The Dodd-Frank Act and the Future of State Commercial Transactions Law

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Despite obvious similarities between our state and federal systems of law, there are also significant differences, and those differences have widened over the past 100 years. Among other things, much of state law is either common law or common law-based, including basic elements of our traditional social compact as embodied in civil procedure and the substantive law of contracts, property and torts. This system of laws and doctrines protects party autonomy, property and personal rights, and private remedies. In combination with constitutional concepts of federalism, due process, individual rights and limited government, this has provided Americans with a nearly unique state law environment for private commercial and consumer transactions, including, e.g., an emphasis on custom, usage, private agreements, and judicial remedies.

In contrast, federal law (at least for commercial and consumer transactions) is largely and increasingly administrative law, typically involving a detailed and comprehensive normative structure with extensive public mandates administered by an authoritative regulatory agency. For at least 100 years, in fits and starts but seldom receding, this federal administrative state has been expanding at the expense of state and local law. In the area of consumer financial services, this trend has accelerated since the late 1960s, with a major expansion since 2006, and took another quantum leap forward with the Dodd-Frank Act and creation of the Bureau of Consumer Financial Protection (CFPB). These 2010 changes (generally effective July 21, 2011) are likely to have significant, practical implications, not only for consumer and commercial transactions law, the industry, and consumers, but also for the legal profession and the future of state laws, agencies and courts.

DIFFERENT LAWS, DIFFERENT WORLDS
The New Non-Uniformity

Increasingly, private parties, issues, and transactions in the United States are subject to significantly different systems of rules, depending on whether they are operating primarily under state law or within the direct jurisdiction of a federal administrative agency. As the latter jurisdiction has expanded it has become more...
difficult to avoid, but lawyers and other private parties whose daily activities traditionally have fallen outside its borders may be slow to react or even unaware of these changes.14 As noted here, the Dodd-Frank Act accelerates this trend. As a consequence, as discussed below (and despite the nationwide uniformity that is achieved by federal law), lawyers, consumers, creditors, merchants and other market participants may find themselves in very different legal worlds, depending on how their transaction is structured.15

Door Number One – CFPB Supervision

Behind this door lies the new legal world for non-depository “covered persons,” i.e., consumer financial services providers (and their customers), that engage in certain types of activities and therefore fall within the direct supervisory and examination authority of the CFPB.16 For some of these service providers (e.g., non-depository home mortgage loan originators), this is a significant reversal of fortune as compared to prior law, taking them from a primarily state-regulated legal environment directly to the world of comprehensive federal supervision, regulation and examination.17

This reinforces (and codifies) recent, significant changes in the home lending markets, with consolidation and federalization of the residential mortgage industry being among the most obvious. Already, a handful of federally-regulated financial institutions plays a dominant role in originating home mortgage loans (supported by federal funding sources), and this has been accompanied by an exodus of private risk-capital and independent, local mortgage lenders, leaving the mortgage markets largely dependent on federal agencies and federally-supervised (and subsidized) funding sources.18 This is a very different world (for lenders and borrowers alike) as compared to traditional American home mortgage markets and lending transactions.19

Door Number Two – Enumerated Federal Laws

Behind this second door lies a CFPB regulatory authority that is broader (covering a wider and seemingly comprehensive set of enumerated federal laws20), yet can be considered to have less depth in the sense that CFPB examination authority may be limited (e.g., as regards small banks21) and the regulatory authority may be limited by the scope of the enumerated consumer laws (see, e.g., the scope provisions of the Truth in Lending Act (TILA)22). Moreover, while the resulting CFPB jurisdiction is clearly broad, it is not unlimited, and this may allow transactions to be structured in ways that account for that jurisdictional reach.

The obvious example is a business plan designed to avoid consumer financial services transactions. While not all of the enumerated consumer laws are limited to consumer transactions,23 many are; this means that a business plan limited to commercial credit transactions should be largely outside the scope of the CFPA and the CFPB, and perhaps governed primarily by traditional state laws. Similarly, the focus of the enumerated consumer laws (and therefore the CFPA and the CFPB) is financial services transactions (with a focus on credit); cash sales transactions (by a seller not affiliated with or referring customers to a creditor24) also should be significantly outside the scope of the CFPA and the CFPB.25

For those parties and transactions within the scope of the enumerated consumer laws (and the CFPB’s authority to curb unfair, deceptive and abusive practices26), there is considerable uncertainty, due to the broad, discretionary (and in some ways unprecedented) authority of the CFPB.27 At the time of this writing probably no one (at least outside the CFPB) can say for sure how this authority will be interpreted and used.28 Obviously, some traditional practices, state laws and legal standards are newly at risk.29 Participants in this world of enumerated federal laws and other consumer transactions are likely to find at least some of their precepts challenged, and may find themselves in a legal environment that is different from the past in important ways.

Door Number Three – State Law

Here, perhaps, is a surprise — both for those who may be unaware they are entering doors number one and two, and for those eager that everyone else do so: Despite the quantum leaps forward in the scope of federal administrative law in recent decades (culminating, to date, in the Dodd-Frank Act), a significant range of transactions remains subject to traditional state law legal principles.30

Partly this is because the legal “marketplace” has spoken, and often favors traditional private transactions, state law, and judicial remedies, to the extent they remain available. Two illustrations should suffice. First, despite the extensive public and private statutory remedies available under federal consumer finan-
A remaining important legal issue for all concerned is: how to determine which door the parties are entering.

Another example can be found in the context of check deposits and collections, involving the relationship between Federal Reserve Board (FRB) Regulation CC and UCC Articles 3 and 4. The scope of Regulation CC is broad as to aspects of the check collection process, and it clearly preempts state law as to any inconsistency. Yet, the overwhelming majority of the checking system case law is governed by the UCC, and this case law is extensive despite the diminishing role of such transactions. While all of this ultimately may change, as federal administrative law increasingly preempts the UCC, for now it demonstrates a preference for state law, transactions and remedies on the part of many lawyers, merchants, creditors and consumers.

So, it is quite possible that such parties will desire to continue having their legal relations governed primarily by state law, rather than federal regulation. While this may not always be possible, especially for consumers, to the extent that it is possible private transactions may be increasingly differentiated by whether they are subject primarily to state or federal law — e.g., according to the strata noted here: Some transactions (e.g., residential home mortgage loans), possibly aided by federal subsidies or constrained by federal regulation, will go through door number one and be limited to transactions with large entities pursuant to comprehensive federal supervision; other transactions (e.g., vehicle loans) may be conducted with consumers by a broader range of entities, pursuant to federal consumer financial laws with a limited scope, such as TILA, and therefore will pass through door number two; still other transactions will pass through door number three and be covered primarily by traditional state laws and legal principles. Each of these transaction categories will be subject to a very different legal environment.

A remaining important legal issue for all concerned is: how to determine which door the parties are entering. This is likely to be a significant issue for practitioners, businesses and consumers in the years ahead, even more so than in the past. For example, the scope of TILA has seemed to diminish in importance in recent years, as creditors came to appreciate the litigation benefits of the TILA disclosures and embraced them almost across the board. That may now change, if TILA under the CFPB is perceived to carry with it an increasingly onerous compliance burden. Thus, where possible, it may become more important to conduct transactions (e.g., cash transactions and commercial loans) outside the scope of TILA, in order to avoid unnecessary legal and compliance costs, risks, liabilities and other burdens. The implications of this are discussed below.

IMPLICATIONS FOR STATE LAW

A long-standing benefit of our common law-based federalist system has been the ability of private parties to structure transactions in creative ways so as to fit within (or outside of) applicable legal mandates. This task has become increasingly difficult, and at the same time increasingly important, as federal administrative law has expanded these mandates in recent years. This requires consideration of the extent to which state laws (such as the UCC and related laws) still apply in an age of seemingly comprehensive federal administrative law and regulation.

The UCC remains the foundational state commercial law governing personal property transactions and, of course, it has long been subject to extensive federal preemption (or incorporation). But, as noted, and despite this preemption, UCC law and issues have continued to play a predominant role in private transactions (and litigation). Thus, an important question is: How and to what extent will
At this point, of course, the larger part of any answer is necessarily limited to speculation (or worse, pure guesswork), but that does not mean the exercise is irrelevant or useless. So, the following observations are offered.

As noted, the focus of the CFPA and CFPB is consumer protection,\(^5\) while the UCC governs commercial as well as many consumer transactions. Therefore, assuming Congress does not decide to wholly preempt state commercial laws, and assuming the CFPB does not branch too far in that direction,\(^6\) many commercial transactions and issues should continue to be governed largely by state law including the UCC. This should include, e.g.: commercial sales of goods (UCC Article 2); commercial equipment leases (Article 2A); negotiable instruments in commercial transactions (including promissory notes and drafts) (Articles 3 and 4);\(^7\) letters of credit (Article 5);\(^7\) documents of title (Article 7);\(^7\) investment securities (Article 8);\(^7\) and commercial personal property secured transactions (and related: consignments; sales of accounts, chattel paper, payment intangibles and promissory notes; agricultural lien priorities, etc.) (Article 9).\(^7\)

Thus, parties limiting themselves to commercial-purpose transactions may have legal relationships largely outside the scope of CFPB jurisdiction and rules,\(^8\) thereby remaining within the scope of state laws including the UCC. This should include, e.g.: commercial sales of goods (UCC Article 2); commercial equipment leases (Article 2A); negotiable instruments in commercial transactions (including promissory notes and drafts) (Articles 3 and 4);\(^7\) letters of credit (Article 5);\(^7\) documents of title (Article 7);\(^7\) investment securities (Article 8);\(^7\) and commercial personal property secured transactions (and related: consignments; sales of accounts, chattel paper, payment intangibles and promissory notes; agricultural lien priorities, etc.) (Article 9).\(^7\)

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This analysis suggests that a significant (though diminished) swath of private transactions (primarily commercial and non-financial transactions) will remain largely subject to the UCC and other state laws.\(^8\) This may be important, e.g., to lawyers, businesses and their customers that rely on the intuitive, user-friendly nature of state contracts, tort and property laws (and the UCC) and cannot afford the costs and burdens of monitoring and compliance with the complex and ever-changing world of federal administrative law.\(^7\)

For many businesses, the alternative to state law is to go out of business, or at least to dis-
continue the lines of business subject to comprehensive federal laws and regulations. The result is likely to be a continuing trend toward consolidation (and concentration) in those industries (such as banking and home mortgage lending) that cannot escape the comprehensive federal regulatory umbrella. In some sectors of these markets, the results may be an economic concentration that will leave segments of society unserved by the private economy, and dependent on other sources such as the federal government.

But for those lawyers, businesses and customers who are able to fit their transactions into categories that are at least partly outside the scope of a seemingly comprehensive federal administrative law system — barring unforeseen developments — the UCC and other state common law-based legal structures will still exist to provide a foundation for consensual private transactions. It is likely that identifying and understanding the boundaries and relationships of these structures, transactions and issues will be an increasingly important part of the lawyer’s role.

2. See, e.g., infra notes 16 & 17.
4. Including codifications such as the Uniform Commercial Code (UCC).
5. For a recent discourse on these issues in a case on otherwise unrelated (criminal law) issues, see, e.g., Bond v. United States, 564 U.S. 211, 131 S.Ct. 2235, 2011 U.S. LEXIS 6617, 79 USLW 4490 (U.S. S.Ct. June 16, 2011) (illustrating the uniqueness of our federalist system). For another case, although the decision in the case is largely of historical interest, at another point in the chronological spectrum, see also Erie R.R.V.F., Tompkins, 304 U.S. 64, 78 (1938) (“There is no federal general common law.”). These issues are an important part of what is sometimes called “American exceptionalism.” See, e.g., Victor Davis Hanson, Commentary, “a toast to American exceptionalism,” Oklahoman, July 1, 2011, at 10A.
6. Of course, this emphasis has never been total; but it has been significant. See, e.g., UCC §1-103(a)(3).
7. Again, this is not a total emphasis, as illustrated by the extensive private litigation under the federal Truth in Lending Act. See, e.g., Rohner & Miller, infra note 22, Chs. 1 & 12. But this is correct as a generalization.
8. See, e.g., Clark, supra note 3.
10. See Harrell, supra note 9, infra notes 18-19.
11. See supra note 1.
12. Id., Title X, §§1001-1067 (The Consumer Financial Protection Act, or CFPA).
14. In your author’s experience, lawyers accustomed to the state law world of private contracts, negotiations, and judicial remedies sometimes are ill-prepared for representing clients in the very different world of federal administrative agencies.
15. This nonuniformity is more commonly recognized in the context of payment transactions (where this nonuniformity is sometimes cited as evidencing a need for a further expansion of federal law, to eliminate the disparities). See, e.g., Mark E. Budnitz, “Payment Systems Update 2005: Substitute Checks, Remotely-Created Items, Payroll Cards and Other New-Fangled Products,” 29 Consumer Fin. L.Q. Rep. 3, at 9 (2005) (raising this issue). See also infra this text and notes 31-37. However, as discussed below, such nonuniformity is a far more prevalent phenomenon than this narrow example suggests. Ironically, then, the result of increasing federalization is sometimes more rather than less nonuniformity, although it is a nonuniformity based on parties and transactions rather than state borders.
16. Section 1002(b) of the Dodd-Frank Act, supra note 1, defines the term “covered person” to include any provider of consumer financial products or services (as defined at id. §1002(c) (15)) for any 30 activities that are deemed to be financial products or services subject to CFPB authority. Covered persons are subject to regulations issued by the CFPB pursuant to 18 “enumerated consumer laws” (see id. §1002(12)) or other “federal consumer financial law[s]” (as defined at id. §1002(14)), but are not necessarily subject to regular reporting requirements and examinations by the CFPB unless the covered person is also within the scope of Dodd-Frank Act §1024. The latter include covered persons who: originate, broker or service residential mortgage loans; provide mortgage loan modification or foreclosure relief services; are “larger participants” to be defined by the CFPB; are engaged in mortgage lending (and concentration) in those industries (such as banking and home mortgage lending) that cannot escape the comprehensive federal laws and regulations. 71 The result is likely to be a continuing trend toward consolidation (and concentration) in those industries (such as banking and home mortgage lending) that cannot escape the comprehensive federal regulatory umbrella. In some sectors of these markets, the results may be an economic concentration that will leave segments of society unserved by the private economy, and dependent on other sources such as the federal government.
17. In some ways, the scope of this CFPB authority is relatively narrow (see supra note 16), but within that scope the authority is very deep. See, e.g., John L. Roiphe, Christopher S. Naveja & Jason B. Hite, “The Dodd-Frank Act Changes the Consumer Financial Landscape,” 64 Consumer Fin. L.Q. Rep. 284 (2010); Richard P. Hackett & Frank H. Bishop Jr., Summary of the Consumer Financial Protection Act of 2010, id., at 295. It is sometimes said that home mortgage lenders were previously “unregulated.” In your author’s experience, this is a misnomer, as mortgage lending has long been one of the most heavily-regulated activities, at both state and federal levels. See also Niall Ferguson & Ted Forstmann, Opinion, “Back to Basics on Financial Reform,” Wall Str. J., April 23, 2010, at A19 (“The crisis of 2007-2009 originated in one of the most highly regulated sectors of the financial system — the U.S. residential mortgage market.”). See also Harrell, supra note 9. But there can be little doubt that the new world of CFPB supervision and examination is an entirely different matter.
20. See supra note 16.
21. Compare, e.g., the direct and exclusive examination authority, with respect to federal consumer financial laws, as to insured depositary institutions with total assets over $10 billion (Dodd-Frank Act, supra note 1, §1025) with the CFPB’s limited examination authority over smaller depository institutions (id. §1026).
25. See supra note 16; Dodd-Frank Act, supra note 1, §1027 (excluding cash sales of goods and services not covered by a federal consumer financial law, among other things). Consumer Finance Act, supra note 1, §1001(b)(5)(D) (retained authority of the FTC). See also infra notes 26 & 66; see generally infra this text and notes 30-44 (Door Number Three – State Law) and 45-68 (Implications for State Law).
26. See Dodd-Frank Act, supra note 1, §1031. See also id. §1045 (absolute, unfair, deceptive and predatory mortgage practices); supra note 16 (referring to the CFPB authority to regulate “conduct that poses risks to consumers”).
27. See supra notes 16-17.
28. But see infra note 51.
29. See infra Part III. Your author is aware that a salient feature of the Dodd-Frank Act is its new limitations on federal preemption of...
state law by the bank regulatory agencies. See, e.g., Roland E. Brandel & Jeremy R. Mandell, “Preemption under the Consumer Financial Protection Act of 2010,” 64 Consumer Fin. L.Q. Rep. 307 (2010). However, the preemption authority inherent in the CFPB jurisdiction over enumerated consumer laws and federal consumer financial laws open the door to increased federal preemption of a different kind.

30. See supra this text and notes 23-25; discussion below; and infra this text and notes 45-68 (Implications for State Law).


32. E.g., alleging a TILA violation as the basis for a state-law fraud claim.

33. This includes but is not limited to requirements for documentation of the transaction. Compare, e.g., the documentation required for a small commercial real estate loan, governed primarily by state law, with that of a consumer home mortgage loan, governed heavily by federal law. As another example, one impedes for the Dodd-Frank Act, supra note 1, at least among plaintiffs’ lawyers, was a desire to limit preemption of state laws by federal banking agencies. See, e.g., Brandel & Mandell, supra note 29. Partly, it should be emphasized, this preference for state law may arise because the state law issues are governed by widely-accepted and easily understood common law principles and well-written uniform laws such as the UCC and UNC. But this merely emphasizes the point made in this text, that the pressure for federal preemption comes from large, nationwide creditors seeking to overcome the patchwork of unrealistic and nonuniform laws in some states. Thus, a failure of the states to update and rationalize their laws is an invitation to pressures for federal preemption.

34. 12 CFR §229. See also infra note 35, and infra this text and notes 45-68 (Implications for State Law).


37. See supra note 35. This is not a new issue. See, e.g., Alvin C. Harrell, “UCC Article 4 and Regulation CC: Can They Ever Be Reconciled?” 54 Consumer Fin. L.Q. Rep. 236 (2000).


40. Potentially with a corresponding diminution in state law litigation, a trend that may impact the legal profession. See, e.g., supra notes 17, 29 & 33; infra this text and notes 45-68 (Implications for State Law).

41. See, e.g., supra notes 5-7, and infra this text and notes 16-19 (Door Number One – CFPB Supervision).

42. See supra this text and notes 20-29 (Door Number Two – Enunmerated Federal Laws).

43. See, e.g., Rohnen & Miller, supra note 22, Ch. 2.

44. See, e.g., sources cited supra at notes 16 & 17; supra this text at notes 29-30; supra note 37.

45. See generally supra note 5. Without suggesting a direct parallel, it can be noted that this phenomenon is not limited to the United States. See, e.g., Andrew Collier, Opinion, “How China’s Banks Break the Rules,” Wall Str. J., June 6, 2011, at A15. A significant portion of a, or the so-called, is that in the United States this has been possible within the law.

46. See also supra notes 26 – 29 and accompanying text.

47. See, e.g., UCC §2-102 (Article 2 applies to “transactions in goods,” id. §1-109(a)(1) (Article 9 applies to “a transaction, regardless of form, that creates a security interest in personal property”). Other UCC Articles and scope provisions complete the almost comprehensive UCC coverage of personal property transactions, with the primary exception of sales, licenses and leases of general intangibles (some of which are covered by the Uniform Computer Information Act (UCITA), as applicable).

48. See, e.g., the impact on UCC Articles 3 and 4 of: FRB Regulation CC (12 CFR pt. 229); and the Check Clearing for the 21st Century Act, 12 U.S.C. §§5001-5018 (“Check 21”). See also supra this text and notes 3, 15, 34-40.


50. Again, the UCC Article 4/FRB Regulation CC example is instructive. See, e.g., supra law and text at notes 34-40.

51. See supra note 16. However, as also noted, some of the enumerated consumer laws, e.g., the ECOA, cover commercial as well as consumer transactions. See supra note 23. See also supra note 25, and infra note 65. As reported in the press, the CFPB has announced that it will focus initially on the following areas of law: “debt collection; consumer reporting; consumer credit and related activities; money transmitting; check cashing and related activities; prepaid cards; and debt relief services... [plus] automobile loans and personal loans...” See Deborah Solomon & Maya Jackson Randall, “Agency Outlines Role,” Wall Str. J., June 24, 2011, at C3.

52. See, e.g., supra note 16 (CFPB authority over “conduct that poses risks to consumers”).

53. But see supra this text and notes 34-40 and 48; discussion below at notes 60-63.

54. Subject, as now, to related laws such as the Custom Uniform and Practice for Documentary Credits (UCP); the United Nations Convention on Independent Guarantee and Stand-by Letters of Credit; and Office of the Comptroller of the Currency (OCC) Interpretive Rules, 12 C.F.R. §§87.106 & 7.1017. See generally Alvin C. Harrell & Fred H. Miller, Commercial Transactions, Documents of Title, Letters of Credit, 15 West’s Legal Forms Ch. 8 (4th ed. 2009).


56. Subject to federal securities laws. For illustrations of the continuing relevance of UCC Article 8, see, e.g., Howard Darmstadter, “Investment Securities,” 65 Bus. Law. 1283 (2010).

57. See UCC §9-109 (scope of Article 9).

58. This is not limited to personal property transactions under the UCC; much the same can be said for commercial real estate transactions, governed by state real property law rather than the UCC. See but supra notes 50 & 52.

59. For banks, this includes state and federal bank regulatory agencies.

60. The Uniform Law Commission (ULC) and American Law Institute (ALI).

61. The chair was Professor Fred H. Miller and the reporter was Professor Linda J. Rusch.

62. While the initial focus was payment issues, the scope was subsequently redirected to focus on mortgage notes and loans, in response to the sub-prime mortgage crisis.


64. See, e.g., UCC §§69-613 and 9-614.


66. See also supra note 25.

67. See id., supra notes 16 and 26.

68. See supra notes 47-50.

69. See supra notes 16, 25, 26, 51 & 65.

70. Consumer transactions will also remain subject to some state laws, including consumer protection laws, but this will be subject to an increasingly complex (and perhaps restrictive) overlay of federal regulations and supervision. See, e.g., supra notes 16-17, 25-27, and 65.

71. In some instances that may, in fact, be the intention.

72. See supra this text and notes 16-19 (Door Number One – CFPB Supervision).

74. At least in some states. Of course, states wishing to be in this category, so as to foster commercial transactions and economic growth, will need to update their commercial transaction laws by, e.g., enacting the 2010 amendments to the uniform text of UCC Article 9 and companion reforms such as the Uniform Certificate of Title Act (UCOTA). A state’s failure to maintain updated commercial transaction laws will be an invitation to increasing irrelevance. See, e.g., supra note 33.

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