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Choice of Law Under the Uniform Commercial Code

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attitude, the visiting professor gladly assumes responsibility. The application of the method to specific problems has been the students' task and responsibility. I have, of course, attempted to do my best in being available with advice and suggestions, and I have to confess that in quite a few places I have attempted to help student writers in their mode of arrangement or presentation. But, senior students of the Louisiana State University Law School all seem to possess one of the lawyer's most precious qualities, namely, independence of mind. They can be convinced, at least most of the time, but they cannot be persuaded. Thus, for his final product each of the student authors has to assume individual responsibility as he is entitled to individual credit. But it was the visiting professor's privilege to work with the law review students and to profit from their research and their ideas. He believes that similar profits can be obtained from the students' endeavors by the readers of the Louisiana Law Review.

Baton Rouge, La.

December, 1949.

MAX RHEINSTEIN*

CHOICE OF LAW UNDER THE UNIFORM COMMERCIAL CODE

The American Law Institute and the National Conference of Commissioners on Uniform State Laws have recently published a proposed draft of a Uniform Commercial Code.¹ If the expectations of the draftsmen are realized, this code will answer the great demand of modern business for uniformity and certainty in commercial law. But, however meritorious the code may be as substantive law, maximum national *uniformity* can only be achieved by the adoption of the code in the forty-eight states and the District of Columbia. The possibility that such unanimous reception will not take place has been anticipated by the drafters. For the first time in the history of the Uniform Laws, provision has been made for that perennial problem, the conflict of laws. Section 1-105 of the Uniform Commercial Code provides:²

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1. May 1949 draft.

2. The following is a copy of the October 1949 revision of this section. Substantial changes were made between this and the proposal embodied in the May 1949 draft.

“(1) In any suit brought in this state this Act shall apply to any contract or transaction within its terms if the contract is made or the transaction occurs after the effective date of this Act, and

- “(a) the contract is completed, or the offer made or accepted, or the transaction occurs within this state; or
- “(b) the contract is to be performed or the transaction is to be completed within this state; or
- “(c) the contract or transaction relates to or involves goods which are to be or are in fact located, delivered, shipped or received within this state; or
- “(d) the contract or transaction involves a bill of lading, warehouse receipt or other document of title which is to be or is in fact issued, delivered, sent or received within this state; or
- “(e) the contract or transaction involves commercial paper which is made, drawn, transferred or payable within this state; or
- “(f) the contract or transaction involves a commercial credit made, sent or received within this state; or involves a commercial credit issued in this state or confirmation or advice of which is sent or received within this state, or involves any negotiation within this state of a draft drawn under a credit; or
- “(g) the contract or transaction involves a foreign remittance drawn, transferred or payable within this state; or
- “(h) the contract or transaction involves an investment security issued or transferred within this state; or
- “(i) the contract or transaction involves a security interest created within this state or relating to tangible personal property which is or is to be actually within this state or to intangible personal property which has or is to have its situs within this state; or involves a bulk transfer of property to the extent that such property is within this state; or if the borrower’s

principal place of business is within this state;
or

“(j) whenever the contract, instrument or document states in terms or in substance that it is subject to the Uniform Commercial Code.

“(2) Notwithstanding the provisions of the foregoing subsection, the parties to a contract or transaction involving foreign trade may agree in writing that the law of a specified jurisdiction shall apply.

“COMMENT.

“*Prior Uniform Statutory Provision:* None.

“*Purposes:*

“1. This Section gives direction to the court of a state which has enacted the Code when to apply its provisions to a given transaction before it, the transaction having contacts not only with that state but also with other states or jurisdictions. When the transaction takes place in its entirety in a state which has enacted the Code, no question of applicability in the sense of this Section arises; the Code applies. When suit is instituted in a state which has not enacted the Code but the transaction has contacts with a state that has, if the choice of law rule of the former points to the latter state, this Section does not and is not intended to prevent the application of any of the provisions of this Act.

“2. The provisions of the Section change pre-existing rules of the common law with regard to the application of the local or foreign rules of law to settle the rights of parties in a particular case. The offer here is to make a provision which will call for the application of the rules provided in this Code whenever the transaction has a sufficient contact with the state having the Code to make such an application reasonable and not arbitrary. It is to be noted, also, that parties may, if they wish, contract for the application of the Code to their dealings regardless of whether part of the transaction occurs within the state or not.

“3. Parties may, in transactions involving foreign trade, agree that the provisions of this Act shall not apply. It was felt that it would be going too far to require the application

of the Code to the American acceptance of a foreign offer which might come from one living under a system of law quite different from our own and means for making it inapplicable are therefore provided."

In order to provide coverage for commercial contracts and transactions falling within the federal sphere of regulation and control, an alternative Section 1-105³ is provided for use when the Uniform Commercial Code is introduced in the Congress of the United States. For purposes of clarity and simplicity of exposition, the whole of this alternative section, with the Comment of the draftsmen, is here reproduced.

"Section 1-105. Applicability of the Act.

"(1) This Act shall apply whenever any contract or transaction within its terms is made or occurs after the effective date of this Act; and

"(a) is in interstate or foreign commerce or affects interstate commerce; or

"(b) is completed, or the offer is made or accepted within federal territory which for the purpose of this Act includes any territory outside of the states and not having its own legislature; or

"(c) is to be performed or completed within federal territory; or

"(d) relates to or involves goods which are to be or are in fact located, delivered, shipped or received within federal territory; or

"(e) involves a bill of lading, warehouse receipt or other document of title which is to be or is in fact issued, delivered, sent or received within federal territory; or

"(f) involves commercial paper which is made, drawn, transferred or payable within federal territory; or

"(g) is an application or agreement for a commercial credit made, sent or received within federal territory; or involves a commercial credit issued in federal territory or under which drafts are to be presented in federal territory

3. Ibid.

or confirmation or advice of which is sent or received within federal territory of a draft drawn under a credit; or

- “(h) involves a foreign remittance drawn, transferred or payable within federal territory; or
- “(i) involves an investment security issued or transferred within federal territory; or
- “(j) whenever the contract, instrument or document states in terms or in substance that it is subject to the Uniform Commercial Code.

“(2) Notwithstanding the provisions of the foregoing subsection, the parties to a contract or transaction involving foreign trade may agree in writing that the law of a specified jurisdiction shall apply.

“COMMENT.

“*Prior Uniform Statutory Provision:* None.

“*Purposes:*

“1. Hitherto the field of law covered by this statute has been almost entirely state law.

“Today the number of commercial transactions which pass between the states or which directly or indirectly affect interstate commerce has become so great as to warrant the Congress of the United States in entering the field by enacting this Code to apply wherever the contract or transaction falls within the permissible jurisdiction of Congress under the commerce clause as that jurisdiction has been defined in the recent decisions of the Supreme Court of the United States construing the words ‘affects interstate commerce.’

“2. In addition, the Act is intended to apply to all transactions over which Congress, as the legislative authority for federal territory, has jurisdiction, where the federal territory is outside of the states and does not have its own legislature. The offer here is to make a provision which will call for the application of the rules provided in this Code whenever the transaction has a sufficient contact with a federal territory to make such an application reasonable and not arbitrary. It is to be noted, also, that parties may, if they wish, contract for the application of the Code to their dealings regard-

less of whether part of the transaction occurs within a federal territory or not.

"3. Parties may, in transactions involving foreign trade, agree that the provisions of this Act shall not apply. It was felt that it would be going too far to require the application of the Code to the American acceptance of a foreign offer which might come from one living under a system of law quite different from our own and means for making it inapplicable are therefore provided."

The Comment of the draftsmen indicates that the federal version is designed to cover commercial contracts and transactions when any of the contacts enumerated in Section 1-105 occur within federal territory. This version would also extend the application of the act to commercial contracts or transactions in interstate or foreign commerce or affecting interstate commerce.⁴ A comparison of these two sections discloses certain important differences in substance and style. The state version declares that "this Act shall apply to *any contract or transaction within its terms*," but the federal version states only *when* the act applies, and gives no indication as to *what* the act applies.

There is no parallelism of method of presentation in the federal and the state versions. Subsections 1(a) through 1(i) of the federal version are mere phrases commencing with verbs, which find their subjects in the introductory clause. Subsection 1(j) of the very same section is itself a complete adverbial clause. This manner of presentation was followed by both sections in an earlier draft, but the state version was later modified to conform with better English usage.⁵ It is of course to be desired that both sections adhere to such standards.

It is difficult to understand why Subsection 1(g) of the federal version differs in phraseology from that of the corresponding Subsection 1(f) of the state version. In the original draft both of these subsections contained similar language, but the state version was amended to give greater clarity and exactness.⁶ The improvement in the redraft of the state version

4. It is not within the province of this article to discuss the effect that this section may have upon the law pertaining to foreign and interstate commerce.

5. Compare federal and state versions of the May 1949 draft with those of the October 1949 revisions of that section.

6. *Ibid.*

subsection could well be extended to the corresponding subsection in the federal version.

The state version contains Subsection 1 (i) dealing with security interests and similar transactions, but there is no counterpart of this subsection in the federal version. An earlier draft of the federal version provided for security transactions, yet no reason for the deletion from the present draft is given in the Comment of the drafters. The only apparent explanation for this omission is inadvertence.

Another basic difference between the federal and state versions of Section 1-105 is the court or courts to which each is directed. The state version directs the courts of the adopting state to apply the Commercial Code in certain enumerated instances. The subsections of the federal version creating choice of law rules for the federal territories are much broader in operation. If any one of the events enumerated in Subsections 1 (b) through 1 (j) of the federal version occurs in a federal territory, the draft would order every American forum to apply the Commercial Code to issues arising between the parties to a commercial transaction. Thus, according to Subsection 1 (b), if an offer were sent from the Virgin Islands to a party in Florida, all issues between the parties to the transaction would have to be determined by the Commercial Code, regardless of the forum state. It is at least doubtful whether Congress has the constitutional power to thus impose choice of law rules upon the states.

The most serious objections to Section 1-105 arise as to the desirability and practicability of the criteria set forth to determine the applicability of the code. These possible difficulties apply alike to both federal and state version, but in order to facilitate simplicity of analysis, only the state version will be specifically discussed herein.

In the Comment the drafters frankly admit that Section 1-105 is a departure from present choice of law rules. The stated intention was "to make a provision which will call for the application of the rules provided in the Code whenever the transaction has a sufficient contact with the state having the code to make such an application reasonable and not arbitrary." This discussion will center around an analysis of the various provisions of Section 1-105 in an attempt to ascertain whether or not it would be "reasonable and not arbitrary" to apply the code to factual situations falling within the ambit of that section.

Section 1-105 is directed toward the achievement of the

widest possible application of the new code. While the purpose of wide application is clear, the means to this end are most unusual. Emphasis is placed entirely on contacts with the state of the forum. If all the elements of a transaction occur in states other than the state which has adopted the code, Section 1-105 does not attempt to indicate the law applicable to issues between the parties. But the broad, all inclusive language used in this section will force the application of the code to contracts having only a slight connection with the code state. The unreasonableness of this approach may be best illustrated by the following analysis of the individual subsections.

Subsections 1(a) and 1(b) represent a combination and extension of two of the traditional rules of conflict of laws, that is, one pointing to the law of the place of contracting and the other to the law of the place of performance. These two rules have often been considered as mutually incompatible by the protagonists of each and separately unworkable by the antagonists of both.⁷ The unprecedented extension of these rules gives rise to serious criticism. No court has ever held and no writer has ever advocated that simply because an offer was made in one state the law of that state should apply to all the problems that may arise out of the subsequent contract.

Assume that X, a New York businessman, is vacationing in Atlantic City, New Jersey. While there, he wires Y in Illinois, offering to sell him certain goods. This offer is accepted by Y after X has returned to New York. According to the terms of the contract delivery is to be made at X's place of business in New York. Later X sets aside the goods from stock and notifies Y that the goods are at his disposal. Before Y removes the goods, they are destroyed by fire. Y sues for the return of the sale price in New Jersey, where the Commercial Code has been adopted. Under Section 2-509 of the proposed Commercial Code a "merchant" bears the risk of loss until actual receipt of the goods by the buyer. Under the Uniform Sales Act, Section 19, Rule 4(1), adopted in New York and Illinois, risk passes with title. Since the offer was made in New Jersey, a court of that state must apply Section 2-509. Is it possible that such a result was desired by the draftsmen of Section 1-105? Certainly the parties never expected the law of New Jersey to apply to any part of their contract, nor did the contract have a substantial connection with

7. Cf. Lorenzen, *Selected Articles on Conflicts* (1947) 298, where the two rules are combined in a proposed answer to the choice of law problem.

New Jersey. The seller is especially injured because he is saddled with a loss he had no reason to anticipate or guard against by insurance. The entire rationale behind the adoption of choice of law rules would be defeated by the application of such a rule.

Subsection 1(c), providing that the code shall apply to contracts or transactions involving "goods which are to be or are in fact . . . received within this state," may readily yield an unusual result. Assume that X and Y, both residents of Louisiana, in that state enter into a contract to sell certain chattels. X ships the goods to Y's address, but by mistake of the carrier, the goods are carried to Tennessee, where an agent of Y thereupon agrees to receive them. Assume that Tennessee has adopted the Commercial Code, but Louisiana has not. Y now sues for breach of warranty in a Tennessee court. Since the goods were *in fact* received in that state, the Commercial Code will apply, even though the contract was made in Louisiana, the parties were residents of this state and the contract was to be performed here. Can it be supposed that the parties contemplated the application of Tennessee law? The contract had all of its elements in Louisiana, and connection with Tennessee was not established until long after the contract was concluded. If, in the same case, there was a dispute as to whether title had passed at the time of the contract, rather than at the time of the delivery, the Commercial Code would also determine that issue. This surprising conclusion would be in clear contradiction to the well-settled rule⁸ of conflict of laws that problems of passage of title to chattels are determined by the law of the situs of the chattel at the time the title is alleged to have passed. This rule is based on the convenience and desirability of having one certain law apply to all title problems regardless of the place of the forum, the domicile of the parties or the place of contracting. Title is usually of more importance to a third person than to the parties contracting, and with the *lex rei sitae* as the prevailing rule, any interested third person may easily ascertain the validity of any purported transfer of title by looking to the law of the place where the chattel was situated at the time of the alleged title transfer. It would be highly impractical to require third persons to search for the place of the making of the conveyance, or the owner's domicile, or the offer to the contract to sell. This policy of aiding the interests of third persons has led the courts uniformly to distinguish title problems from the general body of contract problems. Section

8. Goodrich, *Conflict of Laws* (2 ed. 1938) 473; Falconbridge, *Conflict of Laws* (1947) 416.

1-105 completely ignores this distinction and omits any mention of the law applicable to title problems. As indicated in the above illustration, title disputes under the code are apparently to be referred to the same law that determines the contracting parties' rights and obligations under the contract. If a suit involving the title issue is instituted in a code state, then the code will be applied if the transaction was in any way connected with the state, regardless of the location of the chattel at the time of the transaction in question. A state that has not adopted the code will undoubtedly apply the *lex rei sitae*. This possible application of two different laws, depending only on the forum chosen, affords the plaintiff an undue advantage and leaves third persons interested in the location of the title in an impossible position.

Subsection 1 (i), providing that the code shall apply to transactions involving "a security interest created within this state," also ignores the situs of the property. If a "security interest" was purported to be created in X affecting property in a distant state, Y, subsequent interested persons have no possible way of determining which of the two laws might apply to issues arising with respect to the title to the property. Furthermore, the code applies under Subsection 1 (i) "if the borrower's principal place of business is within this state."⁹ If A, whose principal place of business is in Y, gives a chattel mortgage to B on property in Y while both parties are in X, the arbitrariness of applying the code to any issues of title to the property is obvious. A's principal place of business is completely inconsequential in the light of the other circumstances.

Subsection 1(c) states that the act is to apply where the contract "*relates to or involves* goods which are to be or are in fact delivered, shipped or received within [the] state," but it is difficult to determine the exact meaning of the phrase *relates to or involves*. Furthermore, does this provision mean that the act applies to the entirety of the transaction, or only to that portion of it which relates to or involves the goods? Apparently the draftsmen intended that in such a case the entirety of the transaction, including its obligatory aspects, would come under the

9. This vague grammatical structure creates unnecessary problems of interpretation. Section 1-105 declares that "this Act shall apply to any contract or transaction within its terms if the contract is made or the transaction occurs after the effective date of this Act, and . . . ; or if the borrower's principal place of business is within this state. . . ." Does the act apply to *all* transactions if the borrower's principal place of business is in the forum state? What is meant by "the borrower"?

purview of the act, but this leads to the surprising conclusion that the act would apply to a case such as the following:

A and B, domiciliaries of Louisiana, enter into a contract in this state, whereby A agrees to sell to B certain goods which C has contracted to ship to A from New York. Assume that New York has adopted the Commercial Code. If suit is brought in New York on any phase of the contract, the courts of that state apparently must apply the provisions of the act to the entirety of the contract entered into between A and B simply because it "relates to" goods which were shipped from New York. Is it possible that the contracting parties could have envisioned the application of New York law to the determination of their personal rights and duties arising out of a contract of this nature?

The word "involves" used in Subsection 1(c) through 1(i) presents the same difficulty as "relates to" in Subsection 1(c). Assume A and B enter into a contract to sell in Arkansas, which has not adopted the Commercial Code, delivery to be in that state. As part payment of the purchase price, A gives B commercial paper that was once transferred in California, a state that has adopted the Commercial Code. If action is brought in California on the sale, the courts of that state would apparently be required to apply the code to all issues raised, for the sale had *involved* commercial paper which was transferred in California. In this case there is no real choice of law problem as to the sale itself. In this and numerous other situations, Section 1-105 would create and "settle" a choice of law problem that was never actually in existence. These examples indicate the possible consequences of the use of such broad language as "relates to" and "involves."

In the above two hypothetical cases, goods and commercial paper have been used merely as illustrative of any of the items enumerated in Section 1-105, but it is to be noted that documents of title, commercial credits, foreign remittances, investment securities, or security interests are included within that category.

Even if the subsections dealing with goods and specific instruments of commerce should be interpreted as invoking the code only in connection with issues under the instruments themselves or in connection with the goods, aside from other questions of the general transaction between the parties, the result in many cases will be unexpected and unreasonable. For example, assume that commercial paper or a foreign remittance is drawn in Texas by X and transferred to Y in Indiana. Y later transfers the

instrument to *B* in Japan. A suit has now arisen between *Y* and *B* as to whether or not a valid transfer has taken place. If the suit is brought in Indiana, which has adopted the code, the court would have to apply the Commercial Code because the instrument at one time had been transferred there. It can hardly be argued that the transfer between *Y* and *B* in Japan has any essential connection with Indiana. The parties could not possibly have contemplated that Indiana law would be applied to issues arising under such transfer.

Subsections 1(d) through 1(i) provide for the application of the Commercial Code if the instruments therein mentioned are made, drawn, issued, created or transferred within a state having the code. It is startling to learn that the law of the place of some remote transfer may determine the obligations of the maker, drawer, issuer or prior or subsequent endorser or that the law of the place of making, drawing, issuing or creation may determine whether a valid transfer of the instrument took place in some remote region. For illustration of the possibilities let us assume the following: An investment security is issued in New York by *X* corporation. Several years later the then holder transfers the investment security to *A* in Illinois and still later *A* transfers it to *B* in Wyoming. Apparently, if Wyoming had adopted the Commercial Code, the courts of that state would have to apply it in any action brought on the investment security by *B* against *X* corporation. In the same case, if New York had adopted the code, and Wyoming had not, the code would be applied if an action was brought in New York to ascertain if a valid transfer had taken place in Wyoming.

Two separate choice of law rules have been developed for the determination of the applicable law in cases concerning negotiable instruments. Generally, and subject to certain exceptions, if there is a dispute between the principal obligor, that is, the maker; drawer, or issuer on the one side and a subsequent holder on the other, the courts will apply the law of the principal obligor's place of business, if the instrument had its inception there. This place is regarded as the seat of his obligation and both the principal obligor and any subsequent holder should reasonably expect the law of that place to determine the nature of the obligation. On the other hand, there is no reason to require the application of the law of the place of making, issuing, or drawing to a transfer occurring in another state or foreign country, since the parties would usually expect as reasonable

men that the law of the place of transfer would apply to questions concerning the transfer. Consequently the validity of such a transfer is usually decided by the law of the place of the instrument at the time of the transfer. This latter rule also enables third persons interested in title location to know with certainty the law determinative of that issue. Section 1-105 makes it possible for the law of the place of making to decide questions arising out of any subsequent transfers as well as the obligation of the principal debtor and for the law of the place of transfer to decide not only the questions concerning transfers there made, but also the obligations of the principal debtor.

Subsection 2 allows the parties to stipulate *in writing* that the law of a specified jurisdiction shall apply to the transaction, even though the transaction has sufficient contact with the forum state to call for the application of the code. But this opportunity is limited to those transactions involving foreign trade. The Comment of the drafters states that "it was felt that it would be going too far to require the application of the code to the American acceptance of a foreign offer which might come from one living under a system of law quite different from our own and means for making it inapplicable are therefore provided." Actually it would be going too far in many instances to apply the code to a transaction in interstate trade where the parties have stipulated that the law of some state not having the code shall apply. This absence of limitations on "contracting in" the Commercial Code and the relatively narrow field where "contracting out" the Commercial Code is allowed indicate with clarity that the sole motivation of the drafters of this section has been to promote the wide application of this new and improved commercial law.

Section 1-105 lays down fixed, determined, unchanging rules as to choice of law. It directs the courts of states which have adopted the Commercial Code to apply the code whenever any of a variety of contacts have occurred within the state of the forum. In numerous cases, the application of the provisions of Section 1-105 would surprise the contracting parties whose justified expectations would find no protection from the courts. By studying the choice of law rules of the several states, in conjunction with the substantive rules of those same states, a plaintiff would be able to select a forum whose rules would combine to give him victory. The defendant would be at the mercy of circumstances which have combined to cause his defeat in one particular forum. If there is to be certainty and uniformity in

the commercial world, then different courts must apply the same rules to the settlement of disputes. Section 1-105 would not give us the certainty, uniformity, and predictability that is a necessity in the commercial world.

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ADDITION TO THE FOREGOING NOTE

On August 20, 1949, the scholars interested in conflicts law, including leading specialists, who met in Ann Arbor for a discussion of world law problems, expressed their unanimous concern about Section 1-105 of the proposed Commercial Code. They resolved on the motion of Professor Elliott E. Cheatham as follows:

"Resolved, that the undersigned, participants in the 1949 Institute of International and Comparative Law, Ann Arbor, Michigan, are of the opinion that Section 1-105 (in both forms) of the May, 1949, draft of the Uniform Commercial Code, dealing with conflicts of laws, is unwise and should be omitted from the Code; and the Executive Secretary of the Institute of International and Comparative Law is requested to transmit a copy of this resolution to the President of the American Law Institute and the Chairman of the Commissioners on Uniform Laws."

In the minds of those who signed there was not the slightest doubt that the new work was badly disfigured by this crude extension of the code to transactions subject to other legal systems under any existing conflicts theory. If some particularized demonstration is needed, the foregoing students' note furnishes illustration. The editors of this Review have requested my own opinion, which cannot be more than a strictly personal comment on the implications, not discussed at the Ann Arbor meeting, of the resolution printed above.

The meeting voted simply for cancellation at the time being, manifestly because of the considerable efforts necessary for establishing appropriate rules. Now, in my personal view and as far as I can see, two different sets of rules of application should be created.

On one hand, regular rules of conflict must be found, really deserving the epithets, reasonable and not arbitrary. They may

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