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UCC Article 4 and Regulation CC: Can They Ever Be Reconciled?

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assignments evidently have not disappeared. For example:

- All 50 states have provisions in their workers' compensation laws that either restrict or flatly prohibit transfers of workers' compensation recoveries.
- At least 20 states have provisions in their insurance codes that restrict or prohibit transfers of rights to receive payments under insurance/annuity contracts.
- At least 18 states have crime victims' compensation laws that prohibit or restrict transfer of crime victims' compensation awards.
- 18 states have recently enacted structured settlement protection statutes that restrict assignments of future payments under structured settlements. Similar legislation is pending in other states.

- At least six states have enacted periodic payment statutes that limit assignments of periodic payments of tort claims.
- Lottery statutes in many states prohibit or restrict assignment of lottery winnings.

As an extreme example of continuing legal restrictions on assignment of payment rights by individuals, Alabama law provides:

Any person...who for a consideration takes or accepts from an employee an assignment of his claim or award or judgment for, or agreement to pay, [workers'] compensation, or who accepts or takes same as security for a loan or a debt...shall be guilty of a misdemeanor, and on conviction, may be imprisoned in the county jail or sentenced to hard labor for the county for not more than 12 months....⁴²

The clash between these and other continuing legal restrictions on

assignments of payment rights and the sweeping overrides of legal restrictions in sections 9-406(f) and 9-408(c) of Revised Article 9 may not be resolved in favor of the overrides.

D. Key Point to Remember

Despite the broad overrides of restrictions on assignment of accounts, chattel paper, promissory notes, health-care-insurance receivables and general intangibles provided in the official text of sections 9-406 and 9-408 of revised Article 9, such restrictions will not necessarily be affected by the overrides as they are actually enacted. Especially in dealing with payments rights of individuals, secured parties/purchasers should satisfy themselves that their proposed collateral (or the payment rights that they propose to purchase) are within the expanded scope of revised Article 9, are not covered by any of the express statutory exclusions and are not subject to extrinsic transfer restrictions that are not, or may not be, rendered ineffective under revised sections 9-406 and 9-408.

42. See Alabama Code § 25-5-231.

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Miller, is that the parallel existence of Article 4 and Regulation CC is not satisfactory as a long-term solution. Over time, if not coordinated and unified, they will likely diverge, and the payments system will be at risk. It is surely better to anticipate such problems, and this means the systems should be unified at one level or another. It is ironic that the resistance to resolving this in the traditional bank collection code comes from the industry, at a time when the FRB is amenable to a state-law solution.

Of course, any such effort raises the spectre of turning the project into another

consumer issues battleground, as with recent projects to revise UCC Articles 2 and 9. But there is a danger of that anyway, either in the context of FRB regulation or a broadening Article 3, 4 and 4A Drafting Committee agenda. Consumer issues could indeed complicate any Article 3 and 4 revision effort; but that may be an issue to be confronted with or without Regulation CC repatriation.

Without unanimity and support from the industry, the Drafting Committee was compelled to defer further consideration of Regulation CC repatriation. A motion

was adopted to remove Regulation CC from the agenda for the Chicago meeting and focus instead on other Article 3 and 4 issues. If sustained at future meetings, this will alter the nature of the revision project, eliminating the original core thrust, and perhaps yielding to a new focus on issues previously deemed peripheral. Thus, the basic direction of this revision project remains as uncertain as the relationship between Article 4 and Regulation CC.

of the new rule at revised section 9-615(f), barring use of the repossession sale price as the basis for a deficiency (or surplus) in certain below-market sales and in sales to the creditor, related parties or secondary obligors.¹⁵⁶

X. Conclusion

The general rules governing when property can be repossessed and how it

is to be repossessed, and the debtor's liability for a deficiency, appear to be little changed in revised Article 9. Generally this should be perceived as good news, as the old rules in this area were satisfactory from virtually any perspective. However, the revisions have added substantial burdens to secured parties in terms of the sale, notice of sale, and post-disposition stages, especially when a deficiency is sought or a surplus exists.

Differences in procedures between commercial and consumer transactions have been widened. These changes are sufficiently challenging that secured creditors should begin now (if they have not already) to prepare for compliance with the new requirements that go into effect on July 1, 2001.

156. See *supra* Pt. IX, F. 1.

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and conflicts between state and federal law, and return bank collection law to its single, traditional source. But whatever the reasons, industry views as expressed at this meeting seemed to scuttle any hope of a comprehensive repatriation of Regulation CC, thereby dooming the industry to a bifurcated system of bank collection laws and the endless possibility of divergent state and federal law.¹⁶

D. Transition Issues

There followed an interesting discussion of the transition issues that would result from movement of Regulation CC into Article 4. Clearly, Regulation CC could not be repealed until or unless there was enactment of a new Article 4 in all 50 states, a process that could take some time. On the other hand, a "rolling repeal" seems quite feasible: The FRB would defer to state law in any state that adopted a new Article 4 incorporating Regulation CC as deemed appropriate.¹⁷

This would encourage state enactments (assuming the revisions represent an improvement in the law), and if enactments were not unanimous, the two systems could coexist side-by-side in some states indefinitely. Indeed, the resolution of the current conflicts between Article 4 and Regulation CC (in a revised Article 4) would undoubtedly have a salutary effect on such conflicts even in the states that did not enact the revisions. The result—resolution of the uneasy and unclear relation between these state and federal laws—is a laudable goal even as an academic exercise. Any reliable guidance at all in this area would be an improvement. Again, it seemed odd that the industry representatives did not embrace this goal.

It was argued at the Chicago meeting that the minor problems encountered to date do not justify the enormous task of integrating Regulation CC into Article 4. But the task needs to be done—uncertainties and inconsistencies in bank collection law are not acceptable on a long-term basis, and the need to accommodate changing technologies is icing on the cake. Clearly, it would be easier to integrate Regulation CC into Articles 3 and 4 rather than the other way around; arguments that repatriation of Regulation CC is too big a job seem disingenuous

when made by those who instead favor federalization of this entire area of law.

III. The Project Changes Course

Despite the obvious need to resolve the fundamental uncertainties in current law, the initial effort to overhaul Regulation CC apparently was being driven by the need of the industry to resolve the check image return issue. When it appeared that this issue was receding somewhat and that banking industry representatives favored only a narrow, technical solution,¹⁸ the likelihood of the Drafting Committee fashioning a broad solution declined proportionately. Check imaging alone probably does not justify repatriation of Regulation CC, especially if the imaging issues are to be handled elsewhere (*e.g.*, by more aggressive FRB regulation). Thus the opportunity to repatriate Regulation CC may have been lost.

The danger in all of this, as pointed out at the meeting by Professor Fred H.

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16. Understandably, FRB representatives and Drafting Committee members made clear they had no intention of seeking to resolve these issues without the support of the industry.

17. This was analogized to the deference to the UETA in the federal ESIGN law, followed by some titling over the concern that ESIGN is not sufficiently well drafted to serve as a sterling example.

18. Several industry representatives urged the FRB to take a more aggressive stance regarding its own authority in order to resolve the issue by regulation. In any event, it seems fair to say the bank representatives were focused largely on the technical issues involved in facilitating check image return and were relatively uninterested in the broader issues.

credit reporting; credit scoring. In addition, it would address certain topics specifically tailored for debtors—reaffirmation, dischargeability, post-discharge anti-discrimination, re-establishing credit and restoring oneself to a sounder financial position.

V. The Need for Empiricism

While I firmly believe that financial literacy education can improve the lives of those who receive it, that hypothesis is largely untested. In addition to providing new and additional programs, we need to assess empirically, over the long and short term, the effects of financial

literacy education. That is not an easy task; such studies are complex and costly. But, if we do not provide empirical verification of success (howsoever success is ultimately defined), then we cannot fully justify financial literacy education. So, in addition to thinking programmatically, we also need to think like (and with) social scientists and pursue, even on a small scale basis, the testing of programs before they are implemented on a large scale.

VI. Conclusion

Money and credit are all around us. Rather than treating the topic as dry or

shying away from teaching it altogether, these suggested programs seek to make the learning and thinking about money and credit fun and informative. It is material that can be employed relatively easily, following quality teacher training programs. These are programs that can and should produce positive results for the people enrolled in them, and we need to have empirical verification of what many of us suspect is true. Stated most simply, we cannot ignore teaching about money and credit any longer.

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meeting that section 4-103 cannot confer rule-making authority on the FRB as to matters outside the scope of federal law; limits on the scope of federal statutes have significance, as illustrated by uncertainty in some of the cases with respect to the extent of FRB regulation.⁹ This again suggests a need for a comprehensive state law solution.

Of course, banks can extend bank deposit rules to their customers by changes to bank deposit agreements, subject to some limitations.¹⁰ But even these cannot extend to noncustomers, *e.g.*, prior parties who may need to reacquire the instrument in order to enforce it under Article 3.¹¹ It was argued in Chicago that this is a small and unimportant subset of transactions that essentially can be ignored,¹² but this seems an extraordinarily unsatisfactory answer. It seems better to recognize that the limits of fed-

eral authority in this area are real and to seek a comprehensive state law solution, though some at the Chicago meeting argued consistently for a complete federalization of this entire area of law via FRB regulation.

C. State Versus Federal Law

There were extensive discussions during the Chicago meeting on the relative merits of a state versus a federal solution, and the merits of a wholesale versus a narrow repatriation of Regulation CC issues into Article 4. It was somewhat surprising to your author to hear many of the bankers at this meeting argue against a wholesale repatriation and reconciliation of Regulation CC in Article 4. After years of chafing about the inconsistency of Regulation CC with the established principles of bank collection law in Articles 3 and 4, one would have expected some enthusiasm about fixing the system and returning bank collection law to a single, integrated source. But perhaps the very ineffectiveness of Regulation CC augers against such a reconciliation. Despite its inconsistencies and uncertain impact on bank collections, the Regulation CC check return rules

have not been much of a factor in bank collection litigation, and banks have learned to live with the uncertainties and inconsistencies as well as the funds availability requirements.¹³

Thus there is some apparent comfort with the status quo, and perhaps a natural wariness of the uncertainty that is inherent in any law reform effort. Some bankers at the Chicago meeting also expressed a preference for FRB regulation over state legislation, invoking the usual arguments that regulation is quicker and more uniform than a 50-state enactment process.¹⁴ Some bankers noted that a FRB regulation can be revised easily, quickly and even continuously while a uniform state law is more difficult to change once enacted.¹⁵ As noted, it seemed ironic to see banking industry representatives at this meeting arguing against an opportunity to eliminate a troublesome regulation, resolve meddlesome issues

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9. See *e.g.*, Miller and Harrell, *supra* note 1, at ¶ 8.01[2]. The issue is not entirely a new one. See, *e.g.*, Federal Reserve Bank of Richmond v. Malloy, 264 U.S. 160 (1924).

10. See, *e.g.*, Miller and Harrell, *supra* note 1, at ¶ 9.03[3]; Bodie v. Bank of America, 79 Cal. Rptr. 1999 Cal. LEXIS 1198 (1999).

11. See, *e.g.*, Miller and Harrell, *supra* note 1, at ¶ 3.03 and Ch. 4.

12. An interesting argument, inasmuch as the issue encompasses some 2000 years of negotiable instruments law.

13. And probably view the latter as inevitable, though also as a contributing factor in check fraud losses.

14. An argument that ignores likely differences in the quality of the resulting product.

15. This was intended as an argument for federalization, but can just as easily be taken the other way.

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By Alvin C. Harrell

I. Introduction

One of the festering sores in commercial law is the uneasy relationship between Uniform Commercial Code (UCC) Articles 3 and 4 (covering, among other things, check deposits and collections)¹ and Federal Reserve Board (FRB) Regulation CC² (implementing the federal Expedited Funds Availability Act, or EFAA).³ The EFAA was apparently drafted with little regard for its impact on or relationship to state law; although the FRB has been careful to minimize disruptions to the payment system via Regulation CC, the fact is that these state and federal laws never have meshed.⁴

As a result, neither state nor federal law accurately describes the legal environment governing the collection and payment of checks in the banking system. This is rather striking, considering the importance of these issues. States enacting the latest revisions to UCC Articles 3 and 4 did so with the knowledge that the statute being enacted was preempted to some extent by Regulation CC (though no one was or even now seems certain of the exact parameters of the preemption), and to that extent was not the law at all. Similarly, while Regulation CC has preemptive effect, it is interstitial in nature, and therefore its true effects cannot be defined without reference to the underlying state laws. More than a de-

cade later, the details and impact of this interface remain unclear.

Perhaps this would not have happened had state law been more responsive to the concerns that gave rise to the EFAA, and there has long been a perception that the matter could and should be rectified by an expansion of UCC Article 4 to encompass the purposes of Regulation CC. This possibility was reinforced recently when parties in the banking industry and at the FRB began to perceive roadblocks in Regulation CC to certain technological advances in check processing (relating to check image returns, as discussed *infra*). The result was formation in 2000 of an Article 3, 4 and 4A Drafting Committee (Drafting Committee) to consider the "repatriation" of Regulation CC into Article 4.

The Drafting Committee met for the first time on April 7-9, 2000, in Boston, and for the second time on December 8-10, 2000, in Chicago. This article discusses some of the issues addressed as of the second meeting.⁵

II. Repatriation of Regulation CC into Article 4

A. Check Image Return

As noted, the driving issue in formation of the Drafting Committee was the need to repatriate Regulation CC into UCC Article 4. This, in turn, was initiated in part due to a perception that Regulation CC impedes the return of dishonored check images (check image returns), because the scope of Regulation CC does not extend to the bank customers and others outside the bank-

ing system who will be affected by the inability of the depository bank that receives check image returns to return the original dishonored item to the depositor. Prior and subsequent owners of the dishonored item, outside the banking system and therefore beyond the scope of Regulation CC, could be affected adversely by the absence of the dishonored item.

Check imaging typically means destruction of the original paper item, which will therefore be unavailable for return to the customer who owns and deposited it. This may impede the ability of that customer to assert holder in due course status⁶ or otherwise to collect the instrument from parties liable on it under UCC Article 3.⁷ There is a perception that the FRB lacks the authority to alter the rights of these parties as to nonbanking transactions governed by Article 3 (although, as one might expect, some disagreement on this point has surfaced⁸); thus a state law solution was deemed appropriate in order to encompass these broad state law issues.

B. Agreement of the Parties

One issue is whether Article 4 could be interpreted or revised to simply incorporate Regulation CC as an agreement of the parties under section 4-103. However, it was noted at the Chicago

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1. See generally Fred H. Miller and Alvin C. Harrell, *The Law of Modern Payment Systems and Notes* (2d Ed. 1992).

2. 12 CFR Pt. 229.

3. 12 U.S.C. §§ 4001-4010 (1987).

4. See Miller and Harrell, *supra* note 1, at ¶ 8.04; Conni L. Allen, *The New Rules Governing Collection and Payment of Checks in the Banking System: Impact of Regulation CC*, 47 Consumer Fin. L. Q. Rep. 129 (1993).

5. Your author attended this meeting as an observer. The third meeting is scheduled for February 16-18, 2001 in San Diego.

6. See UCC §§ 3-302 and 3-305.

7. See, e.g., Miller and Harrell, *supra* note 1, at ¶ 3.03 and Ch. 4. Other prior parties in the chain of title who may be liable on the instrument could be similarly affected, in that their right to become a holder of the item upon discharging that liability would be impaired by destruction of the item. *Id.*

8. Some apparently favor complete federalization of the law of commercial paper, bank deposits, and collections, perhaps by broad assertion of FRB authority, as the solution to this problem.