1994

Why the U.C.C. Should Not Subordinate Itself to Federal Authority: Imperfect Uniformity, Improper Delegation and Revised Section 3-102(c)

Norman I. Silber
Maurice A. Deane School of Law at Hofstra University

WHY THE U.C.C. SHOULD NOT SUBORDINATE ITSELF TO FEDERAL AUTHORITY: IMPERFECT UNIFORMITY, IMPROPER DELEGATION AND REVISED SECTION 3-102(c)

*Norman Silber**

TABLE OF CONTENTS

---

* Associate Professor, Hofstra Law School; Ph.D., Yale University, 1978; J.D., Columbia University, 1986.

Many thanks for helpful comment are extended to Alex Aleinikoff, Thomas Baxter, Robin Charlow, Neil Cohen, Carl Felsenfeld, Linda Galler, Gail Hillebrand, Larry Kessler, Eric Lane, Malachy Mahon, Fred Miller, Deborah Prutzman, Alan Resnick, Wendy Rogovin, Ed Rubin, Ron Silverman, Jeff Sovern, Robert Williams and Julianna Zekan. Luke Bergstrom, David Jaffe and the staff of the University of Pittsburgh Law Review provided thoughtful assistance.

A special debt of gratitude is due to Dwight L. Greene, a departed friend and colleague. Dwight kindled my curiosity about the problems explored here and helped me to evaluate their importance.

Support from Hofstra made possible the valuable research assistance of Kevin Buggy, Alexander Fear, Andrew Gould, Scott Greissman, Eileen Lehmann, Jennifer Lyon, and Christopher Maurer.

Cast all blame for shortcomings on me.

I. Introduction: The Conflict Over Federalization of the Code

A knot of controversy over the merits of federalizing nonregulatory state banking laws by preempting or otherwise displacing them has gathered in an area where state authority to govern commercial law commonly has been taken for granted. The problems pervade recent revisions to the state uniform law provisions of Articles 3 and 4 of the Uniform Commercial Code ("U.C.C." or "Code"),[1] which are intended to codify the law of negotiable instruments, and the laws governing bank collections and payment. The proposed adoption of these changes by the states has raised questions about the proper scope of uniform laws and the extent to which state laws should endorse deference to federal regulatory authority. The implications of these revisions extend beyond abstract concerns about the coherence of the Code when

1. The history of the process of revising Articles 3 and 4 has been recounted elsewhere. *See, e.g.*, Fred H. Miller, *U.C.C. Articles 3, 4 and 4A: A Study in Process and Scope*, 42 ALA. L. REV. 405 (1991); Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83 (1993). Article 4A, Funds Transfers, emerged from the drafting process as a separate product, concerned with nonconsumer electronic funds transfers. Developed apart from Articles 3 and 4, 4A has been approved widely without the difficulties in adoption that have troubled revised Articles 3 and 4—at least in part because of 4A's limited scope. *See generally* Carl Felsenfeld, *But The Proposed Uniform [?] Commercial Code Was Adopted*, 26 LOY. L.A. L. REV. 597 (1993).

they are considered together with concerns about the demise of federalism in banking and the adequate representation of interests in federal and state rule-making processes.

Most law students in their first year of law school learn that after the reversal of *Swift v. Tyson*[2] by *Erie Railroad Co. v. Tompkins*[3] in 1938, the substantive common law of commercial transactions became the province of state law rather than federal adjudication. The law of negotiable instruments has evolved since then through a series of uniform law enactments into Article 3 of the Uniform Commercial Code. Until recently, the Code has reserved for the states the principal legislative and judicial role.

Recent events indicate that a part of negotiable instruments law is being removed from state hands. In particular, in the area of check collections, Congress has deprived states of part of their authority. In 1987, Congress, through the Expedited Funds Availability Act ("EFAA"), delegated to the Federal Reserve Board of Governors "the responsibility to regulate . . . any aspect of the payment system, including the receipt, payment, collection, or clearing of checks."[4] The Federal Reserve Board responded by issuing Regulation "CC," which preempted a considerable part of Article 4, dealing with bank collections.[5]

The preemption of much of Article 4 by the EFAA and Regulation CC posed a new problem for the drafters, who were then in the midst of revising Article 4. Should the Revised Article seek to preserve the unpreempted portions of Article 4, or should it allow the Federal Reserve Board to preempt these areas as well? By 1990, the premature demise of much of Revised Article 4 provoked new proposals to coordinate Article 4 with Federal Reserve Board regulations, and also generated a scholarly debate about the proper justification for ceding major areas of uniform law to federal regulatory agencies.[6]

2. 41 U.S. (16 Pet.) 1 (1842).

3. 304 U.S. 64 (1938).

4. Expedited Funds Availability Act, 12 U.S.C.A. § 4008(c)(1)(A) (West 1989).

5. Fed. Reserve Reg. CC, Availability of Funds and Collection of Checks, 12 C.F.R. § 229 (1993); *see* Edward L. Rubin, *Efficiency, Equity and the Proposed Revision of Articles 3 and 4*, 42 ALA. L. REV. 551, 559 (1991). The portions preempted by Regulation CC primarily concerned the check return process. *Id.*

6. Complete preemption was not a proposal that the banking industry favored. *See* Miller, *supra* note 1, at 423-24; Edward L. Rubin, *Uniformity, Regulation, and the Federalization of State Law: Some Lessons From the Payment System*, 49 OHIO ST. L.J. 1251, 1257-61 (1989). As of this writing it is not clear how much of Article 4 ultimately may become a dead letter, nor whether the acts of Congress and the Federal Reserve Board amounted to the equivalent of man-

With respect to Revised Article 3, the debate over the Code revisions has yet to explore what appears to be one small step backward for federalism and a move forward for federalization—the insertion of a scope provision, section 3-102, which endorses the preemption and requires the displacement of state law.[7] The language of that provision expands the opportunities for Federal rulemaking authority to defeat otherwise enforceable provisions of Article 3 and to defeat interpretations of those uniform law provisions that have been adopted by state legislative bodies and settled by state courts.

Originally titled "Commercial Paper" but now limited in scope to "Negotiable Instruments,"[8] the new Article 3 incorporates a deferential approach to the expansion of federal control. Section 3-102(c) states that "[r]egulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency."[9] As the analysis below suggests, this provision increases the likelihood that Federal Reserve authorities will administratively supersede the Code and perhaps other state laws in cases where previously they only supplemented them. The substantive areas that could be affected encompass checking account practices of consumers,

---

slaughter, homicide, or mercy killing. Professor Rubin views the consumer movement as having played the central role in the story of federalization, and believes that "[t]he demand for [consumer protection] regulation generated the Expedited Funds Availability Act, and with its passage, the era of state law control over the payment system is coming to an end." Rubin, *supra*, at 1276.

7. *See infra* part II.A.2. "Preemption" as used in this essay refers to the constitutionally mandated subordination of state authority to supreme federal law. "Displacement" refers to the subordination of state legislative and judicial authority by either federal or state legislative expressions that are not constitutionally mandated.

See generally WILLIAM B. LOCKHART ET AL., CONSTITUTIONAL LAW 307-15 (6th ed. 1986) (discussing leading cases and general principles of federal preemption); KENNETH STARR ET AL., THE LAW OF PREEMPTION: A REPORT OF THE APPELLATE JONES CONFERENCE (American Bar Association, 1991); JOSEPH F. ZIMMERMAN, FEDERAL PREEMPTION: THE SILENT REVOLUTION (1991). *See* discussion of operating circulars, *infra* notes 96-131 and accompanying text; *see also* Administrative Procedure Act, 5 U.S.C.A. §§ 551-706 (West 1992); PETER L. STRAUSS, AN INTRODUCTION TO ADMINISTRATIVE JUSTICE IN THE UNITED STATES 155-84 (1989).

8. Former Article III applied not only to "negotiable instruments" but also to "any instrument whose terms do not preclude transfer and that is otherwise negotiable . . . but which is not payable to order or bearer." U.C.C. § 3-805 (West 1987). Revised Article 3 contains no similar provision relating to nonnegotiable instruments. Although Revised Article 3 gives certain instruments the status of negotiability which they formerly would not have possessed, "it excludes from its coverage altogether certain nonnegotiable promises and orders other than checks that are subject to the existing article." *See* Robert G. Ballen & Paul Homrighausen, *Revised Articles 3 and 4: Selected Topics*, 24 UCC L.J. 3, 7 (1991).

9. U.C.C. § 3-102(c) (West 1990).

merchants and banks, and include the definition of negligent conduct by banks and consumers.[10] Section 3-102(c) is intended by its drafters to become part of each state's commercial law. Ironically, it anticipates and even hastens its own possible subordination by federal administrative law.

Since the scope provision not only recognizes the federalization of state law but advances it, questions arise about its legal effect and wisdom. Is this provision really necessary? What substantive effects can be anticipated? If one of the notable accomplishments of the U.C.C. is the preservation of a strong role for state lawmaking authority in the area of commercial law, why should a provision of model uniform state law demand its own supersession? If we explore closely the proposed federal administrative preemption of the law of negotiable instruments contained in Revised Article 3, perspective may be gained about the Uniform Commercial Code's prevalent resistance to displacement by federal regulatory law.

Part II of this study reviews general principles of federal administrative preemption and displacement of state laws. Part III suggests a framework for understanding the historical importance of the Code and the values of federalism that stand to be undercut by federal administrative displacement. Parts IV and V then examine two existing scope provisions in U.C.C. Articles 3, 4 and 7 in an effort to identify the extent to which these articles have entertained their own supersession. The remainder of this study examines potentially adverse practical consequences and state law constitutional problems flowing from anticipatory displacement provisions. It suggests that section 3-102(c) should not be adopted, and should be repealed in states where it has been approved.

It is understandable and laudable, perhaps, for the Uniform Commissioners and state legislators to amend the U.C.C. to reflect the force of preemptive Congressional actions. However, it is far more problematic for state appointed representatives to assist in the dilution of their own strength through the passage of uniform law revisions. It is peculiarly ironic that with Article 4 of the U.C.C., the drafters chose to deemphasize the Code's new subordinate relationship to federal law,[11] while in Revised Article 3, which is concerned with the law of negotia-

10. *See infra* part VI.
11. *See infra* note 131 and accompanying text.

ble instruments, the drafters embraced subordination when it had not yet been generally mandated by Congress.

Adoption of revised U.C.C. section 3-102(c), this article concludes, results in an unwarranted and potentially damaging preemption of state law. The provision anticipates further federal action and invites the Federal Reserve Board to displace state negotiable instruments law in areas that were not meant to be reachable by ordinary preemption doctrine.

The result of the drafters' work in this case is difficult to square with the important values preserved by the Code. As a matter of state lawmaking, displacement is dangerous. As a matter of drafting, it presents a troubling portrait of the Code's revision process.

II. BACKGROUND: THE PREEMPTION AND DISPLACEMENT OF STATE LAWS

The allocation of power between the federal government and the individual states absorbed the profound attention of the framers.[12] Searching for ways to balance their fear of an omnipotent centralized federal government against their desire for a unified country, they devised a system of divided sovereignties, of "empires" within the American Empire.[13] State autonomy was curtailed after the Civil War, which resulted in new constitutional limits on the legal rights of the states. Subsequently, and as a product of the economic and social integration of twentieth century American life, the balance tipped further toward centralized authority. "The powers and choices accorded state governments have been increasingly limited, while national rule has become increasingly pervasive."[14] This trend away from federal*ism* and toward a federal*ized* form of government is reflected in the federal legislative and administrative preemption of state law,[15] and in a correspondingly

---

12. *See* JOSEPH LESSER, THE COURSE OF FEDERALISM IN AMERICA—AN HISTORICAL OVERVIEW IN FEDERALISM: THE SHIFTING BALANCE 2-3 (Janice C. Griffith ed., 1989) [hereinafter FEDERALISM: THE SHIFTING BALANCE].

13. *See id.*; *see also* ZIMMERMAN, *supra* note 7, at 83-106.

14. Laurence J. Aurbach, *Foreword: Federalism in the Bicentennial Year of the Constitution*, 19 URB. LAW. 433, 439 (1987); *see also* Laurence J. Aurbach & Ross D. Davis, *Federalism for the Third Century?*, 19 URB. LAW. 445, 456-57 (1987). An explanation for this shift in balance is that the American system of government is expected to react effectively to the multiplying demands of a progressively interrelated and interdependent world in which physical, social, and economic relationships and patterns typically transcend not only the borders of the individual states, but the borders of the United States as well. *Id. See generally* FEDERALISM: THE SHIFTING BALANCE, *supra* note 12.

15. The centralization of governmental functions has been especially notable in commercial

diminished role for state judiciaries. The states have been both unwilling victims and helpful participants in their own demise. They have endured the erosion of their authority at the hands of congressionally sanctioned preemption, and they also have willingly relinquished some of their power.

A. Distinguishing Preemption from Displacement

The field of federal preemption is overgrown and muddy.[16] State and local autonomy has been preempted by federal legislative authority in varying degrees. Moreover, there are a multitude of theories on which preemption has been premised.[17] In many instances, federal preemption is supported either by the Constitution itself, or by a congressionally authorized statute. Often, however, it flows from a federal agency's administrative declaration made by virtue of congressionally delegated authority to engage in preemptive rulemaking.

1. Preemption by Valid Regulatory Authority

Where Congress establishes a statutory scheme based on a substantive source of legislative power,[18] the Supremacy Clause[19] allows congressional objectives as implemented through regulations authorized by the scheme to override the conflicting objectives pursued by individual states.[20] On many occasions, Congress has by statute expressly preempted state authority.[21] At other times, courts have determined con-

---

law fields, where communication and transportation technologies have expanded markets and diminished the significance of political and geographic boundaries. *See* Rubin, *supra* note 6, at 1253-73 (referring to the payment system as an example).

16. *See, e.g.*, LAWRENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 479 (2d ed. 1988) ("The question whether federal law preempts state action, cannot be reduced to general formulas. . . ."); *see also* JOHN E. NOWAK ET AL., CONSTITUTIONAL LAW 312 (4th ed. 1991) (While the touchstones involved by the Court can be delineated succinctly, there is no simplistic constitutional standard for definitive preemption parameters.).

17. *See generally* Norman Silber, *The Federal Preemption of State Consumer Protection Laws*, PROCEEDINGS OF THE APRIL 1992 CONFERENCE ON GOVERNMENT STRUCTURES IN THE U.S.A. AND THE SOVEREIGN STATES OF THE FORMER U.S.S.R. (forthcoming 1994); ZIMMERMAN, *supra* note 7.

18. Examples include constitutional grants of authority to regulate commerce and to establish uniform naturalization and bankruptcy laws. U.S. CONST. art. I, § 8.

19. U.S. CONST. art. VI, cl. 2.

20. LOCKHART, *supra* note 7, at 307.

21. *See, e.g.*, Federal Food, Drug, and Cosmetic Act, 21 U.S.C.A. § 360 (West 1992), which forbids state and local governments "to establish . . . any standard which is applicable to the same aspect of the performance of such product and which is not identical to the federal standard."

gressional legislation to be preempted by implication.[22] One well-known example of an Act that has presented courts with difficult preemption issues is the Federal Cigarette Labeling and Advertising Act ("FCLAA").[23] Congress inserted into the FCLAA an express preemption provision. Courts have construed other portions to contain an implied preemptive effect.[24]

If Congress acts within the scope of its constitutional authority, it also may delegate the power to preempt a state law to a federal administrative agency.[25] For example, language which expressly or impliedly permits federal regulations to supersede state laws exists in many federal banking and credit-related enactments.[26] It long has been established that the regulations of congressionally authorized federal agencies, including those of the Federal Reserve Board, can have the effect of statutory law. Accordingly, valid regulations will preempt incompatible state law.[27] Conversely, federal agencies are sometimes given the discretionary authority to prohibit state law from diminishing the preemptive effects of valid federal regulatory schemes.[28] Of course it is not always simple to determine whether any given assertion of federal au-

---

22. *See* Conference of Fed. Sav. & Loan Ass'ns v. Stein, 604 F.2d 1256, 1260 (9th Cir. 1979), *aff'd*, 445 U.S. 921 (1980) (finding that the Federal Home Loan Bank Board has such "pervasive" control over the federal savings and loan associations that there is "no room for state regulatory control"); Silber, *supra* note 17, at 12-18.

23. 15 U.S.C. §§ 1331-1341 (1988).

24. Section 5 of the 1969 Cigarette Act states:

> (a) No statement relating to smoking and health, other than the statement required by section 1333 of this title, shall be required on any cigarette package.
>
> (b) No requirement or prohibition based on smoking and health shall be imposed under State law with respect to the advertising or promotion of any cigarettes the packages of which are labeled in conformity with the provisions of this chapter.

15 U.S.C. § 1334 (headings omitted). Section 5(b) has been read to limit common law tort claims by implication. *See* Cipollone v. Liggett Group, Inc., 112 S. Ct. 2608, 2619-25 (1992).

25. Louisiana Pub. Serv. Comm'n v. Fed. Communications Comm'n, 476 U.S. 355, 369 (1986).

26. *See, e.g.*, Expedited Funds Availability Act, 12 U.S.C. § 4001 (1989); Truth in Lending Act, 15 U.S.C. §§ 1610, 1666 (1989); *see also* Fred H. Miller, *The Problem of Preemption in Consumer Credit Regulation*, 3 OKLA. CITY U. L. REV. 529 (1979).

27. Most federal regulations, including those of the Federal Reserve Board of Governors, are promulgated under the authority of congressional enactments. To preempt state law therefore, such regulations must be valid exercises of validly delegated authority to the agency by Congress. The Supremacy Clause of the Constitution provides that federal law shall displace or preempt state laws in the event of conflicts. *See supra* notes 18-20 and accompanying text.

28. *See infra* note 164 and accompanying text; *see also* Susan Bartlett Foote, *Administrative Preemption: An Experiment in Regulatory Federalism*, 70 VA. L. REV. 1429, 1430 n.4 (1984).

thority is a valid exercise of federal power or whether it conflicts with, and therefore necessarily supersedes, state law.[29]

With respect to the Federal Reserve Board, courts have determined the extent to which rulemaking, pursuant to the Federal Reserve Act, will preempt state banking laws.[30] Where congressionally authorized purposes[31] are concerned, courts recognize the Federal Reserve Banks' authority to issue preemptive regulations. For instance, with respect to the check collection process, Congress delegated to the Federal Reserve Board Banks power to make the rules to enable the Federal Reserve to function as clearinghouses and collectors in order to carry out the congressional policy of establishing a nationwide system of check clearing and collecting.[32]

When Congress either explicitly or implicitly delegates rulemaking authority to the Federal Reserve Board, the Board is authorized to develop specific rules that give specificity to federal statutes.[33] Some of the Fed's rules have been limited in their preemptive effect by courts or invalidated as beyond their authorized authority.[34] To the extent that the Federal Reserve Board fills in the details,[35] however, it implements congressional policy through its rulemaking. Furthermore, following the Supreme Court's ruling in *Chevron U.S.A., Inc. v. Natural Resources Defense Counsel, Inc.*[36] and its progeny, the deference afforded to agency interpretations of the breadth of their own rulemaking authority increased significantly. The promulgation of preemptive regula-

---

29. *See infra* note 241 and accompanying text; *see also* S. Candice Hoke, *Preemption Pathologies and Civic Republican Values*, 71 B.U. L. REV. 685, 738-50 (1991).

30. See *infra* notes 35-37.

31. The Federal Reserve Act serves "[t]o provide for the establishment of Federal Reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." Preamble to the Federal Reserve Act of 1913, ch. 6, 38 Stat. 251, 259 (codified as amended in scattered sections of 12 U.S.C.). *See generally* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, FEDERAL RESERVE SYSTEM 1—PURPOSES AND FUNCTIONS (6th ed. 1974).

32. Independent Bankers Ass'n of Am. v. Board of Governors of the Fed. Reserve Sys., 500 F.2d 812, 814 (D.C. Cir. 1974). *See generally* Alfred C. Aman, Jr., *Bargaining for Justice: An Examination of the Use and Limits of Conditions by the Federal Reserve Board*, 74 IOWA L. REV. 837, 838-91 (1989); Robert G. Ballen, *The Federalization of Articles 3 and 4*, 19 UCC L.J. 34, 35-44 (1986).

33. *See supra* note 27 and accompanying text.

34. *See infra* note 188 and accompanying text.

35. Greater Buffalo Press, Inc. v. Federal Reserve Bank of N.Y., 866 F.2d 38, 44 (2d Cir. 1989), *cert. denied*, 490 U.S. 1107 (1989).

36. 467 U.S. 837 (1984) (paying deference to agencies in construction of responsibilities and powers under ambiguously worded federal statutes).

tions by the Federal Reserve Board, within its jurisdiction, thus has been held to be a constitutional delegation of legislative authority.[37]

2. *Displacement of State Law by the Operation of State Law*

Even in the absence of constitutionally sanctioned preemption, federal laws may displace state laws through the operation of state law. Such displacement occurs when, through legislative delegation or otherwise, a state accedes to the supremacy of nonpreemptive federal statutes or subordinates its laws to the rulings of federal agencies which do not have the preemptive force of federal law, such as the administrative guidance issued by federal agencies, bureaus and other bodies.

Even if not constitutionally compelled to do so, a state may express an intent to be bound by noncontrolling federal law. Frequently, state statutes require state agencies to limit their own power according to established minimum federal requirements for social service allotments.[38] Similarly, state statutes often require state agencies to issue interpretations that are consistent with existing federal rules, opinion letters, or agency practices.[39] In the area of banking regulation, for example, a number of state legislatures have adopted "wild card statutes" which apply regulatory limits to state-chartered banks equivalent to those that federal authorities have bestowed upon national banks.[40] State actions which invite federal displacement may violate state constitutional principles if too broad a power is delegated.[41]

Inevitably, the consequence of federal preemption or statutory displacement of state laws is the reduction of state authority in deference to federal solutions or "federalization." Federal solutions sometimes provide states less with various options or alternatives. But it is federal, not state, solutions that control.[42] As a general rule, the potential rewards of federalization are improved uniformity in rulemaking and in-

---

37. *See* Panama Refining Co. v. Ryan, 293 U.S. 388 (1935). Federal Reserve Regulations sometimes provide for a process for advance "preemption determinations" by Federal Reserve authorities. *See, e.g.*, Fed. Reserve Reg. CC, 12 C.F.R. § 229.20(d) (1993).

38. *See, e.g.*, Diversified Inv. Partnership v. Department of Social and Health Servs., 775 P.2d 947 (Wash. 1989), discussed *infra* notes 258-60 and accompanying text.

39. *See, e.g.*, Department of Legal Affairs v. Rogers, 329 So. 2d 257 (Fla. 1976), discussed *infra* notes 248-50.

40. At least 34 states have some form of "wild card" statute, which grants their state-chartered banks authority to engage in activities permissible for national banks. 1 RAYMOND NATTER ET AL., BANKING LAW § 4.03[10] (Supp. 1993).

41. *See infra* note 246 and accompanying text (discussing the delegation doctrine).

42. *See* Ballen, *supra* note 32, at 45.

terpretation, greater efficiency in transacting business and more certainty about the rules.

The perceived disadvantages of federalization include fewer opportunities to make law responsive to local conditions and lawmaking processes and a loss of competitive improvement in lawmaking from the response to legal reform in other jurisdictions. As one scholar has stated, federalization "vitiates the opportunity to experiment in the states with various approaches to the same issue."[43]

B. The Diminished State Role in Banking Law

In few areas of American law has the tension between federal preemptive authority and state power been more controversial or dynamic than in bank regulation. Banking institutions and transactions have been the target of sovereignty conflicts because they are governed either concurrently by state and federal authorities, or by federal law alone.[44]

The state-federal banking regulatory relationship appeared for many years prior to 1980 to be defined by lines of regulatory authority that looked stable, if sometimes arbitrary.[45] This "dual banking system" of state-chartered and federally chartered banks generally provided states with exclusive control over branching practices.[46] Exclusive federal control over state banks was chiefly confined to bank reserve requirements and some consumer protection measures.[47] Both state and federal authorities held concurrent control over most other aspects of the banking process including charters, insurance and usury limits.[48]

---

43. *Id.*

44. *See* NATTER, *supra* note 40, § 1.04, at 10-11; Kenneth E. Scott, *The Patchwork Quilt: State and Federal Roles in Bank Regulation*, 32 STAN. L. REV. 687 (1980) [hereinafter *The Patchwork Quilt*] (dividing bank regulation into four classes: federal domination, federal overlay, independence, or state domination, and analyzing the patterns of bank regulation based on these classes). *See generally* Emmette S. Redford, *Dual Banking: A Case Study in Federalism*, 31 LAW & CONTEMP. PROBS. 749 (1966) (a historical discussion of the dual banking system and the then-existing federal-state relationship).

45. The regulatory functions of the banking system can be separated into two levels: the primary level involves regulation and supervision by either the state or federal chartering authority, while the secondary level is "exclusively federal in origin." Kenneth E. Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 STAN. L. REV. 1, 5-6 (1977) [hereinafter *The Dual Banking System*]. For a depiction of this "tangled web of bank regulation," *see id.* at 7.

46. *See The Patchwork Quilt*, *supra* note 44, at 699-701; Joan Senzel Nestor, *Interstate Branch Banking Reform: Preserving the Policies Underlying the McFadden Act*, 72 B.U. L. REV. 607 (1992).

47. *See The Patchwork Quilt*, *supra* note 44, at 695-734.

48. *See The Dual Banking System*, *supra* note 45, at 6-7.

During the 1980's, federal banking laws, regulations, and other administrative promulgations preempted or displaced state banking laws, at an accelerated pace.[49] The Federal Reserve Board, the former Home Loan Bank Board (now the Office of Thrift Supervision), and the Oversight Board of the Resolution Trust Corporation, acquired greater statutory authority.[50]

In addition to preemption of state laws by direct congressional action, state commercial laws have also been preempted through the expansive assertion of delegated administrative power. In 1982, the Supreme Court upheld a Federal Home Loan Bank Board regulation which preempted a California Supreme Court interpretation of a mortgage agreement in the case of *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta*.[51] The regulation was issued without an explicit statutory basis for preemption. Commentators viewed that result as a relatively new event in federalism.[52] Thereafter, courts invoked preemption doctrines to invalidate several state laws and regulations that had previously governed both federally chartered and state-chartered banks.[53] Court de-

49. Federal law deprived states of authority to establish maximum interest rates on most home mortgages. *See* Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 1735f-7, § 501, 94 Stat. 132, 161 (1980). During recent years, for instance, the Office of the Comptroller of the Currency ("OCC") has found that the National Bank Act ("Act"), 12 U.S.C. §§ 21-216d (1989), preempted a state law that prohibited national banks from conducting full service banking on Saturdays. *See* M. Nahas & Co. v. First Nat'l Bank of Hot Springs, 930 F.2d 608 (8th Cir. 1991) (finding state usury law preempted by the Act); First Nat'l Bank of E. Ark. v. Taylor, 907 F.2d 775 (8th Cir. 1990), *cert. denied*, 498 U.S. 972 (1990) (finding state law purporting to prohibit banks from offering debt cancellation contracts preempted by the Act); MacKey v. Pioneer Nat'l Bank, 867 F.2d 520 (9th Cir. 1989) (finding contract and tort claims preempted by the Act); OCC Unpublished Interp. Ltr. from William P. Bowden, Chief Counsel, LEXIS Banking Library, ALLOCC file (Reference: Text is illegible) (Feb. 4, 1992) (finding Iowa laws concerning licensing, interest rates, credit card fees and bank supervision preempted by the Act); OCC Interp. Ltr. No. 564 (Oct. 29, 1991), *reprinted in* FED. BANKING L. REP. (CCH) ¶ 83,317 (finding Idaho restrictions on Saturday operations preempted by the Act); OCC Interp. Ltr. No. 52 (July 25, 1978), *reprinted in* FED. BANKING REP. (CCH) ¶ 85,127 (finding Kansas law restricting activities conducted at national bank branches preempted by the Act).

50. *See* David W. Adams, *Is The Power of the RTC Unlimited? Federal Preemption of State Banking Law*, 18 FLA. ST. L. U. REV. 995 (1991) (discussing the increase in preemptory power of the Resolution Trust Corporation); *see also supra* note 49 and accompanying text.

51. Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta, 458 U.S. 141 (1982). At issue in *de la Cuesta* was the traditional ability of homeowners to assign their mortgages. California courts upheld the validity of these transactions; but the agency rule, primarily motivated by an interest in improving the profitability of bank loan portfolios, invalidated them and allowed banks to consider repurchase a ground for acceleration of debt. *Id.* at 169.

52. *See, e.g.*, Foote, *supra* note 28, at 1441-42; James G. Kreissman, Note, *Administrative Preemption in Consumer Banking Law*, 73 VA. L. REV. 911, 944 (1987).

53. *See* Hoke, *supra* note 29, at 690-91 nn.21-25 (offering cases in a wide range of areas that address the preemption of state or local laws).

terminations also allowed federal banking agencies to preempt some state laws "completely" by upholding agency rulings and regulations, issued without explicit statutory authority, that wholly invalidated state laws with respect to both state and national banks.[54]

It has come to the point where state banking authorities express regret that they can no longer regulate any area of banking law without considering the impact of administrative preemption analysis on their actions.[55] Just the specter of court-sanctioned preemption, even in the absence of any express congressional statutory mandate, has forced states to accept a more limited role in regulating banking practices.[56]

The recent trend toward federalization of banking law has led some observers to suggest that complete federalization is desirable and inevitable considering the integration of banking on a global scale and the emergence of electronic banking technologies.[57] Commentators have suggested that state geographical boundaries no longer provide rational lines for allowing idiosyncratic juristic patterns to prevail.[58] Furthermore, exact uniformity is now perceived to be more critical than ever to economic efficiency and fairness.[59] It has been asserted that a meaningfully competitive dual state banking system never really existed at all.[60]

---

54. *See* Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in The Dual Banking System*, 73 CORNELL L. REV. 677, 705 (1988).

55. One of the most open-ended federalizations is contained in § 303(a) of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. § 1831a (West Supp. 1993) ("FDICIA"); this has been followed by detailed descriptions by the Federal Deposit Insurance Corporation ("FDIC") of what national banks may and may not do, notwithstanding conflicting state laws. *See, e.g.*, FDIC Interp. Ltr., LEXIS 84 (Dec. 10, 1993) (discussing impact of FDICIA).

One effect of the competitive regulatory environment in which state banks have sometimes received less favorable treatment than national banks has been the adoption of "wild card laws" to prevent state banks from operating at a competitive disadvantage. *See supra* note 40 and accompanying text.

56. The New York Clearing House, for example, recently resisted the New York City Council's effort to improve security at automated teller machines by arguing that such matters as the number and type of door locks and video cameras were governed by the National Bank Act. *See* Memorandum from Sullivan & Cromwell to the Counsel to the Speaker (June 10, 1992) (on file with the author); *see generally* Butler & Macey, *supra* note 54.

57. *See* Rubin, *supra* note 6, at 1276 (explaining that further federalization is imminent and that more changes in the banking system will likely occur); James J. White, *Ex Proprio Vigore*, 89 MICH. L. REV. 2096 (1991).

58. F. Stephen Knippenberg & William J. Woodward, Jr., *Uniformity and Efficiency in the Uniform Commercial Code: A Partial Research Agenda*, 45 BUS. LAW. 2519, 2523 (1990).

59. Rubin, *supra* note 6, at 1262.

60. Butler & Macey, *supra* note 54, at 693-94.

On the other hand, computer and electronic technologies that have permitted the unification of commercial markets and the centralization of decision and rulemaking have allowed financial institutions to customize their products to the demands of local markets at ever diminishing cost. Such technology also permits lawyers to accommodate local commercial law practices with greater facility than in the past.[61] The globalization of finance and media purportedly demonstrates the logic of centralization. This globalization has occurred, however, because local economic advantages can be exploited more easily and cultural differences can readily be accommodated. Moreover, the consequences of differing legal rules can be anticipated and planned for. In other words, rather than thwarting interests of efficiency, the presence of different rules in different jurisdictions may be more practical than ever and provides more accurate, efficient, and socially beneficial results.

The U.C.C. stands in stark contrast to the diminishing state banking law and the trend toward federalization. It is not coincidental that the movement toward federal control of banking law has been notably constrained in those areas that are governed by the Code, and which primarily have been the product of developments in state lawmaking and state decisionmaking.[62] To weaken the Code's hold in these areas is to accelerate the pace of federalization.

III. CONTEXT: THE VIRTUES OF THE CODE'S IMPERFECT UNIFORMITY

The gradual adoption of the Uniform Commercial Code by every state in the Union during the decades following World War II was a unique accomplishment in the history of federalism. The drafters[63] ac-

---

61. *See generally* Alan Radding, *Banking on Technology in the 90's*, MAG. BANKING MGMT., July 1991, at 34; John Robinson Thomas, *Legal Responses to Commercial Transactions Employing Novel Communications Media*, 90 MICH. L. REV. 1145 (1992). *See also* Knippenberg & Woodward, *supra* note 58, at 2523 ("[O]ne is struck by the void of hard data on the nature of American business practice for lawmaking purposes . . . [I]f most relevant transactions are local, the data might support a quiltwork Code that can be tailored to fit various local interests.").

62. *See generally* Ballen, *supra* note 32 (1986) (discussing trend of federalization of nation's payment system affecting Articles 3 and 4).

63. Regarding the history of the U.C.C., see JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 1-6 (3d ed. 1988). Regarding the U.C.C. and its originators, see WALTER P. ARMSTRONG, JR., A CENTURY OF SERVICE: A CENTENNIAL HISTORY OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 56-131 (1991); Robert Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798 (1958); William A. Schnader, *A Short History of the Preparation and Enactment of the Uniform Commercial Code*, 22 U. MIAMI L. REV. 1 (1967).

complished a task that's significance grows with the passage of time and when compared to the accumulating wreckage of less ambitious projects.[64] The body of commercial law that emerged from their work was more comprehensive and intellectually coherent than any previous set of uniform laws.

However, it would be a mistake to ascribe the contributions of Gilmore, Llewellyn, Leary, Mentschikoff and their less well-known contemporaries mainly to the magnitude of their system-building and to the uniformity and simplification that resulted from their work. Their accomplishment would have been less significant if, as was contemplated by some, they chose to persuade Congress of the correctness of the U.C.C. and Congress accordingly preempted the commercial law of the states. To have done so would have been, in a term coined by Robert Cover, fundamentally "jurispathic."[65] The growth of diverse jurisprudential traditions in the different states would have been destroyed, and the opportunities for non-uniformity in the application and interpretation of the Code would have diminished. Additionally, the federalization of the Code would have been "legispathic." The interplay of interest group politics with special economic conditions in the many states would have been replaced by more remote, more centralized, federal political and regulatory interaction.[66]

---

64. White, *supra* note 57, at 2103. Examples of some ambitious, yet unsuccessful, projects have included the New Payments Code and the Uniform Divorce Law. *See* Miller, *supra* note 1, at 407-09, as well as the Uniform Consumer Credit Code ("U3C"); *cf.* Fred H. Miller, *Administrative Interpretations of the Uniform Consumer Credit Code,* 43 CONSUMER FIN. L.Q. REP. 84, 84 (1989) (reporting that as of 1989 only ten states have adopted the U3C since the original 1968 version was drafted). On the other hand, a number of uniform acts have been adopted with successful results by forty or more states. *See* White, *supra* note 57, at 2103 n.36.

65. Robert M. Cover, *The Supreme Court 1982 Term Forward: Nomos and Narrative,* 97 HARV. L. REV. 4, 40-42 (1983). Cover emphasized the destruction done by the appellate courts in the interest of removing uncertainty and doubt: "Interpretation always takes place in the shadow of coercion. . . . Courts, at least the courts of the state, are characteristically 'jurispathic.'" *Id.* at 40. He continued:

> Modern apologists for the jurispathic function of courts usually state the problem not as one of *too much* law, but as one of *unclear* law. The supreme tribunal removes uncertainty, lack of clarity, and difference of opinion about what the law is. This statist formulation is either question begging or misleading. To state, as I have done, that the problem is one of too much law is to acknowledge the nomic integrity of each of the communities that have generated principles and precepts.

Id. at 42. Understandably, the proponents of uniform law approaches and also the advocates of federalization have disparaged nonuniformity in state law for lack of clarity, uncertainty and unpredictability, but do not generally attack nonuniform laws or revisions as products of inferior or structurally inadequate rulemaking processes.

66. *See* Hoke, *supra* note 29, at 718-22. *See generally* D. RODERICK KIEWIET & MATHEW

Paradoxically, the most remarkable aspect of the "Uniform" Commercial Code is its commitment to diversity and imperfect uniformity.[67] Although as General Schnader wrote in the forward to West's 1962 publication of the Code, the project was surely undertaken "to achieve UNIFORMITY in state laws regulating commercial transactions," and "the Act was promulgated not as a *model* act but as a *uniform* act,"[68] the drafters recognized at the outset that there would be nonuniform amendments and nonuniform interpretations as states adopted the U.C.C.[69] Even today, as the Code's guardians and enthusiasts at the National Conference of Commissioners on Uniform State Laws (NCCUSL), the American Law Institute (ALI), and the Permanent Editorial Board (P.E.B.) labor mightily to achieve identical code provisions in every state, they promote diversity in state laws by forestalling federalization and by conceding very little state legislative or regulatory autonomy to federal bodies.[70]

As a matter of principle, diversity and decentralization of lawmaking authority has long held the devotion of advocates of a stronger federalism, whereas the principle of uniformity in the law of commercial transactions "[a]part from economy in drafting . . . has nothing to recommend it as an end in itself," except "to the extent that it advances other Code goals and purposes."[71] Because each state has adopted its own version of the "model" and "uniform" Code, the Code remains subject to legislative modification and judicial interpretation by state authorities. "Rough" uniformity has resulted in greater efficiency without eliminating the responsiveness of the law to changing local conditions and without entirely diminishing the well-recognized potential of the states as "laboratories" in the federal system.[72] Indeed, several im-

---

D. McCUBBINS, THE LOGIC OF DELEGATION 9-12 (1991).

67. The use of the word "diversity" in this context refers to a variety of lawmaking sources, and not necessarily to a variety of constituencies involved in the legislative or adoptive process. *See also* Felsenfeld, *supra* note 1, at 598; Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles*, 26 LOY. L.A. L. REV. 743 (1993).

68. Lawrence J. Bugge, *Commercial Law, Federalism, and the Future*, 17 DEL. J. CORP. L. 11, 30 (1992) (citing *Foreword* to UNIFORM COMMERCIAL CODE (West 1962)).

69. *See* Frederick K. Beutel, *The Proposed Uniform [?] Commercial Code Should Not be Adopted*, 61 YALE L.J. 334 (1952); Felsenfeld, *supra* note 1, at 600-01.

70. *See* U.C.C, § 1-102(2) (underlying policies "to make uniform the law among the various jurisdictions."); *id.* at § 1-104 (Act is "a general act intended as a unified coverage of its subject.").

71. Knippenberg & Woodward, *supra* note 58, at 2521.

72. *See* New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) ("It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a

portant Code revisions and a number of federal consumer protection initiatives of the past decade might not have occurred without the state law experimentation made possible by limited federalization.[73]

The success of the U.C.C. approach led to the accumulation of a vast repository of state commercial law which otherwise might have been federalized. The historical development of state versions of the U.C.C. along lines of uniformity but subject to significant variation is astonishing when it is compared to developments in other fields. Consider the relative disarray of radically differing state laws, and overlapping federal laws (including environmental laws such as CERCLA) concerning real property.[74] Or compare the development of U.C.C. commercial law with bankruptcy law, which, despite certain exceptions

---

laboratory; and try novel social and economic experiments without risk to the rest of the country.") (Brandeis, J., dissenting); *see also* Frank R. Kennedy, *Federalism and the Uniform Commercial Code*, 29 BUS. LAW. 1225 (1974); Herbert Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 COLUM. L. REV. 543, 543 (1954) ("[Federalism requires states to] call upon a people to achieve a unity sufficient to resist their common perils and advance their common welfare, without undue sacrifice of their diversities and the creative energies to which diversity gives rise."). *But cf.* John C. Minahan, Jr., *The Eroding Uniformity of the Uniform Commercial Code*, 65 KY. L.J. 799, 821-22 (1977) (exhorting state legislatures and the state courts to work toward uniformity); E. Hunter Taylor, Jr., *Recent Developments in Commercial Law, Foreword: Federalism or Uniformity of Commercial Law*, 11 RUT.-CAM. L.J. 527, 528 (1980) ("Federalism has been the paramount impediment to the uniformity of commercial law.").

73. Model Article 2A of the U.C.C., Leases, was subjected to significant revision following considerable state law revision. *See, e.g.*, Amelia H. Boss, *The History of Article 2A: A Lesson for Practitioner and Scholar*, 39 ALA. L. REV. 575 (1988) (early period of revision). Two examples of federal legislation preceded by and demonstrated to be workable through state experimentation, drawn from the field of consumer protection are the Expedited Funds Availability Act, 12 U.S.C. §§ 4001-4010 (West 1989), initiated by state law amendments in California and New York, and the Federal Truth in Savings Act, 15 U.S.C. §§ 1601-1677 (West Supp. 1993), initiated by state laws in Kansas and New York. *See* RICHARD L.D. MORSE, TRUTH IN SAVINGS 84 (1992).

74. *See, e.g.*, Michael H. Schill, *Uniformity or Diversity: Residential Real Estate Finance Law in the 1990's and the Implications of Changing Financial Markets*, 64 S.C. L. REV. 1261 (1991).

for state property exemptions,[75] is predominantly federal law with a high degree of uniformity from jurisdiction to jurisdiction.[76]

Furthermore, outside of the Code it is difficult to find contemporary examples of coherently developed, non-federal, multi-state jurisprudence. By contrast, the U.C.C. contains a rich body of state-law jurisprudence.[77] The U.C.C. has offered a uniquely workable middle road, combining positive elements of common law adjudication with statutory lawmaking.[78]

The presence of a principally uniform, but variable commercial law is even more exceptional when it is placed in an international perspective. For example, efforts to bring uniformity and flexibility to the radically different commercial laws of the different European states have been unsuccessful.[79] In the states of the former U.S.S.R., where centrally imposed law is now in disrepute, the task of creating legiti-

---

75. *See, e.g.*, Bankruptcy Code 11 U.S.C. § 522(b)(2) (Bender 1990). The historical and political explanations for § 522(b)'s "opt-out" provision, which enables states to retain their diverse personal property exemptions, is considered in Joseph Lamport, *The Preemption of Bankruptcy—Only Exemptions*, 6 CARDOZO L. REV. 583 (1985); *see also* Matthew J. Kemner, *Personal Bankruptcy Discharge and the Myth of the Unchecked Homestead Exemption*, 56 MO. L. REV. 683 (1991). Diverse conditions in the states led to different exemptions. For example, "[i]n several western and southern states, extremely liberal exemption laws were enacted to attract settlers." ALAN N. RESNICK & BENJAMIN WEINTRAUB, BANKRUPTCY LAW MANUAL ¶ 4.07 (1986).

Few justifications for interstate diversity, discussed *infra*, apply to the opt-out rule for property exemptions, however. In contrast to other state commercial enactments—where businesses can investigate the laws of a given jurisdiction and decide whether to conduct a line of business according to the legal climate—creditors have no control over a debtor's post-transaction choice of a voluntary bankruptcy forum. In addition, the Constitution specifically provides for a uniform federal law respecting bankruptcy. U.S. CONST. art. I, § 8. An alternative rationale for allowing extreme variations in property exemptions is that the employment of the federal bankruptcy remedy would be significantly discouraged if state non-bankruptcy law exemptions were considerably more generous than mandatory federal exemptions inside bankruptcy. See Alan N. Resnick, *Prudent Planning or Fraudulent Transfer? The Use of Nonexempt Assets to Purchase or Improve Exempt Property on the Eve of Bankruptcy*, 31 RUTGERS L. REV. 615, 620-21 (1978).

76. *See* Douglas Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 824 (1987).

77. The Uniform Commercial Code (1990) includes the law of Sales (Article 2), Leases (article 2A), Commercial Paper (Article 3), Bank Deposits and Collections (Article 4), Letters of Credit (Article 5), Bulk Transfers (Article 6), Documents of Title (Article 7), Investment Securities (Article 8), and Secured Transactions (Article 9).

78. On the other hand, the very non-uniformity of the Code has provoked criticism. *See* Bugge, *supra* note 68, at 30. ("[N]onuniformity can impede economic development, complicate transactions, burden the legislature, deprive courts of useful precedent, increase the likelihood of federal preemption, and forego the benefit of a national consensus on important issues.").

79. *See* Uwe H. Schneider, *The Harmonization of EC Banking Laws*, 22 LAW & POL'Y INT'L BUS. 261 (1991) (discussing the problem of unification of law in terms of "harmonization" rather than "uniformity").

mate and uniform commercial law has been described as inordinately difficult.[80]

Those who place themselves within the tradition of discourse about "civic republicanism" and "communitarian studies" have taken a dim view of federalization for reasons unconnected to the substantive outcome of particular legal disputes or the principles of revitalized federalism.[81] Advocates of this view believe that, in the long run, democratic values are sustainable only if citizens inform themselves about the matters that affect their lives and take active roles to address them.[82] Because federalization generally places decisionmaking in fewer hands at a further distance and with less accountability to local communities, the incentive to become knowledgeable about issues that affect economic and social well-being is attenuated. This kind of centralization of power diminishes the incentives for participating in government.[83] From this perspective as well, the U.C.C. has reserved an important space for both state lawmaking and state judicial action in areas related to commercial law.[84]

Of course, to a considerable extent, the vitality of the Code has endured at the sufferance of Federal authority. States have no veto power with which to stop Congress or the federal courts from acting positively to divest them of authority in the commercial field.[85] When

80. *See* Craig Forman, *Soviet Economy Holds Potential Disaster as the Union Weakens*, WALL ST. J., Sept. 4, 1991, at A1, A8; *see also* S. Jan Vukovich, Comment, *East-West Joint Ventures: Lessons from Past Soviet-Western Joint Ventures and Projections for Future Deals with the CIS*, 20 DENV. J. INT'L L. & POL'Y 439 n.196 (1992).

81. *See* S. Candice Hoke, *Transcending Conventional Supremacy*, 24 CONN. L. REV. 829, 875-91 (1992); *see also* Paul Brest, *Further Beyond the Republican Revival: Toward Radical Republicanism*, 97 YALE L.J. 1623 (1988); D. Bruce La Pierre, *Political Accountability in the National Political Process—The Alternative to Judicial Review of Federalism Issues*, 80 NW. U. L. REV. 577, 634-36 (1985); Frank Michelman, *Law's Republic*, 97 YALE L.J. 1493 (1988).

82. *See* Hoke, *supra* note 29.

83. *Id.* at 695.

84. *See id.* at 696. The problem of preserving constitutional liberties for local minorities—for example civil rights, including women's rights and abortion rights, in a scheme where community values are given greater emphasis—is one of the most difficult problems for the communitarian and civic republican school. *See, e.g.*, Cass R. Sunstein, *Interest Groups and American Public Law*, 38 STAN. L. REV. 29, 48-59 (1985). Where economic regulations are concerned these objections have not, barring Commerce Clause objections, generally been viewed as compelling. *Id.* at 53 n.104.

85. *See* Garcia v. San Antonio Transp. Auth., 469 U.S. 528, 547-58 (1985); *see also* Connecticut v. Doehr, 111 S. Ct. 2105 (1991) (holding state property interest brought within protective sphere of Fourteenth Amendment Due Process); Fuentes v. Shevin, 407 U.S. 67, 96-97 (1972) (construing commercial law that violates procedural Due Process as subject to divestment by federal law).

Congress acted on behalf of consumers to limit the hold period on deposited checks[86] in customer accounts, for example, or when the Federal Trade Commission acted to limit the holder-in-due-course doctrine in consumer transactions, the Code necessarily yielded to the effect of the federal law.[87] On the other hand, the Code's posture of comprehensiveness and its historical effectiveness undeniably have played a preventative role, inhibiting federal encroachments.

Considering the historical value of the uniform code approach, the question arises as to whether it is appropriate or desirable to revise the scope and application provisions of the Code in a way that would undermine its very authority. That question is considered next.

IV. OTHER MODELS WITHIN THE CODE: EMBEDDED RELATIONSHIPS OF THE CODE TO FEDERAL LAW

Although pre-revision Article 3 contained no section which explicitly established the Article's relation to federal law, most other articles of the U.C.C. contain "scope" or "relation" provisions which define their relationship not only to other articles but also to other federal or state laws.[88] Each article's scope provision has varied in language and

86. *See infra* note 144 and accompanying text.

87. *See infra* notes 144-45 and accompanying text.

88. Article 1, General Provisions, does not refer directly to federal law, but states that general "principles of law" are displaced by explicit provisions of the Code. U.C.C. § 1-103. Section 1-103 provides that supplemental bodies of law apply to the Code, but its comment makes clear that supplemental laws apply "except as they are explicitly displaced by this Act." *Id.* § 1-103 cmt. 1.

Article 2, Sales, makes no specific reference to federal law, but provides that it does not "impair or repeal any statute regulating sales to consumers, farmers, or other specified classes of buyers." *Id.* § 2-102.

Article 2A, Leases, has been broadly adopted; it contains a scope provision that was subsequently amended. As originally drafted in 1987, § 2A-104 stated that a lease, although subject to Article 2A, was "also subject to any applicable: (a) statute of the United States." *Id.* § 2A-104(2).

In 1990, § 2A-104 was amended to delete subsection (a), because a federal statute "controls without any statement in this Article under applicable principles of preemption." *Id.* § 2A-104 cmt. 2.

Articles 3, 4, and 4A are discussed herein. *See infra* parts IV, V.

Article 5, Letters of Credit, does not contain any discussion of the relation of its rules to inconsistent federal law.

Article 6, Bulk Transfers, was recently revised and contains no provision relating its requirements to federal legislation.

Article 7, Documents of Title, is discussed *infra* notes 133-40 and accompanying text.

Article 8, Investment Securities, contains no scope provision; but the reach and scope of several of its rules hinges upon or is guided by federally established definitions and federal case law. *See, e.g., id.* § 8-102(3) (definition of "clearing corporation"); *id.* § 8-202(2) (rules for estoppel

effect due to the varied development of federal commercial law with respect to each of substantive areas of the U.C.C. In an attempt to compare the posture toward federal law of the new Article 3 scope provision (revised section 3-102(c)), this section considers how the drafters have accommodated existing and prospective federal preemption in Articles 4 and 7. In Article 4, the drafters attempted to contain the effect of federal activity. In Article 7, as in Article 3, they decided to concede completely to federal supremacy even when such supremacy is not mandated.[89]

A. *Section 4-103: Containing Federal Administrative Rules*

Article 4 of the U.C.C. is undoubtedly the most closely intertwined with Article 3. The two provisions were drafted together initially, and have been revised in tandem in the current round of revisions. Article 4 governs bank collections procedures and regulates the way banks process checks and other items.

One can infer that the drafters of the original Article 4 recognized that check collection processes would change as technology evolved. Naturally the Code's general provisions would need to be supplemented by more specific ones that were more readily amendable and closer to prevailing practices of the day and the locality.[90] The text of Article 4 that developed was intended to establish binding principles of law but not to be hermeneutical in its detail.[91] It was written at a level of generality sufficient to allow its principles to accommodate changing developments without becoming obsolete.[92] It offered broad rules designed to

---

against government issuers of securities).

Article 9, Secured Transactions, excludes from its application any security interest "subject to any statute of the United States," to the extent that such statute governs the rights of parties . . . affected." *Id.* § 9-104(a) cmt. 1.

89. Section 3-102(c) of Article 3 provides:

> Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provisions of this Article to the extent of the inconsistency.

Section 4-103 provides in relevant part:

> (1) The effect of the provisions of this Article may be varied by agreement . . . .
>
> (2) Federal Reserve regulations and operating letters, clearing house rules, and the like, have the effect of agreements under subsection (1), whether or not specifically assented to by all parties interested in items handled.

90. WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 4-103:01 (1992).

91. *Id.*

92. *Id.*

anticipate both interstitial court interpretations and administrative gap-filling rules.

The technology and media for the collection of checks changed rapidly during the decades following adoption, as did the number of rules and rulemaking sources supplementing Article 4. Most of these new rules flowed from the Federal Reserve System.[93] It became true, as Professors Jordan and Warren recently wrote, that Article 4 was "merely the tip of the iceberg; it is supplemented or replaced by innumerable local clearinghouse rules, operating circulars issued by the various Reserve Banks, as well as by the Fed's own regulations."[94]

The problem for the drafters of the original Article 4 and Revised Article 4 was to structure an appropriate priority relationship between the U.C.C. and the other rules that resulted from very different federal procedures. From its inception, Article 4 anticipated questions about the relationship of the Code to rules promulgated under the Federal Reserve Board's regulatory authority.

The drafters considered statements in the Code regarding the preemptive effect of valid federal regulations relatively uncontroversial, since "various sections of the Federal Reserve Act . . . authorize the Board of Governors of the Federal Reserve System to direct the Federal Reserve banks to exercise bank collection functions."[95] Where such federal statutes led to the promulgation of valid federal regulations which were intended to alter rules established in the U.C.C., those regulations would have binding effect. Of greater concern, however, were "operating letters, clearinghouse rules, and the like."[96] While these

---

93. Professors Jordan and Warren, in a teaching commentary to Article 4, suggest that because of the length and difficulty of amending uniform laws, it was necessary to anticipate subsequent rules developing outside the uniform law process that would "vary" Article 4:

> Experience shows that these laws are likely to be in force for 30 or 40 years and major revisions may take a decade to get through all the state legislatures. . . . MICR technology was introduced in the early 1960s and new imaging technology is now on the horizon. . . . But the major source for the flexibility that has allowed check collection law to keep up with technological change is found in § 4-103(b) which provides that the Fed's regulations and operating circulars, as well as the clearing house rules, "have the effect of agreements" under § 4-103(a) which allows agreements to vary the provisions of Article 4. The Fed's Regulation J and Regulation CC alter Article 4 in important ways . . . .

Robert L. Jordan & William D. Warren, COMMERCIAL LAW 330-31 (3d ed., Commentary 1992).

94. *Id.* at 330.

95. U.C.C. § 4-103(b) cmt. 2 (citation omitted).

96. The term operating "letter" was revised to reflect the Federal Reserve Bank's practice of referring to them as "circulars" in the Revised § 4-103(b). U.C.C. § 4-103(b). In the text these administrative rules are referred to collectively as "operating circulars."

The lawful effect of private clearinghouse rules generally has not been differentiated in the

rules did not have the status of regulations, they played—and they continue to play—a large role in governing the system. No official publication described or established the process by which operating circulars were developed and promulgated.[97] Clearinghouse rules, promulgated by groups of private commercial banks, were adopted in a private and undefined manner.[98] The proposition that these rules should displace state uniform law provisions was then and continues to be troubling.

The operating circulars with which the drafters have been concerned typically set forth instructions, procedures, and disclaimers related to collection and payment systems that Federal Reserve Banks are authorized to impose on the parties who deal with the Reserve Banks or the Board.[99] The twelve regional Federal Reserve Banks operate under the supervision of the Board of Governors of the Federal Reserve System (a government body), but each Bank individually is "quasi-public" in that it is overseen by a board of directors, a majority of whom are elected by private commercial banks that are members of the Federal Reserve System.[100] Each Federal Reserve Bank promulgates its own circulars under the express authority of the Federal Reserve Act, or pursuant to authority indirectly delegated through a Federal Reserve regulation.[101]

Code or case law. Conclusions in the text regarding the procedural and substantive authority of operating circulars apply *a fortiori* to clearinghouse rules. Local clearinghouses that are part of the Federal Reserve System are essentially groups of private commercial banks that issue rules which govern their members and are designed to facilitate payment transactions engaged in by institutions that maintain clearing-house accounts. *See* JOHN F. DOLAN, UNIFORM COMMERCIAL CODE § 23 (1991).

97. *See infra* note 242.

98. *See infra* note 246 and accompanying text.

99. *See, e.g.*, FEDERAL RESERVE BANK OF NEW YORK, OPERATING CIRCULAR NO. 4: COLLECTION OF CASH ITEMS AND RETURNED CHECKS (revised effective Sept. 1, 1988) [hereinafter OPERATING CIRCULAR NO. 4], which imposes rules including: the type of items the Reserve Bank will handle, *id.* at 5-10; the way the items sent must be prepared, *id.* at 11-16; the extent to which credit for items will be granted and credit made available, *id.* at 17-19; policies regarding returned checks, *id.* at 34-45; limitations on the Reserve Bank's liability for breaches of warranty, *id.* at 46; and the right of the Reserve Bank to charge member banks' accounts under various circumstances, *id.* at 65. The role played by OPERATING CIRCULAR NO. 4 and others may be compared to the role of a vendor's form contract in a "battle of forms" problem in commercial sales contracts, except that member banks are severely restricted in their choice of alternate clearinghouses.

100. *See* David Warsh, *Paul Volcker and the Temple of Doom*, HARV. BUS. REV., May 1988, at 22.

101. Federal Reserve Act §§ 4, 13, 14(e), and 16 (codified, in part, at 12 U.S.C.A. §§ 248, 301, 341, 342, 343, 358 (1989)); 12 C.F.R. §§ 210.25(c), 210.3(a) (1991); *see generally* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL RESERVE SYSTEM: PURPOSES AND FUNCTIONS 105-110 (1984) (discussing the Federal Reserve Board's payment system

Although the circulars are the product of lawfully delegated authority, many do not have the force of law.[102] Nor have they all been promulgated according to the administrative processes and procedures that normally would lend legitimacy to federal regulations.[103] The process through which all operating circulars are promulgated is neither standardized nor formalized. No official publication describes or establishes the method by which they are adopted.[104]

Descriptions of Federal Reserve Board operations indicate that some operating circulars are unique to individual Reserve Banks, while others are uniformly adopted throughout the Federal Reserve System.[105] The Reserve Banks follow individualized practices when they draft operating circulars. When operating circulars are uniformly adopted, it appears that the Reserve Banks cooperate in drafting the language of a circular and then submit it to the Federal Reserve Board. The Federal Reserve Board then adopts that operating circular as its own for uniform application by all of the regional Reserve banks.[106]

Although Congress explicitly has sanctioned the issuance of some operating circulars by the Federal Reserve Board,[107] the procedures used by the Board and Banks to promulgate them do not conform to the ordinary rulemaking standards established by Congress for the promulgation of regulations, under the Administrative Procedure Act

---

responsibilities).

102. See Miller, *supra* note 26, at 531-32.

103. *See* Administrative Procedure Act, 5 U.S.C. §§ 551-706 (West 1992); *see also* STEPHEN G. BREYER & RICHARD B. STEWART, ADMINISTRATIVE LAW AND REGULATORY POLICY 561-623 (1985); STRAUSS, *supra* note 7, at 155-84.

104. Telephone interview with Thomas C. Baxter, Esq., Counsel to the Federal Reserve Bank of New York (Oct. 25, 1993) (notes on file with the author). Mr. Baxter indicated that although there is no publication that describes the process of developing operating circulars, the practice is rather routine. A group of lawyers from several Federal Reserve Banks known as the subcommittee of "counsel on payments" meet to consider changes to the circulars. Agreed-upon changes are submitted to a subcommittee on the "payments mechanism," which forwards them to the Board of Governors, which reviews them for consistency with other such rules and allows the circulars to be sent out. Comment on the circulars is frequently solicited from banks. According to Mr. Baxter there is no similar process involved in the promulgation of rules by the clearinghouses, which are composed of private commercial banks. *Id.*; *see also* HAWKLAND, *supra* note 90, § 4-103:04,05 (1992).

105. *See* U.C.C. § 4-103 cmt. 3.

106. Telephone Interview with Thomas C. Baxter, Esq., Counsel to the Federal Reserve Bank of New York (October 22, 1993) (notes on file with the author); *see also* U.C.C. § 3-102 cmt. 3; *id.* § 4-103 cmt. 2 ("Federal Reserve regulations," "Federal Reserve operating circulars," "And the like").

107. *See* discussion of Expedited Funds Availability Act, *supra* note 72.

("A.P.A.").[108] Section 553(b) of the A.P.A generally requires that public notice be given of proposed rules. No similar law governs operating circulars. Section 553(c) of the A.P.A. generally requires the regulatory agency to elicit comment from interested parties concerning the proposed rule. Moreover, there are no mandatory opportunities for public notice and comment in the process of creating operating circulars. There are no elected or politically appointed officials directly accountable for the content of the operating circulars. An interested party may not have the opportunity to question the result of an operating circular until after it is already in effect.[109] The undocumented process that private commercial banks employ to develop clearinghouse rules apparently is even less systematic than the process by which operating circulars are developed.[110]

The drafters of Article 4 were aware of the substantial discrepancies in the processes by which the Code and the circulars were developed. The drafters took note of the fact that whereas the enacted Code of each state constituted binding law within its jurisdiction, the operating circulars and clearinghouse rules were applicable only to "members" of the system.[111] They undoubtedly also considered the larger policy objectives, discussed above, of the proponents of uniform law. These considerations led them to handle with special delicacy the question of whether "operating letters, clearinghouse rules, and the like,"[112] could "vary" Article 4.

An articulated purpose of the movement for uniform laws, as indicated in part III, was to stem the tide of the administrative federalization of state law by diminishing the need for federal intervention in the

108. 5 U.S.C. §§ 551-706 (West 1992); *see infra* note 242.

109. The Reserve Banks do not require the same notice and comment periods required by the Administrative Procedure Act. "In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, a Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board." Revised U.C.C. § 3-102 cmt. 3 (1990).

For a consideration of the difficulties of challenging rulings developed within the Internal Revenue Service but without conventional APA protections, see generally Linda Galler, *Emerging Standards for Judicial Rulings*, 72 B.U. L. REV. 841 (1993).

110. *See infra* note 242.

111. *See* U.C.C. § 4-103 cmt. 3. In 1980, Congress enacted the Monetary Control Act of 1980, Pub. L. No. 96-221, tit. I, 94 Stat. 132, 132-41. The Act provided that all banks in the United States would be required to maintain reserves with the Federal Reserve System. In addition, check clearing services were to be made available to all banks regardless of whether they were members. *Id.*

112. U.C.C. § 4-103 cmt. 3; *see infra* notes 116-31 and accompanying text.

interest of uniformity.[113] Given this purpose, provisions of the Code were not to be displaced whenever a Federal Reserve circular either immunized conduct that the Code repudiated or mandated conduct that the Code did not. Validly issued regulations having the force of law might require the subordination of contrary state laws, but many valid operating circulars did not have such an effect since they did not carry the force of law.[114]

Deliberations over the Code resulted in a compromise that sought to establish a proper balance between federal administrative rules and state authority. In explicit language in section 4-103 and its lengthy official comment, the drafters created broad opportunities for operating circulars to vary Code outcomes.[115] But these opportunities flowed from private contractual provisions negotiated by the parties—not from any constitutional grant of power to the Federal Reserve.

Section 4-103(b) declared that Article 4 could be varied by agreement, and that regulations, operating "letters," and similar agency rules were merely "agreements."[116] A reading of that section clarifies neither what is variable[117] by agreement of the parties nor what constitutes an agreement.[118] Nonetheless, the drafters appeared to reach an accommodation that reinforced traditional rulemaking practices in the Federal Reserve System without implicating preemption theories or automatically invoking displacement of the U.C.C.

The section 4-103 "agreements" provision allowed operating circulars to "vary" Article 4 in most of the cases that were important to the efficient operation of the Federal Reserve System.[119] But the justification for this power did not rest on the theory that circulars presumptively superseded Article 4 because they were statutorily authorized and had intrinsic preemptive force. Instead, circulars varied the statu-

---

113. *See* Miller, *supra* note 1, at 412-13; White, *supra* note 57, at 2101.

114. The policy considerations examined when § 4-103 was originally drafted are discussed in HAWKLAND, *supra* note 90, § 4-103. The modification of § 4-103 regarding regulations and operating letters occurred in 1951, as the product of the "M and M" team of Walter Malcolm and Soia Mentchikoff. This was a revision to save Article 4 from elimination. *Id.* at 147.

115. *See* U.C.C. § 4-103 cmt. 3 (1987). This guidance is substantially retained in revised § 4-103, which was modified without any intent to change its substance. *See* U.C.C. § 4-103 cmt. 3 (1990).

116. U.C.C. § 4-103(b).

117. *See* HAWKLAND, *supra* note 90, § 4-103:03, at 166-74.

118. *Id.*, § 4-103:02, at 148-66.

119. *See* United States Fidelity & Guaranty Co. v. Federal Reserve Bank of N.Y., 590 F. Supp. 486 (S.D.N.Y. 1984), *aff'd*, 786 F.2d 77 (2d Cir. 1986).

tory provisions of Article 4 through the application of classical contract theory.

Operating circulars could vary Article 4 provisions in two distinct ways. First, they were applicable as agreements "whether or not specifically assented to by all parties" under section 4-103(2).[120] Second, the establishment of customary conduct or trade usage in accordance with an operating circular, in a transaction covered by an operating circular, could produce an "agreement" under section 4-103(1). The official comments to 4-103(2) made it clear that the word "agreement" was intended to incorporate the statutory definition set forth in U.C.C. section 1-201(3), which included those agreements that could be implied from commercial practice.[121] The comments went on to observe that operating letters "issued pursuant to the regulations and concerned with operating details" were valid *as agreements*, and were, under traditional theories of contract, "appropriate means, within their proper sphere, to vary the effect of the article."[122]

The rule established in section 4-103 proved durable and malleable in the hands of courts. For example, with respect to the important question of who was bound by an operating circular under the Code's theory of agency, courts typically held that operating circulars were "contracts binding on parties having an interest in items handled by the Reserve Bank in question."[123] The rule regarding "operating letters" in Article 4 was "specifically drafted to confer a special status on Federal Reserve regulations and quasi-official rules by permitting such rules by themselves to vary the effect of Article 4 provisions," but only "where parties to a transaction used collecting banks as agents [who] have authority to make binding agreements with respect to items being handled."[124] If no agreement could be implied, and an operating circular did not create a customary practice, courts would not enforce the rule of the circular.[125] Nor would operating circulars be given the force

120. *See* Security Bank and Trust Co. v. Federal Nat'l Bank and Trust Co., 554 P.2d 119 (Okla. Ct. App. 1976) (Federal Reserve operating letter requiring notice by wire supersedes U.C.C. § 4-103, which requires written notice from payor banks.).

121. U.C.C. § 4-103 cmt. 3; *cf.* Delbrueck & Co. v. Manufacturers Hanover Trust Co., 609 F.2d 1047, 1050 (2d Cir. 1979) ("The practices associated with banking transactions can be conclusive evidence of the legal effect of those transactions.").

122. U.C.C. § 4-103 cmt. 3.

123. *See* United States Fidelity & Guaranty, 590 F. Supp. at 492 (scope language of an operating circular generally determines who is bound by a circular); *see also* U.C.C. §§ 4-103(1)-(2).

124. U.C.C. § 4-103 cmt. 3.

125. *See, e.g.*, Appliance Buyers Credit Corp. v. Prospect Nat'l Bank of Peoria, 505 F.

of law—they would be interpreted as elements of a contractual relationship between the parties.[126] As one court concluded when it declined to allow the requirements of an operating circular to vary Code requirements in a transaction involving allegations of liability of a Federal Reserve Bank, the Article 4 reference to the Federal Reserve regulations and operating letters provided "a kind of instant accommodation between the U.C.C. and Federal Reserve governance of transactions within the Federal Reserve System," but not a license for the Federal Reserve Board to make law.[127]

The problem of preventing federal preemption of part of the U.C.C. by administrative fiat thus was resolved deftly in a manner that did not implicate federalism or invoke a constitutional theory of preemption. Moreover, prior to the recent revisions to the U.C.C., all of the reported caselaw which considered the ability of operating circulars to vary the U.C.C., approached the issue within the context established by Article 4. The cases involved private parties or banking institutions seeking either to hold a Federal Reserve Bank responsible pursuant to Article 4 for a loss attributable to its negligence in the collection process, or else seeking to avoid liability for dishonored instruments by claiming that rules established by circulars are not applicable to them.[128]

On one hand, the language of section 4-103 represented a victory for federal authority, since in most of the Article 4 case law courts interpreted federal operating circulars and clearinghouse letters as "agreements" of the parties.[129] On the other hand, the drafters preserved the integrity and comprehensiveness of the U.C.C. None of the cases testing the supersession of Article 4 by operating circulars established that an operating circular preempts a provision of the Code as a

---

Supp. 163 (C. D. Ill. 1981), aff'd 908 F.2d 290 (7th Cir. 1983).

126. *See* Wells Fargo Bank v. Hartford Nat'l Bank & Trust Co., 484 F. Supp. 817, 821 (D. Conn. 1980).

127. *See* Gulfstream Bank v. Irving Trust Co., No. 82, Cir. 4126, slip op., at 10 (S.D.N.Y. 1983). Lexis, GENFED Library, Courts file; *c.f.* U.C.C. § 4-213 (allowing "Federal Reserve regulations or circulars, clearinghouse rules, and the like" to prescribe the medium and time of settlement by a bank).

128. *See, e.g.*, Empire Nat'l Bank v. Chester Nat'l Bank, 320 N.Y.S.2d 705 (1971); *see also infra* notes 170-86 and accompanying text.

129. *See, e.g.*, Greater Buffalo Press, Inc. v. Federal Reserve Bank of N.Y., 866 F.2d 38, 45 (2d Cir. 1989) (Regulation J binding); Appliance Buyers Credit Corp. v. Prospect Nat'l Bank of Peoria, 505 F. Supp. 163, 164 (C.D. Ill. 1981) (same), *aff'd*, 908 F.2d 290 (7th Cir. 1983). *But see* Colorado Nat'l Bank v. First Nat'l Bank, 459 F. Supp. 1366, 1373 (W.D. Mich. 1978) (questioning the ability in all circumstances of operating circulars to vary provisions of the U.C.C.).

matter of constitutional law.[130] Federal authorities might seek to expand their own powers by advocating broader interpretation of the "agreements" language, or through Congressional action. The U.C.C. drafters, however, did not endorse this behavior.

In short, the Article 4 approach aimed to maximize the substantial benefits of uniformity and predictability while minimizing the substantive disadvantages and procedural deficiencies stemming from centralized control. The "agreements" provision in Article 4 attempted, with partial success, to preserve these benefits. It harmonized the state's interest in autonomy with the interests of the Federal Reserve System in creating a uniform payment system. No doubt this remains the justification for the provision in revised section 4-103, since it persists virtually unchanged despite the Federal Reserve's power to federalize much of the collection process.[131]

B. Section 7-103: Conceding Federal Administrative Displacement[132]

By contrast, a far more deferential approach toward federalization is adopted in Article 7 of the U.C.C. entitled "Warehouse Receipts, Bills of Lading and Other Documents of Title." Article 7 was formulated essentially as a revision and recodification of the Uniform Warehouse Receipts Act, the Federal Uniform Bills of Lading Act, and provisions of the Uniform Sales Act relating to the negotiation of documents of title.[133] While there were some major changes from the older uniform laws, the drafters closely followed prior state and federal law in this area. Federal and international law played a strong preemptive role in this area, which always had a strong interstate commerce orientation, beginning in 1906 with the passage of the Federal Bills of Lading Act.[134]

---

130. *See Greater Buffalo, supra* note 129, at 44. (the Supremacy Clause requires the U.C.C. to be read together with applicable federal statutes and regulations).

131. U.C.C. § 4-103. Although § 4-103 remains unchanged in the revision, the scope for the operation of regulations and operating circulars has been considerably enlarged as a result of Congressional action. *See supra* notes 5-6 and accompanying text.

132. U.C.C. § 7-103 (West 1990).

133. *Id.* § 7-101 cmt. 1 (West 1987); HAWKLAND, *supra* note 90, § 7-101:01, at 2.

134. *See* Federal Bills of Lading Act, 49 U.S.C. app. § 81 (1989) (listing all interstate, intrastate and foreign transportation as items covered by the federal law of bills of lading); Interstate Commerce Act, 49 U.S.C. § 11701 (1988) (granting the Interstate Commerce Commission the power to investigate foreign motor carriers violating the Interstate Commerce Act); Rio Grand Motor Way, Inc. v. Resort Graphics, Inc., 740 P.2d 517, 520 (Colo. 1987) (holding that, where state law governing warehouseman's liens conflicts with federal provisions, the federal law preempts state law); Starmakers Publishing Corp. v. Acme Fast Freight, Inc., 615 F. Supp. 787,

The drafters of Article 7 thus needed to adapt the new state codification to accommodate federal law in the field of warehouse receipts. The scope provision of Article 7, section 7-103, entitled "Relation of Article to Treaty, Statute, Tariff, Classification or Regulation," was drafted to recognize the supremacy of both federal and state laws outside the Code: "[t]o the extent that any treaty or statute of the United States, regulatory statute of this State, or tariff, classification or regulation filed or issued pursuant thereto is applicable, the provisions of this Article are subject thereto."[135] The comments indicate that the drafters were concerned with federal statutes and regulations with the force of law, and that they adopted the scope provision "[t]o make clear what would of course be true without the Section, that applicable Federal law is paramount."[136]

Article 7 has not been revised substantially since its inception. Since then, section 7-103 has been referred to primarily to emphasize that conflicts between the Code and federal law are to be resolved in the favor of federal preemption.[137] For example, federal tariffs have been held to apply to cotton warehouse documents notwithstanding Code-approved limitations in bills of lading.[138] Similarly, federally established interpretations of "customary practices" in oil purchase agreements have been upheld notwithstanding Code-approved limitations by agreement.[139]

It is unnecessary to address whether the concessionary approach of section 7-103 has resulted in an efficient or otherwise preferable compromise between flexibility and predictability in rulemaking. The presence of prior federal law made the acknowledgement of federal dominance in section 7-103 an articulation of the obvious. However, if that provision suggests that the Code is preempted not merely by statutes

---

791 (S.D.N.Y. 1985) (holding that, with respect to interstate shipments, Interstate Commerce Act, not U.C.C. Article 7, is the governing law).

135. U.C.C. § 7-103.

136. *Id.* § 7-103 cmt. 1.

137. *See infra* note 139.

138. *See, e.g., In re* Julien Co., 1992 Bankr. Advers. Proc. No. 90-0137, LEXIS 2428, at *24 (W.D. Tenn. 1992) (Section 7-103 provides for relevant federal tariffs to govern cotton warehouse receipts but does not provide for allowance of general lien merely by reference to federal tariffs on the face of the receipts.).

139. *See also* North Am. Phillips Corp. v. Emery Air Freight Corp., 579 F.2d 229, 233-34 (2d Cir. 1978) (stating that federal law preempts all state law in the field of interstate shipment of freight); National Garment Co. v. New York, Chicago & St. Louis R.R. Co., 173 F.2d 32, 35 (8th Cir. 1949) (holding that federal law preempts state law with respect to the interpretation of bills of lading).

and regulations but by all forms of federal administrative law, it has far-reaching implications. Moreover, section 7-103 seems to imply that Article 7 also will yield to future federal rules, whether or not those rules hold the force of law.[140]

V. PUZZLE: EVALUATING THE MEANING OF SECTION 3-102(c)

A. *Negotiable Instruments Law as State Law*

Why, in a world of diminishing state regulatory authority where states have decried the trend toward federalization, should the states legislate uniform laws which appear broadly and unpredictably to circumscribe their own legislative authority? Apart from Articles 3, 4, 7[141] and 4A of the Code,[142] and a few other examples of state commer-

---

140. In light of § 7-103, there have been no successful challenges to the preemption of Article 7 by mere administrative rules. As indicated, *supra* notes 132-39, various federal tariff schedules and interpretations have been upheld in light of § 7-103. *See also* Iligan Integrated Steel Mills, Inc. v. S.S. John Wegerhauser, 507 F.2d 68, 73 n.5 (2d Cir. 1974) (stating that the terms of tariffs will preempt Article 7), *cert. denied*, 421 U.S. 965 (1975); Thomas R. Denniston et al., *Liabilities of Multimodal Operators and Parties other than Carriers and Shippers*, 64 TUL. L. REV. 517, 526 (1980) ("Section 7-103 of the UCC would suggest that pre-approved tariffs should control over the terms of the Code.").

141. *See supra* notes 132-39 and accompanying text.

142. *See, e.g.*, The Truth in Lending Act, 15 U.S.C. § 1666(j) (preempting inconsistent laws "only to the extent of inconsistency").

Article 4A governs wholesale wire transfers, usually between business or financial institutions. Section 4A-107 states that "Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency." Revised U.C.C. § 4A-107 (West 1990). Although the relevant language of § 4A-107 is identical to that of § 3-102(c), it does not present the same problems as Article 3 because the Federal Reserve Banks are intimately involved in the process of wire payments through existing federal statutes and regulations. Furthermore, Article 4A excludes consumer transfers. Indeed, the law of bulk electronic funds transfers might more properly have been enacted as federal law than as an addition to the U.C.C. *See* Patrick B. Fry, *Basic Concepts in Article 4A: Scope and Definitions*, 45 BUS. LAW. 1401, 1419-20 n.101 (1990). Professor Fry states:

> Strong arguments for federal enactment of Article 4A have been made within the Ad Hoc Committee [on Payment Systems], pointing out that a significant portion of the transfers being governed by Article 4A cross state lines. The project nonetheless has gone forward for enactment by the states as a new article in the Uniform Commercial Code. The deference given to regulations and operating letters is justified on several bases, including the power of Congress to federalize payments law, the technology-driven nature of the funds transfers governed by Article 4A and the prospect that developments in technology will alter the regulatory needs of the system, the time and expense inherent in the process of amending uniform state laws, and the risks which a lack of uniformity would impose on the payment system.

Id. (citation omitted); *see also* David B. Goldstein, *Federal Versus State Adoption of Article 4A*, 45 BUS. LAW. 1513 (1990).

cial law,[143] states have not incorporated language which endorses preemption or administrative displacement of state law.

Article 3, moreover, is an unlikely candidate for inclusion of preemption language as open-ended as that of Articles 4 and 7 because, as differentiated from the subject matter of Articles 4 and 7, neither the Federal Reserve Banks nor federal regulatory schemes play an expansive role in the field of negotiable instruments law.[144] The subject matter of Article 3 encompasses rules pertaining to checks and aspects of the payment system with which the Federal Reserve Board also is concerned, but except to the extent that Article 3 is implicated in the process of bank collections, there are no current federal statutes or regulations that expressly permit the Federal Reserve Board to preempt Article 3.[145]

Common law principles have played a primary role in the development of contract law. In the post-*Erie* era, courts regularly have relied on contract law principles when determining the liability of parties to negotiable instruments.[146] Accordingly, a state court's statutory interpretation is fundamental to the general law of commercial transactions.[147] Congress has chosen not to federalize state negotiable instruments law apart from the EFAA (discussed *infra*), federal securities regulation, and the law relating to certain documents of title.[148] Although Congress gave the Federal Reserve Board the authority to make

143. *See supra* note 40 and accompanying text.

144. *See* Expedited Funds Availability Act, 12 U.S.C. § 4007 (1988); see also 16 C.F.R. § 433 (1993), preserving consumers' claims and defenses in credit sales by requiring that credit contracts place holders on notice that they are subject to claims and defenses of the debtor, and thus indirectly revoking Article 3 protections for holders in due course in consumer transactions. The rule is now explicitly and particularly incorporated into U.C.C. revised § 3-106(d) (West 1990).

145. Article 3 contains some collection rules—for example, those relating to presentment and dishonor in Part 5 of Article 3—that are also covered by Article 4. Because Article 4 would control Article 3 in such cases, and because under § 4-103 Federal Reserve operating circulars may vary Article 4, the Federal Reserve already indirectly varies some rule stated in Article 3. *See supra* text accompanying notes 118-21. Section 4-102 provides that the provisions of Article 4 govern when items within Article 4 also come within the scope of Article 3. U.C.C. § 4-102(1) (West 1987).

146. HENRY J. BAILEY & RICHARD B. HAGEDORN, BRADY ON BANK CHECKS ¶ 1.2 (7th ed. 1992) (quoted in Goldstein, *supra* note 142, at 1514).

147. Prior to the decision in Erie Railroad Co. v. Tompkins, 304 U.S. 64 (1938), a federal common law of commercial transactions had developed under the rule in Swift v. Tyson, 41 U.S. (16 Pet.) 1 (1842).

148. *See supra* part IV. B; Henry J. Bailey, *New 1990 Uniform Commercial Code: Article 3, Negotiable Instruments, and Article 4, Bank Deposits and Collections*, 29 WILLAMETTE L. REV. 409, 413-14 (1993); *see also* White, *supra* note 57, at 2103.

laws to regulate "the payment system" and to develop a system of check clearing and collections, it has not empowered the Federal Reserve Board to make general rules governing the broader law of negotiable instruments that is the subject matter of Article 3.[149]

Notwithstanding the historically inobtrusive role of the Federal Reserve in most aspects of Article 3 law, section 3-102(c) apparently facilitates an enlarged role. At the least, it leaves unresolved issues regarding the provision's legal operation and its appropriateness as a matter of the Code's underlying rationale.

B. The Provision Itself

U.C.C. revised section 3-102(c) is identical to Revised Article 4A-107[150] and resembles some *federal* statutes.[151] As noted earlier, section 3-102(c) declares that "Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency."[152] Although it has been suggested that "[r]evised Article 3, particularly when its comments are considered, is much clearer than former Article 3 on its relationship with federal law,"[153] from the states' perspective, the relationship appears neither clear nor fortunate.[154]

---

149. Whereas pre-revision Article 3 was entitled "Commercial Paper," Article 3 is now entitled "Negotiable Instruments." The new title recalls the roots of the Code in the older Negotiable Instruments Law, and also constitutes a limitation on the article's scope. *See* Bailey, *supra* note 148, at 413-14; Miller, *supra* note 1, at 416.

150. *See* text of revised U.C.C. § 4A-107. The inclusion of this preemption provision within Article 4A is less problematic than the inclusion of a similar provision in Article 3, because Article 4A deals with wire transfers, most notably the FedWire system, the premier wire transfer system in the world, owned and operated by the twelve Federal Reserve Banks. *See* Thomas C. Baxter, Jr. & Raj Bhala, *The Interrelationship of Article 4A with Other Law*, 45 BUS. LAW. 1485, 1493 (1990). Regulations and operating circulars naturally govern the system to the exclusion of state law. In contrast, no central aspect of Article 3 has ever been dominated by the Federal Reserve Banks. *See supra* notes 143-45 and accompanying text; Bailey, *supra* note 148, at 413-14. The comment to § 4A-107 states that the section treated operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation. Revised U.C.C. § 4A-107 cmt. 3.

151. *See supra* note 144.

152. U.C.C. § 3-102(c).

153. Miller, *supra* note 1, at 419-20.

154. The vantage point assumed here acknowledges that federalism concerns often are to be explained in terms of political and economic self interest. *See* Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism*, 76 VA. L. REV. 265, 265-69 (1990). Nonetheless, the Code promotes a valuable diversity of policy perspectives, of both a self-interested and public spirited nature, which

One may argue that a state's adoption of section 3-102(c) is superfluous since only Congress can authorize the preemption of state law under valid constitutional authority. From this perspective, the provision is only an innocuous and impotent reminder of the regulatory corollary to the Supremacy Clause discussed in Part I—valid federal regulations that serve important federal purposes, even those concerning subject matter different from that of state law, will displace state law.[155] Accordingly, one reading of section 3-102(c) is that it has no essential purpose except as a restatement of constitutional principle.[156] Indeed, a perceptive discussion of the revisions to Articles 3 and 4 by Professor Fred Miller, a member of the ALI/NCCUSL Permanent Editorial Board,[157] describes the endorsement of federal regulatory preemption contained in section 3-102(c) as "predominantly" a clarification of existing law that already is deferential to the Board of Governors of the Federal Reserve System, and one that is "essentially . . . no more than a statement of basic constitutional law."[158] To the extent that section 3-102(c) merely restates existing law regarding preemption, it is superfluous.[159]

A kindred provision in Article 2A, Leases, was deleted from that article as unnecessary, and, one posits, potentially undesirable if it was intended to have an effect other than mere restatement.[160] Section 3-

---

would otherwise be absent in a centralized scheme. *See supra* note 67 and accompanying text.

155. *See* Miller, *supra* note 1, at 433-34.

156. Regarding whether a regulatory purpose is essential to the statutory scheme so that preemption of an inconsistent state law must result, see Henry Monaghan, *Marbury and the Administrative State*, 83 COLUM. L. REV. 1 (1983).

157. Formed in 1961, the Permanent Editorial Board ("P.E.B.") evolved from the Editorial Board for the original Uniform Commercial Code. *See* Miller, *supra* note 1, at 406. Its purposes include considering and drafting new provisions of the U.C.C. and issuing commentary to existing provisions pursuant to authority specified in U.C.C. § 1-102(2). The P.E.B., among other things, is authorized to clarify or elaborate upon the operation of the U.C.C. as it relates to other statutes, such as the Bankruptcy Code and the various federal and state consumer protection statutes. *See* Permanent Editorial Board for the Uniform Commercial Code, *PEB Commentary on the Uniform Commercial Code*, 9 UNIFORM COMMERCIAL CODE SERIES PEB COMM. 1, 4 (William D. Hawkland ed., 1990).

158. Miller, *supra* note 1, at 420. Professor Miller also states that § 3-102 is subordinate to operating circulars of the Federal Reserve Banks in ways that "would not always be mandated absent an express articulation." *Id.*

159. *Id.*

160. *See supra* note 73. As originally drafted in 1987, § 2A-104(1)(a) stated that a lease, although subject to 2A, was "also subject to any applicable statute of the United States." U.C.C. § 2A-104(1)(a) (West 1987). The provision was deleted in 1990 because a federal statute "controls without any statement in this Article under applicable principles of preemption." Revised U.C.C. § 2A-104 cmt. 2 (West 1990).

102(c) presents the same problem especially since, prior to revision, Article 3 defined the authority of the states in unconfined terms.[161] In this context, even a seemingly innocuous statement of an indisputable fact regarding federal preemption can have interpretational significance when located in a state statute rather than a federal one.[162] Furthermore, by granting operating circulars superseding effect, section 3-102(c) explicitly permits unilateral actions of non-elected officials in the Federal Reserve bureaucracy to displace the determinations of elected state legislators, and to become part of state law when they would otherwise have no preemptive effect.

Apart from the "endorsement" and "displacement" aspects of section 3-102(c), therefore, the "restatement" aspect seems inappropriate. If Congress had drafted a statute which created a federal law of negotiable instruments, and then authorized the Federal Reserve Board to issue suitable regulations, it would not be odd to find language *within the federal statute or regulation* which allowed regulations of the Federal Reserve Board to supersede inconsistent state laws. But the very same language placed within a state statute such as Revised Article 3 presents a judicial quandary. Courts will, logically, turn to the official comments in order to ascertain the drafters' intent.

C. *The Official Comments*

The official comment applicable to revised section 3-102 furthers the impression that subsection (c) serves the limited purpose of restatement. The comment states that federal regulations and statutes "may preempt Article 3."[163] As an example, it refers to the statute which authorizes the Federal Reserve Board to regulate the duty of banks to make funds available for withdrawal and to create procedures incident to this purpose.[164]

---

161. *See supra* note 149 and accompanying text. "Instruments" are "negotiable instruments" under Article III. Revised U.C.C. § 3-102 cmt. 1.

162. *See infra* notes 225-42 and accompanying text.

163. Revised U.C.C. § 3-102 cmt. 3.

164. *Id.* Comment 3 to Revised § 3-102 states:

Although the terms of Article 3 apply to transactions by Federal Reserve Banks, federal preemption would make ineffective any Article 3 provision that conflicts with federal law. The activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board . . . Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a

This solitary statutory reference to the Expedited Funds Availability Act ("EFAA")[165] in the comments does not advance the inquiry very far. The principal regulations that interpret the EFAA are Regulations J[166] and CC.[167] These provisions regulate the system of check collection, and the bank deposit and collection system that is the focus of Article 4. While the EFAA does not restrict its preemptive effect to any portion of the Code, neither does it implicate Article 3 extensively.[168] Thus, the important question is what regulatory incursions on Article 3 can the EFAA justify?

The comment pertaining to section 3-102(c) suggests that courts faced with that provision must preempt Article 3 to the extent that it proves inconsistent with Federal Reserve rules or regulations. An example of such a regulation is the Federal Reserve rule that shortens the wait of a check depositor for funds to be available.[169]

In the same vein, the case referred to in the official commentary relating to revised section 3-102(c), *Childs v. Federal Reserve Bank of*

> federal statute, take precedence over state law if there is an inconsistency. Section 3-102(c) treats operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation. Federal statutes may also preempt Article 3. For example, the Expedited Funds Availability Act, 12 U.S.C. § 4001-4010 (1988), provides that the Act and the regulations issued pursuant to the Act supersede any inconsistent provisions of the U.C.C.

Id. (citations omitted). Comment 3 to § 4A-107 is written in language almost identical to 3-102(c). It states:

> Although the terms of Article 4A apply to funds transfers involving Federal Reserve Banks, federal preemption would make ineffective any Article 4A provision that conflicts with federal law. The payments activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. . . Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. Section 4A-107 treats operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation.

Revised U.C.C. § 4A-107 cmt. 3 (citations omitted).

165. 12 U.S.C. §§ 4001-4010 (1988).

166. Codified at 12 C.F.R. § 210 (1993).

167. Codified at 12 C.F.R. § 229 (1993).

168. There are situations in which Regulation CC establishes alternative, more restrictive methods for conduct more generally described by Article 3. *Compare* revised U.C.C. § 3-503 (requiring only notice of dishonor) *with* Reg. CC, 12 C.F.R. § 229.30 (requiring physical return of dishonored check).

169. *See* Expedited Funds Availability Act, 12 U.S.C. §§ 4001-4010 (1988).

Dallas,[170] sheds little light on these problems. In *Childs*, the plaintiff deposited a $200,000 check in his checking account at the Bank of Commerce in Fort Worth, Texas. That bank sent the check through the Federal Reserve Bank of Dallas. The check was ultimately presented to the Continental National Bank of El Paso, the payor (check drawer's) bank.[171] More than a month later, Childs drew $200,000 worth of checks on his account at the Bank of Commerce. Several weeks later, the Bank of Commerce notified Childs that the payor bank had dishonored and returned for insufficient funds the $200,000 check. Childs was informed that he would have to repay the $200,000 he had withdrawn from his bank.[172]

Childs sued the Federal Reserve Bank of Dallas, alleging that but for the delays of the Federal Reserve Bank in processing his check, it would have been accepted by the payor bank because it would have arrived when there were still sufficient funds in the drawer's account.[173] He sued under Article 4, section 4-202 of the U.C.C., and contended that the Federal Reserve Bank of Dallas violated a duty of care that it owed to him under that provision.[174]

The Federal Reserve Bank in *Childs* relied upon Regulation J in its defense.[175] Regulation J sets out the Federal Reserve Board's rules for collecting and returning checks and other items, and for settling balances. At the time of the case, the relevant portion of Regulation J read:

> A Reserve Bank shall act only as the sender's agent in respect of an item . . . A Reserve Bank shall not act as agent or subagent of an owner or holder of an item other than the sender. A Reserve Bank shall not have or assume any liability to the sender in respect to an item of its proceeds except for the Reserve Bank's own lack of good faith or failure to exercise ordinary care.[176]

The Federal Reserve Bank argued that its duty of care did not extend to a remote check owner such as Childs because Regulation J, by severing the Reserve Bank's agency relationship with Childs, likewise severed the duty which Article 4 normally mandated.[177]

---

170. 719 F.2d 812 (5th Cir. 1983).
171. *Id.*
172. 719 F.2d at 813-15.
173. *Id.* at 813.
174. *Id.* at 814.
175. *See id.*
176. *Id.* (quoting 12 C.F.R. § 210.6(a)(1) (1981)).
177. *See id.*

Childs contended that the rules set out in Article 4 of the Uniform Commercial Code, and especially the "duty of care" obligation set out in section 4-201, existed independently of the Regulation J rule.[178] Regulation J, Childs maintained, was not inconsistent with recovery under the Code, because Article 4 does not make an agency relationship a prerequisite to recovery. Childs also argued that Regulation J's immunization of reserve banks from liability to check owners was statutorily invalid.[179]

The Court of Appeals for the Fifth Circuit decided in favor of the Federal Reserve Bank. It determined that an agency relationship was indispensable to recovery under a U.C.C. theory of breach of duty of care.[180] Furthermore, the court held that Regulation J severed any agency relationship existing under Article 4 between a Reserve Bank and the owner of an item in the collections process.[181] The court further held that Regulation J was appropriately authorized, and that its promulgation was "a lawful exercise of that authority, as it enables the federal reserve system to perform its check collection and clearinghouse functions" in the Federal Reserve Regulations. In sum, the court determined that Regulation J had displaced the Article 4 agency obligations of a Federal Reserve Bank.[182]

Childs certainly stands for the proposition that valid federal regulations which promote the Federal Reserve check-clearing system legitimately insulate Federal Reserve Banks from claims that might otherwise have merit under Article 4 (and common law) theories of negligence. The Federal Reserve Board is legitimately authorized by Congress to enact regulations that protect the Federal Reserve check collection system. Enforcement of the Article 4 rule creating a duty of care would have allowed claims that federal regulation intended to disallow, and so was preempted.

Nevertheless, *Childs* does not intimate that Federal Reserve Regulations always will or should survive state attacks on their validity.[183]

---

178. *Id.*

179. *Id.* at 814-15.

180. *Id.* at 814.

181. *Id.*

182. *Id.* at 815. The court cited 12 U.S.C. § 342 (Supp. 1981) and 12 U.S.C. §§ 248(o), 360 (Supp. 1981) as the relevant statutes granting the authority to issue Regulation J. *Id.*

183. *See* Dimension Fin. Corp. v. Board of Governors of Fed. Reserve Sys., 744 F.2d 1402, 1408-11 (10th Cir. 1984) (invalidating FRB regulation defining "commercial loan" in a manner that explained the jurisdiction of the FRB); Basham v. Finance Am. Corp., 583 F.2d 918, 924 (7th Cir. 1978) (interpreting Truth in Lending Act in light of Uniform Commercial Code require-

Nor does *Childs* establish that a federal regulatory agency's determination of inconsistency always will survive court scrutiny[184] or necessarily result in a "supersession," rather than complimentary enforcement, of state law.[185] Furthermore, it does not in any way justify the insertion of a new endorsement rule into Article 3 or 4 which might be interpreted to expand the displacement of state law. Therefore, resort to the analysis in *Childs* or its progeny cannot clarify the impact of a state-enacted preemption provision on either the breadth of a federal statutory delegation of legislative power or on the extent of the conflict necessary to result in a preemption of state law.[186]

Taken as a whole, the commentary to the new preemption rule does no more than acknowledge the persistence of conventional preemption doctrine without attempting to describe its contours or regulatory limits in relation to Article 3. Until now, the preemptive force of Regulations J and CC has resulted from their validity as duly enacted rules promulgated under authorized delegations of congressional power, coupled with irreconcilable conflicts with state law. No reported case attributes that preemptive force to any provision arising under state law. Thus, neither the text of section 3-102(c) nor the comments following it have been relied upon by courts to determine whether a state law will be preempted. The comments do not refer to any precedent that distinguishes the Federal Reserve Board's authority to preempt different articles of the U.C.C. from its authority to control the different negotiable instruments governed by Article 3.[187]

In sum, the very rule of preemption that now sits without apparent function in section 3-102(c) would be immediately functional in a dif-

ments); Consumers Union of United States v. G. William Miller, 84 F.R.D. 240, 243-44 (D.D.C. 1979) (refusing to dismiss challenge to F.R.B. Truth in Lending Regulation).

184. *See* Monaghan, *supra* note 156, at 25-32 (determining appropriate deference to give to a particular legal interpretation by an administrative body rests on the courts' view of legislative intent in allocating lawmaking power).

185. *See infra* note 241 and accompanying text. The Federal Reserve Board has established mechanisms for states to request "preemption determinations." *See* Reg. CC, 12 C.F.R. § 229.20(d) (1993).

186. Indeed, *Childs* has not been relied upon for guidance about preemption. *Childs* has been relied upon for the proposition that "[w]hen the U.C.C. sets up particular standards of care or limitations on liability, the common law is annulled to the extent it modifies these standards or changes these limitations." Equitable Life Assurance Soc'y of the United States v. Okey, 812 F.2d 906, 909 (4th Cir. 1987); *see also* Greater Buffalo Press, Inc. v. Federal Reserve Bank of N.Y., 866 F.2d 38, 44 (1989) (liability derives only from agency status).

187. *See, e.g.*, Wichita Fed. Sav. & Loan Ass'n v. Comark, 610 F. Supp. 406, 407 (S.D.N.Y. 1988) (book entry regulations of Federal Reserve inapplicable to non-members of Federal Reserve System).

ferent context if Congress had delegated to the Federal Reserve Board the authority to rewrite the law of negotiable instruments beyond "the collections process" and the authority to issue regulations pursuant to such a delegation. But such an authorization has not yet been delegated; nor have courts held that the Federal Reserve Board broadly preempts the states with respect to the law of negotiable instruments.[188]

VI. MISCHIEF: POTENTIALLY ADVERSE CONSEQUENCES OF THE REVISION

Are there situations in which federal regulations, that previously might not have been read to conflict with Article 3, should now be expected to preempt Article 3? Are there statutes which might not have been read to authorize the regulation of Article 3 subject matter, which will now be read to do so? These are questions that the scope provision and related comments might have been expected to address. In light of the accelerating trend towards federalization of the check payment system, and the retention of negotiable instruments law for the states, the fundamental issue is whether preemption or displacement detrimentally alter other parts of Revised Article 3, or other non-U.C.C. state laws related to negotiable instruments.[189] The possibility for mischief is indeed significant.

At least three foreseeable situations can arise. First, the state's enactment may become relevant to a subsequent preemption determination if a federal agency has issued regulations providing for "provisional preemption" that allows states to opt into or out of a federal supersession rule. Alternatively, new federal regulations and operating circulars could be adopted which claim to preempt new areas of Article 3 without receiving any new grant of congressional authority to do so. Second, operating circulars may attempt to displace uniform code provisions, or nonuniform amendments to the Code. Third, situations may arise in which non-U.C.C. state laws—particularly consumer protection

188. *See* Shawmut Worcester County Bank v. First Am. Bank & Trust, 731 F. Supp. 57, 61-64 (D. Mass. 1990) (holding that interbank wire transfers are governed by U.C.C. principles rather than the Electronic Funds Transfer Act and regulations thereunder).

189. Article 4 contemplates that jurisdictions "may wish to address in individual legislation" consumer problems related to the legal framework created by the Article. Revised U.C.C. § 4-101 cmt. 3 (West 1990). Article 3 contains no acknowledgement of general problems which might require separate legislative treatment; however several provisions acknowledge the interrelationship of Article 3 with other state laws. *See* Revised U.C.C. §§ 3-302 cmt. 5, 3-307 cmt. 3, 3-118 cmt. 1.

laws—can be effected adversely by preemption language inside Article 3.

A. *Unwarranted Preemption: Freezing "Opt-In" Provisions of States*

Regulations allowing states to opt-in or opt-out of federal preemption rules have been developed over the past two decades that provide states with the opportunity to choose whether or not they wish to be preempted by particular federal regulations.[190] These kinds of regulations have been encouraged in recent administrations as a way to assist the states in retaining as much authority as possible.[191] A primary objective of such regulations is to strengthen federalism by granting state legislatures greater power to determine the value of uniformity.[192] Recent appellate decisions in *Greenwood Trust Co. v. Massachusetts*,[193] and *In re Lawson Square, Inc.*[194] illustrate the potential destructiveness to challenged state laws of opting into previously preemptive laws.

In *Lawson Square*, a state's affirmative declaration of its intent to be preempted resulted in disregard of a state usury law limiting interest on residential mortgages.[195] The amendment was adopted as a consumer protection measure. Lawson, a debtor in reorganization, contested its duty to pay on a residential mortgage note, alleging that the note was usurious under the law of Arkansas.[196] Under the Arkansas Constitution, the maximum lawful rate of interest on promissory notes was "five percent (5%) above the Federal Reserve Discount Rate at the time of the contract."[197] If the amendment governed, the disputed loan would have been usurious.[198]

---

190. *See, e.g.*, Owen v. Owen, 111 S. Ct. 1833, 1836 (1991) (discussing an opt-out provision in the Bankruptcy Code at 11 U.S.C. § 522(f)); Greenwood Trust Co. v. Mass., 776 F. Supp. 21, 29-32 (D. Mass. 1991) (discussing opt-out provision in usury law), *rev'd*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 113 S. Ct. 974 (1993); Government Supplies Consol. Servs., Inc. v. Bayh, 753 F. Supp. 739, 754 (S.D. Ind. 1990) (discussing an opt-out scheme in the federal Medical Waste Tracking Act, 42 U.S.C. § 6992). For further discussion of *Greenwood Trust*, *see infra* notes 193-213 and accompanying text.

191. Joseph F. Zimmerman, *Federal Preemption Under Reagan's New Federalism*, 21 PUBLIUS 7, 22-26 (1991); *see also* Deil S. Wright, *Policy Shifts in the Politics and Administration of Intergovernmental Relations 1930's-1990*, 509 ANNALS AM. ACAD. POL. & SOC. SCI. 60, 70-72 (1990).

192. *See generally*, Zimmerman, *supra* note 191.

193. 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 113 S. Ct. 974 (1993).

194. 816 F.2d 1236 (8th Cir. 1987).

195. *Id.* at 1236-39.

196. *Id.* at 1237-38.

197. *Id.* at 1238.

198. *Id.*

The Federal Reserve Board had promulgated a regulation that completely overrode state usury limits for mortgages secured by first liens on residential real property.[199] This regulation, however, allowed states to "opt-out" by reasserting their own usury limitation through passage of a law "which states explicitly and by its terms that such State does not want the provisions . . . to apply."[200] The Eighth Circuit found that Arkansas explicitly had allowed its own constitutional amendment to be preempted by the Federal Reserve Regulation:

> The Legislature and voters of Arkansas had the opportunity to override Section 501. . . . But instead of reasserting a State usury limit on mortgage interest rates, the amendment to the Arkansas Constitution included a section that specifically endorsed federal preemption. It reads as follows: "The provisions hereof are not intended and shall not be deemed to supersede or otherwise invalidate any provisions of federal law applicable to loans."[201]

The court of appeals thus relied upon the state's election to allow preemption to reach the conclusion that the amendment was in fact preempted by federal regulation. *Lawson* demonstrates that manifestation of intent is important, if not dispositive, in determining whether or not a state has endorsed preemption of its laws by federal regulation.

The *Greenwood* case presents another, more troubling example of a preemption endorsement that could not be retracted when a state determined to offer greater protection for consumers than existing federal law. Greenwood Trust offered a Discover Credit Card account that assessed a ten dollar late charge against those cardholders who did not make a monthly minimum payment in a timely fashion.[202] Determining that such late charges were unfair to its citizens, the Massachusetts legislature in 1991 passed a consumer protection statute which ordered that "[n]o creditor shall impose a delinquency charge, late charge, or similar charge on loans made pursuant to . . . an open end credit plan."[203]

After being advised that the imposition of its late fees violated state law, Greenwood Trust sought injunctive relief from the state law, arguing that the state law was preempted implicitly by a section of the Depository Institutions Deregulation and Monetary Control Act of

199. *Id.* at 1240.

200. *Id.*

201. *Id.* (quoting ARK. CONST. art. 19, § 13(d)(ii), as amended 1982).

202. 971 F.2d at 821.

203. *Id.* at 822 (quoting MASS. GEN. L. ch. 140, § 114B (1991)).

1980 ("MCA").[204] That Act aimed to prevent discrimination against state-chartered banks with respect to interest rates by allowing them to charge interest at a rate of 1% above the Federal Reserve discount rate, "notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section."[205]

The trial court in *Greenwood* declined to find federal preemption.[206] It held that Massachusetts had previously "opted out" of the MCA's "preemptive grasp."[207] A separate section of the MCA allowed such an "opt-out."[208] The Court of Appeals for the First Circuit, however, returned to the state legislative history and decided that the state legislature had, "in effect, opted back in" to a preemptive regime before this litigation had begun.[209] Accordingly, the court of appeals reversed the trial, reopened the question of preemption, and invalidated the state law using a theory of explicit preemption by the federal statute.[210]

Massachusetts, having expressed its legislative will to prevent the imposition of credit card late fees on its citizens, must not have intended its late-charge law to be a nullity. Otherwise, of course, passage of the law would have been superfluous. Therefore, Massachusetts, by passing the anti-late charge law, clearly demonstrated its intention to "opt out" of federal preemption. Despite this, the court properly rejected a suggestion that the state could back out of the federal scheme, for the reason that federal law had been changed in the intervening period to withdraw the opt-out opportunity.[211] If the appeals court in *Greenwood* accurately interpreted the state's conduct prior to 1991 as being a determination to remain within the grasp of the preemption provision, then because of the change in federal law, Massachusetts inadvertently dug its own grave. The opportunity to withdraw from the federal scheme had evaporated by the time the late fee issue arose.[212]

Greenwood indicates the problems that states can encounter when

---

204. *Id.* at 821.

205. *Id.* at 822 (quoting 12 U.S.C. § 1831d(a) (1988 & Supp. 1990)).

206. *Id.*

207. *Id.* at 823 n.4.

208. *Id.*

209. *Id.*

210. *Id.* at 823-24.

211. *Id.*

212. The trial court determined that Massachusetts in 1981 elected to opt out of the Depository Institutions Deregulation and Monetary Control Act of 1980. 776 F. Supp. at 24 n.6. The court of appeals found that the trial court overlooked a reversal of direction by the Massachusetts legislature which had the effect of opting back in to the MCA. *See* 971 F.2d at 823 n.4.

they voluntarily subordinate themselves to federal regulation. Having once taken steps from which a court determined that Massachusetts remained within the federal regulatory scheme, there was nothing the state could do to prohibit or regulate credit card late fees. Neither Congress nor the Federal Reserve Board has taken steps to address the problem of excessive credit card fees since that time.[213]

The problem of a state unwittingly displacing its own prospective legislative power can arise within the context of the U.C.C. If a state legislature should wish five or ten years down the road to amend Article 3 in response to a new technology or a new type of negotiable instrument, there is no assurance that the state will not be trapped in a federal preemptive scheme barring it from doing so.

In Article 3, there are opportunities for "opt-out" or "opt-in" preemption problems related to regulations specifically promulgated by the

213. An American Bankers Association annual card survey in 1993 reported a 45% increase in credit card fees, which the American Express Company has maintained resulted directly from declining interest rates. Lisa Fickenscher, *Pricing: American Express Fires a Salvo of Statistics Against Bank Cards*, AM. BANKER, Oct. 29, 1993, at 17, 17 [hereinafter *American Express*]. To some bankers it seemed fair to punish those consumers who missed a monthly payment; but to others, "nuisance" penalties were deceptive replacements for lost income to issuers that had more to do with the fact that traditional sources of income, both interest rates and annual fees, were eroding. Lisa Fickenscher, *Pricing: Beyond the Late Fee*, AM. BANKER, Oct. 15, 1993, at 15, 15. Survey results released by American Express late in 1993 indicated that 48% of consumers described their knowledge about fees and interest charges as no better than fair. *American Express, supra*, at 17.

Federal administrative rulings interpreted federal regulations allowing interest rates to be set at very high levels to preempt state common and statutory law and aimed at controlling fees except where states chose to opt-out of DIDA. FED. DEPOSIT INS. CORP., FDIC 93-27 1993 FDIC Interp. Ltr. LEXIS 42 (concluding that DIDA authorizes state chartered banks insured by the FDIC to "export" charges authorized by a bank's chartering state or credit card loans to borrowers in states having common-law prohibitions on such charges, assuming "that the 'opt-out' provision in Section 525 of DIDA does not apply."); *Fed. Deposit Ins. Corp.*, FDIC 92-47 1992 FDIC Interp. Ltr. LEXIS 41 (same); *see also* OCC Unpublished Interp. Ltr. from William P. Bowden, Chief Counsel, LEXIS (Reference: Text is illegible) (Feb. 4, 1992) (asserting inapplicability of Iowa late fee limit to national banks); ROBERT B. SERINO, OFFICE OF THE COMPTROLLER OF THE CURRENCY, INTERPRETIVE LETTER No. 452 [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) P85,676 at 78,063 (Aug. 11, 1988).

In some states that opted out of the federal regime, legislation along the lines of the Massachusetts law discussed in *Greenwood* was debated and judicial challenges to excessive late fee charges were upheld. *See* Beasley v. Wells Fargo Bank, 235 Cal. App. 3d 1383 (Ct. App. 1991) (class recovery of $5.2 million in excessive credit card penalty fees under California law); Stephen Kleege, *Victory on Fees in California Could Backfire*, AM. BANKER, Aug. 31, 1993, at 1. However, challenges in states that fell within the federal scheme failed because of preemption arguments. *See* Copeland v. MBNA Am., N.A., 820 F. Supp. 537 (D. Colo. 1993) (Colorado late fee regulations preempted); Goehl v. Meridian Bank, 825 F. Supp. 1239 (Ed. Pa. 1993) (Pennsylvania state claims based on late charges held to fall within National Bank Act "excessive interest" enforcement provisions); Tikkanen v. Citibank, 801 F. Supp. 270 (D. Minn. 1992) (same).

Federal Reserve Board in Article 3. Given the shifting regulatory conflict between state and federal banking authorities, for example, federal regulations that allow state-chartered financial institutions to opt-in to a preemptive liability rule covering national banks might be promulgated. The preemption provision of Article 3 could itself be interpreted by a court as the state's intent to embrace the subsequent federal regulatory rule. With respect to the broader issue of the general desirability of provisions similar to section 3-102(c), the prospects remain realistic for an increasing number of federally established, preemptive, optionally adopted default rules.

Notwithstanding this predicament, states may still want to opt-in to a particular preemptive federal scheme. Specific cases arise on occasion in which it is desirable for states to seek out federal laws which would preempt their own authority. However, as suggested in *Greenwood* or *Lawson*, states should not establish default rules that invite preemption in unspecified cases and that can undermine their own subsequent legislation.[214]

B. Unwarranted Displacement: Invalidating Nonuniform U.C.C. Amendments

This study has considered the impact on preemption of language within the Code in cases where a state possesses some right to choose to reject federal preemptive authority. However, states cannot control the frequency of preemption "options." Usually, states have no opportunity to opt out of a federal preemption scheme. But states do control the extent to which they choose to adopt Article 3 without amendment. As noted in part I, the variety among the Code provisions adopted by the states is considerable.

As an example of regulatory displacement's effect on the enforceability of Article 3, consider a state legislature that adopts all of the Revised Article 3, except the recommended definition of "ordinary care" contained in section 3-103(7).

214. One explanation for the passage of a general default preemptive provision in uniform state law is that state-invited displacement might reflect the intention of states collectively to inhibit destructive competitive behavior. It might be desirable for states to diminish their own authority in marginal cases and to discourage themselves from legislating in zones of activity close to the regulatory authority of federal agencies, thereby making preemption more likely. As indicated in the text, the difficulty with this position is that it assumes that state legislators would opt to chill their own lawmaking activities by endorsing limitless legislative deference to administrative regulations that are subject to procedural and substantive uncertainties, even though they are already free to seek statutory or regulatory restraints on their authority in individual cases.

Revised U.C.C. section 3-103 (West 1990) provides:

"Ordinary care" in the case of a person engaged in business means observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged. In the case of a bank that takes an instrument for processing for collection or payment by automated means, reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage not disapproval by this Article or Article 4.

Although it long has been apparent that the volume of checks passing through the prevailing mechanized collection process renders the examination of *all* checks infeasible, many states have decided that ordinary care requires physical examination of checks above certain amounts, in order to detect forgeries and alterations.[215] More recently, automated scanning technologies have made it feasible for automated signature comparisons to be made. Such technologies might be required as "reasonable care" by the laws of some states even if not mandated by the official revision.[216]

Despite the view in many jurisdictions that examining a sampling of checks constitutes "reasonable care,"[217] the drafters altered the definition of "ordinary care" in order to facilitate the advent of check "truncation"—a system whereby checks no longer need be physically transferred anywhere else by a depositary bank. The definition of ordinary care appearing in revised section 3-103 therefore excuses banks from having to "examine" checks which they process. The comment to the provision states that "[n]othing in [the section] is intended to prevent a customer from proving that the procedures followed by a bank are unreasonable, arbitrary, or unfair."[218]

Further suppose that a state such as New York enacts a non-uniform amendment and eliminates the special rule for ordinary care by banks. Instead it retains the same definition of "ordinary care" for its banks as for other persons—"the observance of reasonable commercial standards." In New York, let us suppose, reasonable commercial stan-

215. *See* Julianna J. Zekan, *Comparative Negligence Under the Code: Protecting Negligent Banks Against Negligent Customers*, 26 U. MICH. J. L. REF. 125, 166-78 (1992).

216. *See Service Bureau Offers Image Statements*, A.B.A. BANKING J., December 1992, at 74 (optical scanning technology that verifies signatures is available).

217. *See* Zekan, *supra* note 215, at 166-78.

218. U.C.C. § 3-103 cmt. 5.

dards traditionally have involved requiring banks visually to examine signatures on checks written in amounts above $50,000.[219]

Now imagine that the Federal Reserve Bank of New York acts through an operating circular to displace New York's non-uniform amendment. Operating Circular 4, promulgated by the Federal Reserve Bank of New York, is devoted to the collection of checks and other items by Federal Reserve Banks.[220] This circular might be deemed by the Federal Reserve Board to extend the "safe harbor" of ordinary care for banks, which the New York state legislature did not believe was appropriate, by explicitly declaring that visual examination of checks was unnecessary. In other words, the amended federal circular would make it clear that no banks need to examine checks in order to demonstrate ordinary care. U.C.C. section 4-103(c) provides that:

> [a]ction or non-action approved by this Article or pursuant to Federal Reserve regulations or operating circulars is the exercise of ordinary care and, in the absence of special instructions, action or non-action consistent with clearinghouse rules and the like or with a general banking usage not disapproved by this Article, is prima facie the exercise of ordinary care.

But Article 3 has eschewed this approach and left this matter in the hands of state courts.[221]

What would happen if a New York drawer (customer) sued her bank (drawee) in the collection process, Robotbank, for losses attributable to Robotbank's failure to spot a forged signature on a million dollar check, in a situation where the bank asserted that the customer herself had been negligent? Would Robotbank be entitled to shift the loss to the customer by relying on the definition of ordinary care used in the operating circular because it preempts New York's non-uniform version of Article 3? Or would Article 3, as duly enacted and revised by the New York legislature, provide the governing rule?

The "ordinary care" standard as applied to state banks is defined by state law.[222] Furthermore, the observance of a customary practice does not necessarily constitute the exercise of ordinary care.[223] Without

---

219. *See* Putnam Rolling Ladder Co. v. Manufacturers Hanover Trust Co., 547 N.Y.S.2d 611 (1989) (bank negligent in that high volume of work in check-clearing department prevented realistic chance of detecting forgeries).

220. For discussion of the displacement effect of such operating circulars, see Fry, *supra* note 142, at 1419-20.

221. Revised U.C.C. § 4-103(c) (West 1990).

222. *See* Zekan, *supra* note 215, at 166-76.

223. The seminal case is Learned Hand's opinion in *The T.J. Hooper*, 60 F.2d 737 (2d

the displacement principle of revised section 3-102(c), a court determining whether an operating circular legitimately preempts Article 3 would investigate the scope of displacement in light of prior operating circulars. A court would consider whether, by nullifying state negotiable instruments law, the operating circular exceeded the bounds of congressional authority under which it was issued. Did Congress, when it authorized Regulation J, intend to allow the Federal Reserve to alter the standard of "ordinary care" for all banks through its administrative promulgations?[224] A court undertaking this analysis may well decide to nullify preemption.

However, once section 3-102 is included in state law, a result favoring the state law becomes less likely. It becomes reasonable for the courts to infer that the enactment sets the limits the state legislature intended for federal preemption of state negotiable instruments law. Prior to the revision, the scope of permissible regulatory preemption in Article 3 conflicted with the traditional understanding of the roles of states in regulating contract law and policing the financial marketplace.[225]

In the "ordinary care" example above, banks seeking the shelter of the operating circular's safe harbor rule can now argue that, although the New York legislature deleted language providing a "safe harbor" for banks,[226] the same legislature simultaneously adopted section 3-102(c), which endorses the preemption of any inconsistent rules by the Federal Reserve Board, whatever the effect of those subsequent rules might be. In other words, the passage of section 3-102(c) evidences the

---

Cir.), *cert. denied*, 287 U.S. 662 (1932), indicating that no profession may set its own tests of proper diligence.

224. The term "ordinary care" was not defined in pre-revision Article 3, but is used and discussed in pre-revision Article 4. In New York, for example, the phrase "ordinary care" in Article 4 of the U.C.C. is not intended to refer to a standard of care unique to the banking world. Instead, it is "used with its normal tort meaning." N.Y.U.C.C. § 4-103 cmt. 4 (McKinney 1991). Nor is it exhaustively defined by the Code, although "action or non-action approved by [Article 4] or pursuant to Federal Reserve regulations or operating letters constitutes the exercise of ordinary care." *Id.* As a consequence, in the absence of compliance with an applicable rule of law established by the U.C.C. or the Federal Reserve, ordinary care must be determined from all the surrounding facts and circumstances. *Cf.* Wilhelm Foods, Inc. v. National Bank of N. Am., 388 F. Supp. 1376, 1379 (S.D.N.Y. 1974). "If a U.C.C. or Federal Reserve regulation is applicable, however, it provides a safe harbor, and a bank may conclusively demonstrate ordinary care by proving compliance with it." United States Fidelity and Guar. Co. v. Federal Reserve Bank of N.Y., 590 F. Supp. 486, 492 (S.D.N.Y. 1984).

225. *See supra* note 144 and accompanying text.

226. *See* Zekan, *supra* note 215; *see also* FRED MILLER, THE LAW OF MODERN PAYMENT SYSTEMS AND NOTES § 9.01(b) (1992).

state's intention to permit federal preemption of state negotiable instruments law. Such a conclusion, especially in light of recent approaches to statutory interpretation which reject legislative history and accept theories of administrative preemption,[227] has ample support in the law.[228]

Reviewing the operating circular in light of the displacement principle, a court ill-disposed to examine legislative history might reasonably conclude that the relationship between federal and state authority has been consensually redefined under the terms of the U.C.C. Articles 4 and 4A establish that, in states that are hospitable to the Code's regulatory displacement, operating circulars and regulations have wider preemptive effect than otherwise.[229] The same reasoning applies to Article 3.[230]

With respect to the Federal Reserve, section 3-102(c) promotes federal administrative preemption of state law well beyond the authority expressly delegated by Congress. If an operating circular can establish a bank's standard of care with respect to check processing, the next operating circular might define certain negligent conduct with respect to forgeries or alterations under section 3-406; or create a presumption that a bank is a holder in due course under section 3-417. Principled limits upon the scope of such operating circulars would be difficult to set.

227. *See* Eric W. Maclure, Morales v. TransWorld Airlines, Inc.: *Federal Preemption Provision Clips States' Wings on Regulation of Air Fare Advertising*, 71 N.C. L. REV. 905, 922-25 (1993).

228. *Id.* at 916-18.

229. *See* Greater Buffalo Press, Inc. v. Federal Reserve Bank of N.Y., 866 F.2d 38, 45 (2d Cir. 1989) (providing that, notwithstanding rule of § 4-103(1), agreements are ineffective to permit banks to disclaim responsibility for failure to exercise ordinary care; Federal Reserve operating circulars excluded liability of Federal Reserve Bank where there was no agency relationship between the Federal Reserve Bank and the payee), *cert. denied*, 490 U.S. 1107 (1989); Wells Fargo Bank v. Hartford Nat'l Bank and Trust, 484 F. Supp. 817, 821-22 (D. Conn. 1980); *see also* Gulfstream Bank v. Irving Trust Co., No. 82 Civ. 4126 (S.D.N.Y. Nov. 2, 1983) (leaving undecided the question of whether operating circulars could alter the Code as a matter of law).

230. Although it is true in one sense, as Professor Miller suggests, that deference to regulations of the Federal Reserve System "is no more than a statement of basic constitutional law," such a statement of law has the capacity to affect whether regulations are judged valid as they are promulgated and as they are applied especially when the statement extends beyond regulations to include operating circulars. *See infra* part VI. Professor Miller observes that deference by Article 3 to operating circulars "would not always be mandated absent an express articulation." *See* Miller, *supra* note 1, at 420.

C. Unwarranted Extensions: Taking Analysis of Section 3-102 Outside Article 3

The drafters of Revised Articles 3 and 4 maintained that consumer protection laws and other protective measures should be dealt with outside the Code because of the difficulty of developing rules amenable to all jurisdictions, and because this was the traditional U.C.C. approach.[231] Furthermore, this reflected the legacy of the New Payments Code—an unsuccessful predecessor to the Revision Project.[232]

As a result of this approach, these "code-related" laws will be adopted by state legislatures as supplementary or companion legislation.[233] As in *Greenwood*,[234] challenges to such laws based on displacement or preemption theories will probably arise. When they do, section 3-102(c) could be invoked to support their subordination of state laws.

A court considering whether a law related to Article 3 and yet outside of it is preempted or displaced might reasonably conclude that the rules that pertain to Article 3 also apply to the related law. For instance, a court might reasonably conclude that provisions of state banking law which frustrate operating circulars related to Article 3 should be supplanted despite language in section 3-102(c) that the provision concerns "this Article." The court also might conclude from the very presence of section 3-102(c) that the state intended its law to be preempted or displaced because it could have chosen not to adopt the provision.

Alternatively, a court could construe the wording in revised section 3-102(c) as requiring a deferential approach to the preemption of state law[235] since regulations and operating circulars of the Federal Reserve Board are said to "supersede any inconsistent provision . . . to the ex-

---

231. *See* Miller, *supra* note 1, at 408-10. In accordance with this perspective, the drafters included few regulatory laws within the proposed revisions "consistent with the traditional U.C.C. approach [of excluding] affirmative consumer protection provisions from Revised Articles 3 and 4."

232. *Id.* at 408-10.

233. For an example of such supplementary legislation, see W. VA. CODE § 46A-6-110(a)(1) (1993) (criminalizing the solicitation of post-dated checks).

234. *See supra* notes 203-10 and accompanying text.

235. Less deferential preemption provisions are familiar to banking law. *See, e.g.*, Consumer Credit Protection Act, § 919, 15 U.S.C. § 1693q (1988) ("A State law is not inconsistent with this subchapter if the protection such law affords any consumer is greater than the protection afforded by this subchapter."); Revised U.C.C. § 4-103(b) (West 1990) ("Federal Reserve regulations and operating circulars . . . have the effect of agreements . . . whether or not specifically assented to by all parties interested in items handled.").

tent of the inconsistency."[236] To "supersede" typically has meant to "set aside as having no effect."[237] "Inconsistent" has been used in various ways in traditional preemption analysis. Some courts have found only "irreconcilable conflicts" with a federal statute to constitute inconsistencies.[238] Often, however, "inconsistent" has been interpreted to mean merely "different."[239] Interpreting "inconsistent" as merely "different" means that "supersession" can preempt state laws in more situations than are constitutionally mandated under decisions of the U.S. Supreme Court,[240] since not all "differences" between state and federal law necessarily present "conflicts" or "obstacles" to the accomplishment of congressional purposes.[241]

Consider the "chilling" effect such a provision may have on state initiatives aimed, for example, at discrimination against consumers, rate regulations, or disclosure rules. Adopting section 3-102(c) may discourage states from enacting their own legislation under the scenario just described.[242]

VII. DIMENSIONS OF STATE LAW UNCONSTITUTIONALITY: NONDELEGATION DOCTRINE

As previously discussed, the Federal Reserve Bank operating cir-

236. U.C.C. § 3-102(c).

237. BLACK'S LAW DICTIONARY 1437 (6th ed. 1990).

238. John Hancock Mutual Life Ins. v. Harris Trust Co., 114 S. Ct. 517, 525 (1993).

239. *Id.*

240. *See* Cippollone v. Liggett Group, Inc., 112 S. Ct. 2608, 2617-18 (1992).

241. Consistency analysis has proven to be inconsistent with regard to competing state and federal schemes. *Compare* International Atlas Servs., Inc. v. Twentieth Century Aircraft Co., 59 Cal. Rptr. 495, 498-99 (Ct. App. 1967) (holding that owner of security interest in an aircraft, properly filed under the Federal Aviation Act recording system, took priority over owner of security interest in an engine installed therein, even though the latter would have priority under the state law system; and stating that the Federal Aviation Act establishes paramount law in the area to the exclusion of any inconsistent statements under state law); *with* Industrial Nat'l Bank of R.I. v. Butler Aviation Int'l, Inc., 370 F. Supp. 1012, 1016 (E.D.N.Y. 1974) (holding that the Federal Aviation Act was not intended to preempt and displace all state law bearing on priorities of lien and title interests in aircraft).

242. Federal statutes and regulations are promulgated as a result of a well-defined, well-publicized procedure. Accordingly, state legislatures can be expected to know whether a contemplated consumer protection act would be preempted by such federal provisions. However, state legislatures cannot be expected to know whether the contemplated act will be preempted by federal operating circulars. Operating circulars may be revised at will by the Federal Reserve Banks. *See* OPERATING CIRCULAR NO. 4, *supra* note 99, at ¶ 78. Additionally, it is unclear what procedural safeguards are provided for in the adoption, much less the revision, of operating circulars. *Id.* Faced with such perpetual doubt about whether an unknown federal operating circular may preempt the contemplated consumer protection act, state legislatures may not be willing to waste their time debating passage of such an act.

culars and clearinghouse rules do not have the force of law unless they are adopted by the Board of Governors of the Federal Reserve System. Proponents of the Revision have taken the view that section 3-102(c) enlarges the authority of the Federal Reserve System modestly by giving new force to the operating circulars issued by individual Federal Reserve Banks. Ostensibly, this enlargement facilitates coordination of the Code with the Federal Reserve operating circulars.[243] The Revision has not established any clear relationship between clearinghouse rules and Article 3.

The extent to which section 3-102(c) enlarges the authority of the Federal Reserve System depends upon the content of future operating circulars that would not have preemptive effect but for section 3-102(c).[244] It is doubtful that the Federal Reserve Banks will restrict the content of operating circulars to subjects currently addressed once they are given authority to issue rules which supersede the Code. Pursuant to section 3-102(c), Reserve Banks and, possibly, private clearinghouses, could issue rulings that limit a state's legislative and judicial discretion. For example, they could re-define some instruments such as

---

243. The New York State Bar Association's working group to consider the revisions to Articles 3 and 4 consulted Professor Fred H. Miller, a member of the Permanent Editorial Board, for his *personal* opinion about the necessity for § 3-102(c). Professor Miller replied as follows:

> As to the question posed about § 3-102, not all operating circulars have the force of law like regulations and thus cannot preempt even though they are an integral part of the regulatory scheme. In Article 4, where "system" agreements are common, this can be addressed by giving them the status of agreements to alter the effect of the provisions of the statute. In Article 3, such broad-based agreements are not prevalent. Thus, for coordination purposes, such circulars are given predominance over the statutory rules as a matter of state policy.

Letter from Professor Fred H. Miller to New York State Bar Association Banking Law Committee 3 (May 22, 1992) (on file with author).

244. It should be observed that § 3-102(c) states that only regulations of the Federal Reserve Board and operating circulars of the *Federal Reserve Banks* supersede Article 3 rules to the extent of any inconsistency. Revised U.C.C. § 3-102(c) (West 1990). Presumably the Federal Reserve Board is and will be the only regulatory agencies that issue operating circulars. However, the Federal Reserve Banks are not the only agency with an interest in the law of negotiable instruments. Eight other federal regulatory agencies also govern parts of the banking system, and many issue interpretive guidance. In addition there are other agencies whose regulations limit liabilities and privileges otherwise afforded by Article 3. The Federal Trade Commission, for example, has also taken an interest in the rules affecting negotiable instruments. By exclusion, § 3-102(c) implies that the interpretive administrative rulings of agencies other than the Federal Reserve Board should be subordinated to state law. It is also uncertain whether § 3-102(c) gives priority to the administrative interpretations of the Federal Reserve Board in the event of federal interagency regulatory conflicts. If so, federalism concerns are raised and sound principles of administrative law called into question by the suggestion that state law may be determinative of a conflict between federal regulatory agencies.

post-dated checks or certain types of notes, as non-negotiable. It is hard to imagine any aspect of negotiable instruments law covered by Article 3 which is not potentially subject to substantive modification by an operating circular that previously would not have the force of law but for the broad interpretation that could be given to section 3-102(c).[245]

A. Constitutional Restrictions on Delegation by State Lawmakers

As we have just seen, the passage of section 3-102(c) empowers the "quasi-public" Federal Reserve Banks, and perhaps the private bank clearinghouses, to defeat existing state legislation and replace it with Reserve Bank or clearinghouse rules. This displacement transgresses a vital principle of *state* constitutional law that the "legislative power cannot be delegated by a state legislature to the United States Congress, or to a federal agency."[246] It is generally unconstitutional for a state prospectively to empower the federal government to make rules that will substitute for valid state laws.[247]

245. Regarding the impact of operating circulars on Article 4, *see* United States Fidelity and Guar. Co. v. Federal Reserve Bank of N.Y., 590 F. Supp. 486 (S.D.N.Y. 1984) (holding that Operating Circular No. 4 definition of duty of care in handling checks superseded the ordinary care requirement of N.Y.U.C.C. § 4-202(1)); Appliance Buyers Credit Corp. v. Prospect Nat'l Bank of Peoria, 505 F. Supp 163, 164 (C.D. Ill. 1981) (stating that the Illinois Commercial Code is, by its own terms, modified by Federal Reserve Reg J), *aff'd*, 708 F.2d 290 (7th Cir. 1983).

246. 16 C.J.S. *Const. Law* § 138 (1984). Professor Hawkland, reviewing the development of § 4-103, observes that the drafters did not give "too much consideration . . . to the constitutional question of state law involving federal preemption or the issue of state delegation of legislative power to a federal agency." HAWKLAND, *supra* note 90, § 4-103:01, at 139. For further discussion of Professor Hawkland's review of the development of § 4-103, *see supra* notes 89-131 and accompanying text.

The delegation of power limitation on state legislation emanates from "principles and concepts such as the separation of governmental powers, the common law maxim of *delegate potestas non potest delegari* (a power that is originally delegated may not be redelegated), due process, or the principal of government by representative assembly." DANIEL R. MANDELKER & DAWN C. NETSCH, STATE AND LOCAL GOVERNMENT IN A FEDERAL SYSTEM 653 (1990).

247. The policy behind the rule is to prevent the legislature from replacing its judgement with the judgement of a detached federal agency. De Agostina v. Parkshire Ridge Amusements, Inc., 278 N.Y.S. 622, 629 (Sup. Ct. 1935). "The Legislature should neither invite federal encroachment nor surrender to a foreign agency, over which it has no control or supervision, powers given solely to it by the people. Illegitimate and unconstitutional practices get their first footing . . . by silent approaches and slight deviations from legal modes of procedure." *Id.* (quoting Boyd v. United States, 116 U.S. 616, 635 (1886)).

For other cases involving prospective state legislation being declared invalid, *see* Hutchins v. Mayo, 197 So. 495 (Fla. 1940); Wallace v. Commissioner of Taxation, 184 N.W.2d 588 (Minn. 1971); Lee v. State, 635 P.2d 1282 (Mont. 1981); Smithberger v. Banning, 262 N.W. 492 (Neb. 1935); State v. Dougall, 570 P.2d 135 (Wash. 1977). *But see* State v. Thompson, 627 S.W.2d 298 (Mo. 1982) (upholding delegation to federal Drug Enforcement Administration of future listing of certain drugs as controlled substances). Furthermore, most states prohibit state administrative

A state lawfully may incorporate existing federal regulations and interpretations as state law. For example, the Florida Supreme Court in *Dept. of Legal Affairs v. Rogers*[248] upheld the legislative requirement that the state's "little FTC act"[249] be constrained by Federal Trade Commission interpretive rulings, so long as the state law only meant to confine Florida's agency by federal regulations existing at the time the Florida act was established.[250] The court ruled the delegation lawful because it was intended only to incorporate administrative agency decisions and federal court decisions made *prior* to enactment of the act, notwithstanding statutory language indicating that the state law should change as the Federal Trade Commission Act and interpretations of it changed.[251]

The constitutions of the states, however, generally have been construed to prevent legislatures from importing unknown standards into state law by "upwardly delegating" responsibility to federal lawmakers and rulemaking authorities. For example, in *Dawson v. Hamilton*,[252] the Kentucky Supreme Court held unconstitutional a Kentucky law delegating responsibility for determining the standard time zone for Kentucky to the Interstate Commerce Commission or another federal agency. The court reasoned that the law allowed standards to be fixed

agencies from usurping state legislative roles. *See, e.g.*, Boreali v. Axelrod, 517 N.E.2d 1350 (N.Y. 1987).

248. 329 So. 2d 257 (Fla. 1976).

249. The provisions of the statute that were declared valid read as follows:

"*Unlawful acts and practices.*-

(1) Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.

(2) It is the intent of the legislature that in construing subsection (1) of this section, due consideration and great weight shall be given to the interpretations of the Federal Trade Commission and the federal courts relating to § 5(a)(1) of the Federal Trade Commission Act (15 U.S.C. 45(a)(1)), as from time to time amended.

Id. at 262 (quoting § 501.204 of Florida Statute, as then in effect).

"*Rule-making power.*-

(1) The department shall propose rules to the cabinet which prohibit with specificity acts or practices that violate this part and which prescribe procedural rules for the administration of this part. . . .

(2) All substantive rules and regulations promulgated under this part shall be consistent with the rules, regulations, and decisions of the Federal Trade Commission and the federal courts in interpreting the provisions of § 5(a)(1) of the Federal Trade Commission Act (15 U.S.C. 45 (a)(1)), as from time to time amended."

250. *Rogers*, 329 So. 2d at 267.

251. *Id.* at 263.

252. 314 S.W.2d 532, 536 (Ky. 1958).

by federal bureaucrats in the future. In *Crowly v. Thornbrough*,[253] the Arkansas Supreme Court struck down an act which attempted to delegate to the Secretary of Labor of the United States the right to fix a minimum wage scale in Arkansas, because "[t]he State retains no control over the Secretary of Labor."[254] In *Perez v. State*,[255] a majority of the Florida Supreme Court recently held that a state constitutional amendment could not mandate that Florida courts be bound by future search and seizure rulings of the United States Supreme Court.[256] Earlier, Florida's Supreme Court had declared that "new [state] laws should be controlled by representatives of the people, not by a broad designation to a governmental entity outside the state and not responsible to the citizens of the state."[257]

In some circumstances, states may condition the operative effect of a statute upon a future determination by a federal agency. For example, in *Diversified Investment Partnership v. Department of Social & Health Services*[258] a Washington state statute that conditioned the operative effect of the statute upon the happening of a federal, legislatively specified event in the future was held constitutional. The statute's purpose was to ensure the continued receipt of federal aid by declaring that if its provisions were no longer determined by the federal Department of Health and Human Services to satisfy federal requirements for receiving aid, the state rules were invalid.[259] Significantly, however, the statute did not adopt the new federal requirement as immediately controlling. It only denied the operative effect of the inadequate state provision which left the state legislature free to adopt a provision meeting the federal requirements.[260]

Dawson, *Diversified*, *Dept. of Legal Affairs*, and the other cases in this area[261] support the premise that a statute which allows an as yet

---

253. 294 S.W.2d 62 (Ark. 1956).

254. *Id.* at 66.

255. 620 So. 2d 1256 (Fla. 1993).

256. *Id.* at 1258.

257. *Id.* at 1266 (quoting Bernie v. State, 524 So. 2d 988, 994-95 (Fla. 1988) (Overton, J., concurring)).

258. 775 P.2d 947 (Wash. 1989).

259. *Id.* at 948-49.

260. *Id.*

261. *See, e.g.*, Brock v. Superior Court, 71 P.2d 209, 213 (Cal. 1937) (holding attempts to adopt future federal rules, regulations or statutes unconstitutional and void); People v. Kruger, 121 Cal. Rptr. 581, 584 (Ct. App. 1975); Adoue v. State, 408 So. 2d 567, 570 (Fla. 1981) ("Any attempt to incorporate a law as part of this state's body of laws prior to its creation by the appropriate federal authority is an unconstitutional delegation of the legislative power."); *see also* State

unknown federal rule to become a state's rule may be unconstitutional.[262] Where a state purports to bind itself prospectively to the supersession of its laws by unknown regulations or administrative rules, then it has violated the nondelegation principle. Section 3-102(c) delegates state legislative authority[263] by subjecting the validity and applicability of Article 3 to future federal actions.[264] Even when it appeared pragmatically advantageous to do so, state courts have invalidated such prospective delegation of state rulemaking power.[265]

With respect to section 3-102(c), legislative power is delegated not simply to a federal agency, but to the quasi-public[266] Federal Reserve Banks.[267] Delegation to such institutions has been reviewed under more severe standards than have applied to governmental agencies. In the classic case *Fink v. Cole*,[268] the New York Court of Appeals struck down a statute that gave officers of The Jockey Club, a private racing corporation, broad discretion to set rules for horse racing. The Court decided that the delegation by the legislature of its licensing power was "such an abdication as to be patently an unconstitutional relinquish-

v. Urquhart, 310 P.2d 261, 265 (Wash. 1957) (same); Woodson v. State, 623 P.2d 683, 685 (Wash. 1980) (holding legislative delegation of power to determine future permissible osteopathic healing procedures to private Association of Osteopathic Colleges unconstitutional).

262. State courts also use other principles of the nondelegation doctrine to limit state legislatures from preempting their lawmaking function. One such principle is that the delegatory statute must contain some standards or general policy. *In re* Strandell, 562 A.2d 173, 178 (N.H. 1989). Section 3-102 might be declared invalid on this ground because the Federal Reserve Board has not been given any guidelines or limitations in any state legislation. Absent from Article 3 is any mention of whether the Federal Reserve Board may preempt Article 3 and the U.C.C. in general. Typically, a valid delegation occurs where an agency, through the enabling legislation, is given rulemaking power that is checked by strict standards for either the power's exercise or specific policy objectives to be facilitated by the delegation. *See id.* at 174, 178 (holding constitutional a Division of Mental Health and Development Services rule because the agency filled in only those details that were necessary to effectuate the rule's purpose). Section 3-102 establishes no standards that govern the Federal Reserve Board and member banks and no state policy objective is mentioned.

263. Note that legislative function involves discretionary judgement with respect to making rules. Cases in which the state legislature merely delegates to a body the authority to "determine some fact or state of things upon which the law makes, or intends to make, its own action depend" are valid. Locke's Appeal, 72 Pa. 491, 498 (1872); *see also* Tal Rauhoff Constr. Co. v. Industrial Comm., 501 N.E.2d 295, 299 (Ill. App. Ct. 1986) (holding that a statutory scheme, under which the Department of Labor determined the average weekly wage for worker's compensation benefits, was not an improper delegation of legislative power).

264. *See supra* text accompanying notes 90-131.

265. *See supra* notes 252-53 and accompanying text.

266. *See supra* note 101 and accompanying text.

267. If § 3-102(c) is construed to apply to clearinghouse rules, private entities would become the object of delegation as well. *See infra* note 96.

268. 97 N.E.2d 873 (N.Y. 1951).

ment of legislative power in violation of . . . the Constitution of this State which provides: 'The legislative power of this State shall be vested in the Senate and Assembly.' "[269] Under *Fink*'s reasoning, the quasi-public nature of the independent Federal Reserve Banks would certainly affect the constitutionality of their delegated power.

B. Delegation as a Matter of Policy

Assuming that section 3-102(c) were not unlawful according to state constitutional theory, the *wisdom* of adopting a blanket rule granting supremacy to Federal Reserve operating circulars remains circumspect. As a practical matter, it has yet to be shown that operating circulars issued by the Federal Reserve Banks, which conflict with the U.C.C., and which have not received the imprimatur of the Board of Governors, provide a sensible, regional coordination of negotiable instruments law that the states cannot otherwise provide.

Nevertheless, it is often desirable to capitalize on the efficiency, expertise and national scope of the Federal Reserve Board's authority when banking rules are established. Even if operating circulars provided an indispensable regional basis for rulemaking, however, that fact would support a federal legislative delegation of rulemaking authority to the individual Federal Reserve Banks that required them to exercise the highest standards for such rulemaking. Other governmental agencies that employ "informal" administrative procedures, such as the Internal Revenue Service, often reserve such provisions for the issuance of merely interpretive guidance.[270] Alternatively, states could empower the Federal Reserve Banks' operating circulars to prevail over state law in narrowly defined situations where states themselves could not cooperate to produce similar regional effects. Notwithstanding any efficiency benefits, federal rules with preemptive effect, such as operating circulars, should be promulgated according to procedures more suitable for legislative rulemaking, rather than according to the current procedures.

---

269. *Id.* The court in *Fink* went on to state that "[e]ven if the Legislature's power to license had been delegated to a governmental agency, the statute . . . would have to be stricken down for lack of guides and proper standards." *Id.* at 876; ROBERT F. WILLIAMS, STATE CONSTITUTIONAL LAW 571-83 (2d ed. 1993); *see also* David M. Lawrence, *Private Exercise of Governmental Power*, 61 IND. L.J. 647, 650 (1986) (analyzing state constitutional invalidations of delegation of lawmaking authority to private parties).

270. *See* Galler, *supra* note 109, at 862-65.

VIII. CONCLUSIONS: TOWARD REINFORCING THE STRUCTURAL INTEGRITY OF THE CODE

More than thirty states have already adopted Revised Article 3, including section 3-102(c) as proposed.[271] The process of adoption has commenced in many states and will start soon in most others. Unless it can be shown that this provision serves a more important purpose than "restatement" and "coordination," this article suggests that it should be rejected.

It is ironic that, despite the drafters' careful consideration and their devotion to lawmaking by the states, section 3-102(c) has inappropriately subordinated state law to federal statutory and administrative rules. The process by which the National Conference of Commissioners on Uniform State Laws and the American Law Institute fostered the revisions to Articles 3 and 4 of the U.C.C. was subjected to lengthy self-appraisal.[272] Although the impartiality of the drafting committees has been challenged,[273] there can be little doubt that Revised Articles 3 and 4 were not the products of an intentionally closed or insular drafting process.[274] The rationale and method of the U.C.C. drafting process is adequately disclosed in the Prefatory Note to Article 3:

> The essence of uniform law revision is to obtain a sufficient consensus and balance among the interests of the various participants so that universal and uniform adoption by the legislatures of all 50 states may be achieved. . . . Announcement of the drafting undertaking . . . was widely circulated in 1985. Anyone who so requested received notice of all meetings and was invited to attend. . . . The American Bar Association Ad Hoc Committee on Payments Systems closely followed the work of the Conference and widely circulated the drafts. . . . The Drafting Committee had 3 or 4 meetings each year and, by August 1990, had held 20 meetings [which] began on Friday morning and ended

---

271. *See, e.g.*, ARK. CODE ANN. § 4-3-102(c) (Michie 1991); HAW. REV. STAT. § 490:3-102(c) (Supp. 1991); KAN. U.C.C. ANN. § 84-3-102(c) (Vernon Supp. 1992); MONT. CODE ANN. § 30-3-124 (1991); NEB. REV. STAT. § 3-102(c) (1992); N.M. STAT. ANN. § 55-3-102(c) (Michie 1993); OKLA. STAT. ANN. tit. 12A, § 3-102 (West Supp. 1993); VA. CODE ANN. § 8.3A-102(c) (Michie Supp. 1993); WYO. STAT. § 34.1-3-102(c) (1991).

272. It also has been subjected to critical comment concerning its representativeness. *See* Rubin, *supra* note 6, at 1275 (stating that Code sponsors "never made a serious effort to establish representative drafting committees. . . . The failure . . . to include consumer representatives . . . represent[s] the marginalization of the uniform state law effort.").

273. *See* Rubin, *supra* note 67, at 759-62, 787.

274. *See* Revised U.C.C., Prefatory Note to Article 3 (West 1990). *But see* Rubin, *supra* note 6, at 1275 (Code's sponsors retained the structure and selection process for drafting committees that had evolved long ago); Rubin, *supra* note 67, at 768-73 (arguing that drafters of Article 3 and 4 were unreceptive to new approaches).

> on Sunday at noon. . . . In addition, the reporters received a substantial amount of comment and suggestions by written and other communications between meetings. . . . The work product was read line for line at annual meetings of the Conference three different years. . . . The American Law Institute circulated the drafts two or three times to its entire membership. . . .[275]

Moreover, each state that has considered the revisions, has engaged study groups, in accordance with the state political process, to discuss the merits of the provisions before enacting them.

Apart from the supposition that the Federal Reserve was exceedingly well represented in the drafting process and effectively presented the case for further federalization, two explanations of a more general nature may be advanced for the survival of section 3-102(c). The first involves the endorsement of preemption. Notwithstanding their professed belief that revision would obviate Federal preemption of Article 3,[276] the drafters apparently anticipated that federalization was rumbling inexorably onward and, as in the case of Article 7,[277] Article 3 could eventually become an appendage to federal law.

The second explanation involves the expediency of using the operating circulars to patch up holes in the Code. It appears that the revisions reflect emerging distrust of the ability of the uniform law process to generate principles sufficiently general to govern circulars that were originally intended as no more than "gap fillers." Perhaps this distrust has arisen because the uniform law drafting process is too cumbersome and lengthy.

Whether or not the federalization of state U.C.C. law regulating the payment system and commercial paper is inevitable in the area of bank collections, it is neither inevitable nor generally desirable in the area of negotiable instruments. In any event, both the value of reinforcing the integrity of the Code and the value of deferring to the state lawmaking process provides sufficient justification for rejecting provisions such as the one discussed here.

Underlying these conclusions, of course, is a concern for legitimacy, efficiency and fairness. Those interests are capable of being disserved by the Federal Reserve's bureaucratic rulemaking procedures. They are much more likely to be vindicated if those rulemaking proce-

---

275. Revised U.C.C., Prefatory Note to Article 3.

276. The Prefatory Note to Article 3 states that the revisions were undertaken because, "*[a]bsent such an update, further Federal preemption of state law may likely occur.*" Revised U.C.C., Prefatory Note to Article 3.

277. *See supra* notes 133-40 and accompanying text.

dures conform to state uniform lawmaking or adhere carefully to routine federal administrative rulemaking.[278] Despite the Federal Reserve's historic regard for consumer welfare and the wisdom of many of its bureaucratic procedures, the rulemaking authority for the banking system should not lie wholly within the Federal Reserve.[279]

With all of its weaknesses and imperfections, one strength of state-based federalism is the ability of states to reject or amend model legislation instead of enacting it uncritically. This article suggests that, as with the Trojan Horse, the scope provision in Revised Article 3 has the potential to function subversively. Rather than inviting wholesale federalization into the Code, unknown entrants should be greeted warily at the gate. In an attempt to clarify and strengthen the state-federal relationship, the drafters have led negotiable instruments law further away from its rightful place in a Code that is, when functioning at its best, imperfectly uniform.

---

278. One point of view contends that uniform law approaches have been insufficiently responsive to emerging technologies, to economic considerations, and to consumer protection needs. Further, the fundamental reason for deference to an expansive preemption doctrine has been the sluggish reactions of uniform law drafters and state legislators. *See* Albert H. Conrad, Jr. & Richard P. Kessler, Jr., *Proposed Revisions to the Georgia Uniform Commercial Code: A Status Report*, 43 MERCER L. REV. 887, 898 & n.80, 899 (1992) (discussing federal action which incorporated U.C.C. Article 4A through an amendment to Federal Reserve Reg J governing funds transfers as a necessary federal action in the absence of quick uniform and state law response); *cf.* Cheryl D. Block, *Overt and Covert Bailouts: Developing a Public Bailout Policy*, 67 IND. L.J. 951, 1030 (1992) (concluding, in the context of emergency bailout situations, that federal banking regulators are the experts best suited to deal with such matters due to the necessity of quick action). *But see* Rubin, *supra* note 6, at 1261-65 (summarizing arguments used to support retention by states of collection system law and stating that "the body of state law can be kept sufficiently coordinated for most practical purposes"). *See generally* James P. Nehf, *Effective Regulation Of Rent To Own Contracts*, 52 OHIO ST. L.J. 751, 784 (1991) (arguing that federally imposed uniformity of disclosure requirements on the rent-to-own (leasing) businesses would place similarly situated businesses on the same playing field but would not enhance the welfare of the consumer).

279. *See* Hoke, *supra* note 29, at 687-88 ("Banking is one area where American citizens have focused their efforts on the creation of state and local laws in order to address critical public concerns."). Hoke offers several reasons why federal preemption in areas of such traditional local concern is undesirable, including the trillion dollar deficit that increasingly presents obstacles to local enforcement, inspection and funding barriers, and the rejection by federal authorities of formal involvement of states or municipalities in helping to correct federal regulatory inadequacies. *Id.* at 718-19. *See also* THIBAUT DESAINT-PHALLE, THE FEDERAL RESERVE: AN INTENTIONAL MYSTERY (1985); WILLIAM GREIDER, SECRETS OF THE TEMPLE: HOW THE FEDERAL RESERVE BANKS RUN THE COUNTRY (1987).