatures of three additional states. In its second report, the committee recommended that RA 1 be adopted subject to only one major exception. In the committee's view, the existing definition of "good faith" in NY UCC §1-201(19) should be retained without alteration.

The choice of law issue had seemingly evaporated. Why? Of the states that adopted RA 1, only one jurisdiction, namely the Virgin Islands, had adopted RA 1 §1-301. The remainder of the states stayed with the "reasonable relation" standard" of existing §1-105. As a result, in 2008 the sponsors amended RA 1 §1-301 to be virtually identical to former §1-105, hence retaining the "reasonable relation" test.[14]

The Modernization Act reflects the recommendations of the NYC Bar Committee. Although the New York State Senate Introducer's Memorandum in support of the act (the Introducer's Memorandum)[15] notes that it contains many technical revisions, it identifies four changes of a more substantive nature. These are: (i) a new section that replaces existing NY UCC §1-102 (which will instead become part of NY UCC §1-103) and clarifies that the substantive rules of Article 1 apply only to a transaction to the extent it is governed by another UCC article; (ii) a revised NY UCC §1-103 which provides that, unless "displaced" by UCC provisions, general principles of law and equity, such as the capacity to contract, estoppel, duress, principal and agent, and the law merchant, are not preempted but rather supplement the UCC; (iii) deletion of existing NY UCC §1-206, which is a specific UCC (although non-uniform) statute of frauds provision relating solely to sale of personal property, in favor of the more general statute of frauds provisions of New York General Obligations Law §5-701, as well as specific statute of fraud sections contained elsewhere in the UCC;[16] and (iv) a revised NY UCC §1-303 to allow "course of performance" to be used in addition to "course of dealing and "usage of trade" to interpret a contract. In addition, the committee recommended adopting only part of RA 1 §1-308 so as preserve existing New York law on accord and satisfaction—permitting an express reservations of rights to avoid an accord and satisfaction otherwise effected by a payment or acceptance of a payment (currently contained in NY UCC §1-207).

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Articles 3 and 4. Article 3, which is entitled "Commercial Paper," provides the rules relating to negotiable instruments. Article 3 confines its coverage to drafts, checks, certificates of deposits and notes.[17] Article 4, entitled "Bank Deposits and Collections," governs bank deposits and collections. These two articles collectively provide the framework for check processing in this country. New York's Articles 3 and 4 became effective in 1964 based on the 1951 version promulgated by NCCUSL and ALI and, with few exceptions, have not been updated since then. Given the enormous technological developments over recent years in check processing and bank operations and procedures, it is almost astounding to realize that the commercial center of the United States contains the most archaic set of state laws in this area.

The amendments are largely intended to reflect current convention and market practice, as well as check collection and processing procedures. For example, revised Article 3 will include within its scope notes with variable rates of interest and checks not expressly made payable to order or bearer. It will eliminate outmoded requirements, including that allonges (indorsements) to notes be physically attached to the related instrument.[18]

The revisions expressly bring cashier's checks and teller's checks within the definition of "check."[19] They provide that the original payee of a stolen check and forged indorsement retains its right to be paid by the drawer and the drawer retains its right to be credited by the payor bank for an unauthorized payment.[20] They also impose, consistent with federal regulations governing check collection,[21] a comparative negligence standard when both the payor bank and its customer have been negligent in connection with losses arising from an unauthorized check signature or a check alteration.

Additional matters addressed in the revisions include increased information requirements in regard to stop check orders and obligations on customers in regard to post-dated checks, recognition of electronic presentment of checks, greater flexibility for banks in regard to the times for "posting" a check and other changes intended to recognize the automated check processing and clearing house systems which are now prevalent.

To some extent the changes wrought by the revisions to Articles 3 and 4 may be too little too late. Many of the rules and requirements relating to electronic processing of checks are now governed by federal regulation, said by some to be the result of the lag by New York in updating its statutory requirements.[22]

Article 7. UCC Article 7 deals with documents of title for goods. Current NY UCC Article 7 governs warehouse receipts, bills of lading, delivery orders and other documents treated in the regular course of business as evidence that the holder has the right to control the goods they cover.[23] Article 7 also addresses the transfer of rights in goods when stored or shipped, such as the liens of warehousemen and carriers, and their enforcement, as well as allocation of the risk of loss of goods while held in storage or during shipment.

Like NY UCC Articles 2 and Article 3, NY UCC Article 7 became effective in 1964 based on the original 1951 version of the statute, and has been little changed since. NCCUSL and ALI proposed revisions to the statute in 2003 (RA 7). Those revisions were reviewed and recommended for adoption by the NYC Bar Committee in December 2011.[24]

Also like the changes proposed to NY UCC Articles 3 and 4, the revisions under RA 7 bring the UCC provisions governing documents of title into the modern era. The most significant changes effected by RA 7 are recognition of electronic documents of title. The Modernization Act would modify the definition of "document of title" in NY UCC §1-201 to expressly provide for electronic documents[25] and, through a new NY UCC

§7-106, set forth what constitutes "control" of such electronic documents. Similar to the treatment of electronic chattel paper under revised Article 9, RA 7 provides that control of an electronic document of title is the equivalent to possession and indorsement of a tangible document of title.

Article 9. The proposed revisions to Article 9 (RA 9) contained in the UCC 2010 Amendments have been the subject of many recent treatises and articles, as well as previously discussed in this column.[26] Among the most notable of these changes is creation of a set of rules for determining the correct individual debtor names for purposes of filing UCC financing statements.

RA 9 offers two alternative regimes for states under RA §9-503. Under Alternative A (the "only if" rule), a debtor's name on such person's driver's license is the only correct name to use for an individual debtor on a UCC financing statement. Under Alternative B (the "safe harbor" rule), the name on a driver's license is a correct name, but not the only correct name, against which to file. The Modernization Act contains Alternative A, the path chosen by all but eight of the 52 jurisdictions that, as of submission of this article, have either proposed for adoption or adopted the UCC 2010 amendments.[27]

The Modernization Act also contains two notable non-uniform changes. The first such change would amend NY UCC §9-04 to clarify that provisions in a deposit account control agreement that protect the depositary bank from liability in certain circumstances do not interfere with "control" over a deposit account for perfection purposes. Specifically, a new §9-104(d) would confirm that a secured party has control over a deposit account if it satisfies the requirements for control otherwise contained in §9-104 even if the duty of the depositary bank to comply with instructions originated by the secured party is subject to conditions other than consent of the debtor.

The second non-uniform provision would actually modify Article 8. This provision is in response to *Highland Capital*, the controversial ruling of the New York State Court of Appeals.[28] In the *Highland*, the court ruled that promissory notes not traded on an exchange could, in certain circumstances, constitute "securities under Article 8 rather than instruments under Article 3. The court reasoned that since the definition of "security" under NY UCC §8-102(a)(15) includes interest in an issuer or its property "the transfer of which may be registered upon books maintained for that purpose, by or on behalf of the issuer," and since in that case the maker of the notes could (although it did not) maintain such a registry, then the notes would be considered "securities." To override *Highland*, the Modernization Act will revise NY UCC §8-103 to provide that an interest in an issuer is not a security under Article 8 merely because the issuer maintains records other than for registration of transfer or *could* but doesn't maintain books for registering transfers.

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Conclusion

Few practitioners seem fully aware of the extent to which the New York Uniform Commercial Code has fallen behind other states. Many assume at their peril that New York is in the forefront rather than the rearguard of adopting states. This undeserved assumption is fertile ground for error among practitioners. Moreover, the failure to adopt amendments to modernize the UCC risks loss of New York's status as a preeminent commercial jurisdiction, a loss that could have a major adverse impact on the state's economy.[29] It falls to the state legislature to remedy a problem that has been long overdue for correction.

1. Eisenberg, Theodore and Miller, Geoffrey P., "The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts" (2009), Cornell Law Faculty Publications, Paper 204.

2. See New York General Obligations Law §5-1401 and NY UCC §1-105.

3. In addition to New York, the states of Georgia, Missouri, South Carolina and Wyoming as well as Puerto Rico have not adopted the revisions to Article 1 recommended in 2001 by NCCUSL and ALI. See http://www.uniformlaws.org/Act.

4. The amendments to Article 7 have been adopted in the District of Columbia and all states with the exception of Missouri, New York, South Carolina, Vermont and Wyoming. The amendments are also not effective in either Puerto Rico or the Virgin Islands. See http://www.uniformlaws.org/Act.

5. Alabama, Arizona, New York, Oklahoma and Vermont have not adopted the 2010 amendments, although they are now proposed for adoption in all such states. They are also neither effective nor proposed in the Virgin Islands. See http://www.uniformlaws.org/Act.

6. 2013 NY Senate Bill S5901.

7. The Modernization Act was referred to the Judiciary Committee on Jan. 8, 2014.

8. Report of the Committee on Uniform State Laws of the New York City Bar Association on Revised Article 1 of the Uniform Commercial Code (April 2004) (hereinafter the NYC Bar Association of Report of April 2004); Second Report of the Committee on Commercial Law and Uniform State Laws of the New York City Bar Association on Revised Article 1 of the Uniform Commercial Code (July 2010) (hereinafter the NYC Bar Association Report of July 2010); Report of the Committee on Commercial Law and Uniform State Laws of the New York City Bar Association on Article 9 of the Uniform Commercial Code (June 2011) (hereinafter the NYC Bar Association Report of June 2011); Report of the Committee on Commercial Law and Uniform State Laws of the New York City Bar Association on Revised Article 7 of the Uniform Commercial Code (December 2011) (hereinafter the NYC Bar Association Report of December 2011).

9. See letter dated March 6, 2013 from Robert C. Hunter, Executive Managing Director and Deputy General Counsel of The Clearing House Association, to The Honorable Andrew M. Cuomo, Governor, and others.

10. See supra note 8.

11. See NY UCC §1-201(19).

12. Compare NY UCC § 1-105 and RA 1 §1-301(e), (f).

13. See supra note 8.

14. NYC BAR Association Report of July 2010 at 4.

15. 2013 Legis. Bill Hist. NY S.B. 5901.

16. See NY UCC §§2-201 (goods), 8-319 (securities) and 9-203 (security interests).

17. See NY UCC §3-103, cmt 1.

18. Currently, NY UCC §3-202(2) states:

> An indorsement must be written by or on behalf of the holder and on the instrument or on a paper so firmly affixed thereto as to become a part thereof.

19. See the Introducer's Memorandum at 3 and proposed new NY UCC §§3-104 and 4-104.

20. See the Introducer's Memorandum at 3.

21. See Federal Regulation CC, 12 C.F.R. §229.

22. See the Introducer's Memorandum at 4.

23. See NY UCC §7-101, cmt.

24. See supra note 8.

25. RA 7 §1-201 states:

> An electronic document of title means a document of title evidenced by a record consisting of information stored in an electronic medium. A tangible document of title means a document of title evidenced by a record consisting of information that is inscribed on a tangible medium.

26. See A. Christenfeld and S. Melzer, "First Modifications Since 2001 Considered for UCC Article 9," 240 NYLJ No. 106 (Dec. 4, 2008), and A. Christenfeld and B. Goodstein, "State Legislatures Consider UCC Article 9 Amendments," 245 NYLJ 105 (June 2, 2011).

27. Based on the tracking website maintained by the Uniform Law Commission, http://www.uniformlaws.org/Act, RA 9 has now been adopted in 37 states plus the District of Columbia and Puerto Rico and is pending in five states.

28. *Highland Capital Mgt LP v. Schneider*, 8 NY.3d 406 (Crt. App. April 2007).

29. See the Introducer's Memorandum at 10.