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Back to School, Back to Rules

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I’ve Read the UCC Amendments so You Don’t Have To – Part One

September 12, 2024

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Welcome to this series of articles in *Cabinet News & Views* where we will be reviewing changes to the Uniform Commercial Code ("UCC"). Before I lose folks, let me explain why . . .

The UCC is our basic contracting law in the United States and establishes what is “commercially reasonable” in transactions. As the name of the law suggests, the UCC applies to commercial transactions, but because the bar for consumer transactions is deemed to be higher than commercial transactions, we still look to the UCC for the baseline by which to judge what is happening in consumer transactions. As they say, a rising tide lifts all ships.

Our goal in this series is to broadly explain the impact the 2022 Amendments will have on everyday contracts and even on legal practices that rarely tangle with the UCC. There will be some mention of the intricacies of the UCC that keep the expert practitioners busy, but that will mostly be to signal when it would be appropriate to consult them. As I said, I have read the changes so you don’t have to!

Hopefully we have convinced you to keep reading, and, while a lot of these articles will be written by yours truly, I will ask some colleagues who have a better grasp of certain topics to step in and provide their thoughts. One caveat – we will not be covering every change to the 2022 Amendments, just the ones we think will impact our readers the most. Our first two articles discussing changes are published alongside this article – On Being Conspicuous, addressing changes to the definition of “conspicuous” and On the Money, addressing changes to the definition of “money.”

To start – what is happening with the UCC? There are now the “2022 Amendments” to the UCC which includes a new Article 12, entitled “Controllable Electronic Records”. This new Article 12 is focused upon a variety of cryptocurrency-based contracting and financial transaction issues. Cadwalader has already published extensively on aspects of Article 12, so you do not have to wait for coverage on Article 12 in this series, although we will get there. See links to our articles in the footnote below.

So far, 24 states and the District of Columbia have adopted the 2022 Amendments, and they are pending on the legislative dockets of five other states. Some states have withdrawn or failed to move forward legislation involving the 2022 Amendments, including Arkansas, Montana, Texas and West Virginia.

1. **A New Age of PerFFFection June 2024 - Potential Impact of UCC Article 12 on Fund Finance Transactions**
2. **TriBar Releases Report on Digital Asset Opinions Under UCC Article 12**
3. **Expert Q&A on the Effect of the 2022 UCC Amendments on Fund Finance Transactions**

On Being Conspicuous: Changes to the UCC's Definition of Conspicuous – UCC 1-201(b)(10) – Part Two

September 12, 2024

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The following article is part two of our series on the 2022 Amendments to the UCC. Please read the **first article** for context. The discussion below is divided such that the first section discusses the edits made in the 2022 Amendments to the provision, as well as the Official Commentary; the second section provides context for the changes and explores parallel developments in the law surrounding a close, but different, disclosure standard "clear and conspicuous"; and the final section discusses why we decided to highlight this change.

The 2022 Amendment Changes to "Conspicuous"

When the UCC requires a specific disclosure to be given in a contract (or in an offer to make a contract, including in advertisements), often the specific UCC provision will indicate that the disclosure must be "conspicuous" within the document.

For example, as drafters or frequent readers of contracts may recognize, it is common for contracts to exclude or modify certain warranties, such as the implied warranty of merchantability. These warranties were developed through common law, and so Section 2-316 of the UCC provides that any exclusion or modification of such implied warranties is a required term that must be in writing and must be "conspicuous."

Prior to the 2022 Amendments, the UCC defined "conspicuous" to mean that when a required term is "written, displayed, or presented . . . a reasonable person against which it is to operate ought to have noticed it." The definition itself provided examples of how to achieve conspicuousness, including setting apart the disclosure in contrasting font, type or color and adjusting the size of the text. The provision also clearly provided that whether a disclosure is conspicuous is a matter of fact for a court to decide. Section 1-201(b)(10). The previous Official Comment on the definition of conspicuous was **one** paragraph long.

In the 2022 Amendments, the revised conspicuous definition provides that a required term, when "written, displayed, or presented" must, as before, be sufficient for a reasonable person to notice it, but added that determining whether a reasonable person would notice the term is to be evaluated "based on the totality of the circumstances" The revised definition then deleted the examples of how to achieve conspicuousness, but affirmed that the matter was still for a court to decide. Meanwhile, the Official Comment on the definition of conspicuous in the 2022 Amendments was expanded to be **14** paragraphs long.

Included in those 14 paragraphs is a new set of "factors relevant to whether a term is conspicuous" which includes, but is not limited to, the following six elements, each of which is intended to guide drafters to ensure that required terms are conspicuous "based on the totality of the circumstances":

1. Use of headings and text that contrast with surrounding text. (Effectively the same concepts that were part of the previous definition of conspicuous.)
2. The placement of the term within the record (*e.g.*, at the beginning or near an acknowledgment or signature accepting the term).
3. Ensuring that hyperlinks containing required terms are clearly and consistently set apart from surrounding text, and that there is text drawing attention to the hyperlink.
4. Ensuring that the language of a heading or hyperlink is accurate. For example, a paragraph disclaiming implied warranties should be labeled something like "Waiver of Warranties" and not just "Warranties", which could be misleading.
5. The effort the reasonable person must take to access the term. "For example, a term accessible only by triggering multiple hyperlinks is less likely to be conspicuous than a term accessible from a single hyperlink."
6. Whether there is a separate assent or signature to the term.

Context for the Changes

In the intervening years between when the definition of conspicuous was last updated, the variety of channels through which contracts can be presented has significantly expanded; think websites, mobile phones, smart watches and even just software installation processes. Because technology has become such a major part of the way we work and live, the number of contracts people encounter on a daily basis, governing the many facets of their interactions with technology, has expanded exponentially.

This means that ensuring that disclosures are conspicuous has become a lot more complex, as we must now attempt to cut through the contractual clutter to highlight significant aspects of those contracts each and every time a contract is presented. The guidance offered in the Official Comment is intended "to be both more protective of consumers and more useful to drafters by providing more clarity and flexibility in the methods that may be used to call attention to a term."

To date, the concept of "conspicuous" required terms in the UCC has been a lower standard than the so-called "clear and conspicuous" disclosure standard used by federal banking and consumer protection authorities. The "clear and conspicuous" standard near and dear to every advertiser, web designer, privacy specialist, and all of the lawyers working with them, is required for many disclosures that inform consumers of their rights, their rights to choose and of the limitations that may pertain to a product or service. So, while the UCC is focused on required terms for contracts or offers to contract, the "clear and conspicuous" standard applies to communications generally, and not just those involving contracts. Furthermore, the failure to meet the "clear and conspicuous" disclosure standard when required is deemed to be a "deceptive act or practice" that can be redressed by federal agencies and state attorneys general pursuant to Section 5 of the Federal Trade Commission ("FTC") Act or through the Consumer Financial Protection Act ("CFPA"). The UCC does not have a concept of "deception" that ties into whether a required term is conspicuous or not. And, if a court decides that the term was not conspicuous, the court can either nullify the contract altogether or nullify the actual term of the contract that was not conspicuous to the person against whom the term applies. In this way, the UCC's conspicuous standard is still a "lower" standard than "clear and conspicuous."

When we consider the elements captured in the Official Comment, the way the "clear and conspicuous" standard has developed in the last decades informed a lot of what is in there. Just as the last few decades have led to the UCC recognizing that presenting important information in contracts is more complex, the "clear and conspicuous" disclosure standard has changed, as well. For example, consider the so-called "Four P's" of making "clear and conspicuous" disclosures as discussed in this **2014 FTC blog** – prominence, presentation, placement and proximity. Each of these four P's have been mentioned in the Official Comment. So to the "just in time" requirements that apply to certain privacy and mobile disclosures, as discussed by the FTC in its **2013 Mobile Privacy Disclosures Report,** are mentioned in the Official Comment. And also, the Official Comment, in referencing "the effort a reasonable person must take to access the required term," is consistent with the so-called one-click rule for hyperlinked disclosures that is now included in Regulation Z and Regulation DD, and which is discussed by the CFPB **in this 2019 Supervisory Highlights**.

Why Highlight This Change

The 2022 Amendments have significantly closed the gap between the UCC's conspicuous standard and the "clear and conspicuous" standard that has been developed by consumer protection authorities. In light of the changes, failure to evaluate the presentation of required terms "based upon the totality of the circumstances" and taking into account the six relevant factors mentioned in the Official Comment for whether a required term is conspicuous could impair a company's ability to enforce its contracts. Further, while the Official Comment provides an introduction to those six relevant factors, all of the concepts identified have already been developed and expanded in the consumer protection realm.

This means that no more may companies assume that business-to-business agreements in which required terms are documented through huge blocks of capitalized text will be enough to achieve making sure the terms are conspicuous. Companies should now take the time to review their standard agreements and identify required terms that must be conspicuous. It is time to dig them out from contracts that may bury them in voluminous pages or tiny text or in hyperlinks that no one ever clicks on.

On the Money: Changes to the UCC's Definition of Money – UCC 1–201(b)(24) – Part Three

September 12, 2024

By Mercedes Kelley Tunstall
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The following article is part three of our series on the 2022 Amendments to the UCC. Please read the first **two articles** for context. I am going to get right to the point here – the reason that the definition of money has been changed in the 2022 Amendments is to accommodate and address the rise of digital assets and cryptocurrency. Please note that this article addresses the main definition of "money" in the UCC – the definition that appears in the General Provisions. Please note that Article 9 has additional money-related definitions that we will address in a future article.

As our initial article mentions, the 2022 Amendments include an entirely new Article 12 that deals with "Controllable Electronic Records" which is the UCC term for cryptocurrencies like Bitcoin, Ethereum and Litecoin.

This means that the changes to the definition of "money" are to exclude these cryptocurrencies from the definition. But, note that while the definition now excludes cryptocurrencies, it does not exclude all digital assets. Specifically, a central bank digital currency ("CBDC") could still meet the definition of money, for purposes of the UCC.

As a refresher, the Office of the Comptroller of the Currency **describes CBDC as follows** – "CBDC is generally defined as a digital liability of a central bank that is widely available to the general public. Today in the United States, Federal Reserve notes (i.e., physical currency) are the only type of central bank money available to the general public. Like existing forms of money, a CBDC would enable the general public to make digital payments. As a liability of the Federal Reserve, however, a CBDC would be the safest digital asset available to the general public, with no associated credit or liquidity risk." They published this **whitepaper on CBDC in January 2022**.

Because the definition of money in the UCC means "a medium of exchange that is currently authorized or adopted by a domestic or foreign government", if a government issues a CBDC of its own, then it would meet that definition.

Cursorily, cryptocurrencies would seem to be excluded from the definition of "money" already, as they are not generally authorized or adopted by governments as a medium of exchange. However, there have been instances where certain foreign governments, such as El Salvador, have adopted Bitcoin as legal tender, in which case Bitcoin would then be a "medium of exchange" that is "authorized or adopted" by El Salvador. To address this kind of situation, the 2022 Amendments have added the following concept to the definition of money: "The term does not include an electronic record that is a medium of exchange recorded and transferable in a system that existed and operated for the medium of exchange before the medium of exchange was authorized or adopted by the government."

The Official Comment for the money definition, which went from one paragraph to six paragraphs, explains "an existing medium of exchange created or distributed by one or more private persons is not money solely because the government of one or more countries later authorizes or adopts the pre-existing medium of exchanges." The Official Comment provides greater elucidation of this in a set of examples, involving "spitcoin" and "beebucks". Basically, the examples illustrate that only a digital asset or cryptocurrency that **started** as money (i.e., was authorized or adopted by a government to start) can be deemed money, for purposes of the UCC.

The reason that digital assets or cryptocurrencies that did not start as money, cannot become money for purposes of the UCC is primarily because of Article 9 of the UCC – the article governing secured transactions which prescribes how a perfected security interest can occur with "tangible coins, bills, notes, and the like", which occurs through *possession* of those tangible items. As the previous major amendments to the UCC established by introducing the term "electronic chattel paper" in 1998, money that is intangible can only have a perfected security interest when *control* of the intangible can be reliably transferred in a manner that allows verification of the identity of the transferor or the source of the transferor's title to the intangible. And, a pre-existing digital asset or cryptocurrency (especially the ones in the marketplace now) cannot meet those requirements. Never fear, though, pre-existing digital asset or cryptocurrency transactions are not being ignored by the UCC – that is the entire point of the new Article 12.

What Happens When You Ignore the Supreme Court? Maybe the Ninth Circuit Will Find Out – an Update on National Bank Preemption

September 12, 2024

By Mercedes Kelley Tunstall
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As we reported in June, the Supreme Court handed down a decision in *Cantero v. Bank of America* on bank pre-emption matters that remanded cases decided by three different Circuit Courts, finding that the courts did not apply the correct analysis to determine whether a state law requiring interest to be paid on a mortgage escrow is preempted by the National Bank Act. The Second Circuit's case was the namesake for the Supreme Court decision, and that case is being dutifully briefed on remand, as is the Citizens Bank case in the First Circuit. However, the Ninth Circuit, in its remanded case, *Kivett v. Flagstar Bank*, moved forward with a new resolution of the preemption issue, without receiving briefing from the affected parties, and found once again that its state law is **not** preempted.

As you may recall, the Supreme Court's *Cantero* decision admonished the Circuit Courts to conduct a "nuanced comparative analysis" consistent with the *Barnett Bank* preemption standard that was codified in the Dodd-Frank Act. As we described previously, Dodd-Frank provided "that the National Bank Act preempts a state law 'only if' the state law (i) discriminates against national banks as compared to state banks; or (ii) 'prevents or significantly interferes with the exercise by the national bank of its powers." And therefore, the Supreme Court remarked that the only way forward is to "make a practical assessment of the nature and degree of the interference caused by a state law."

The "unpublished" Memorandum announcing the Ninth Circuit's decision, written by a three-judge panel, basically ignored the *Barnett Bank* preemption analysis and instead applied a preemption analysis endemic to the Ninth Circuit, a case they decided in 2018 called *Lusnak v. Bank of America*. In deciding to rely upon their *Lusnak* precedent, the Ninth Circuit panel did explain that they believe "the Supreme Court's decision in *Cantero* suggests that *Lusnak* was correctly decided" and they stated that *Lusnak* "properly applied the test for preemption from" *Barnett*. However, they did not take the time to go back through the inner workings of that earlier preemption analysis, which is a shame because *Lusnak* focused on a TILA provision that **allowed** interest to be paid on certain mortgage escrow accounts. Meanwhile in *Cantero*, footnote #1 provided that, "all parties agree that [that provision] does not apply to the mortgages in this case."

California and the Ninth Circuit have a long history of chafing against national bank preemption, so in some ways, the new decision in *Kivet* is not all that surprising. But it is surprising that the Ninth Circuit did not take the opportunity to reconsider its earlier preemption analysis, as they were directed to do. This means that the industry can take no comfort in *Kivet* and must continue to operate in a cloudy post-*Cantero* world and hope that the opinions that come out from the remands to the First and Second Circuits can better dissipate the fog.

The UK’s FCA Offers a Temporary Extension on Sustainability Disclosure Requirements

September 12, 2024

By Alix Prentice
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The UK’s Financial Conduct Authority ("FCA") Sustainability Disclosure Requirements and investment labels regime ("SDR") was originally scheduled to come into force from 2 December 2024. In order to allow firms to deal with the required changes, the FCA is now offering limited temporary flexibility for firms to comply with the ‘naming and marketing’ aspects of the rules until 2 April 2025.

The ‘naming and marketing rules’ are set out in **part 4.3 of the FCA’s ESG Sourcebook**. This section of the Sourcebook also sets out the FCA’s anti-greenwashing rule, which has been in force since 31 May 2024, and which permits investment funds to use investment labels on their offerings under certain circumstances. The naming and marketing rules apply to the use of sustainability-related terms in relation to a ‘*sustainability product*’ that references environmental or social characteristics. Managers undertaking business that is designated as in-scope for the purposes of sustainability disclosure rules and who elect to use certain terms (including, among others, ‘climate’, ‘green’, ‘impact’ and ‘social’) must comply with rules designed to make sure that the product has a name, description and disclosures that ensure that the suitability description is accurate and gives a full explanation of the relevant characteristics.

Firms wishing to take advantage of the extension of time will need to have submitted an application for approval of amended disclosures (see part 5.3.2R of the ESG Sourcebook) by 1 October 2024, currently be using one or more of the terms ‘sustainable’, ‘sustainability’ or ‘impact’ (or a variation of the same) and intend to either use a sustainability label or change the name of the fund. Firms are also reminded that they are required to comply with the existing anti-greenwashing rules.

The PRA and the Treatment of Overseas Branches

September 12, 2024

By Alix Prentice
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The UK's banking regulator, the Prudential Regulation Authority ("PRA") has issued a **consultation on its approach to the treatment of branches of international banks operating in the UK** (CP11/24). Among the proposals is a rethink of what the PRA calls its 'branch risk appetite', which is founded on the expectation that '*where an international bank is undertaking significant retail activity, this should take place through a subsidiary rather than a branch'.* This rethink has been driven, at least in part, by the UK resolution of Silicon Valley Bank ("SVB"); while the majority of SVB's deposits were not retail in nature, the UK entity had been required to convert from a branch to a subsidiary in 2022, a fact which was credited at least in part with effecting the successful resolution of SVB in the UK.

In light of this, the PRA is proposing to increase the threshold for the level of deposits that a branch may hold before it considers requiring subsidiarisation and including within that threshold small company demand deposits (with small companies being defined as those with up to £10.2 million of turnover). Again looking to the SVB UK experience, the FCA is also proposing that the assessment of whether it is appropriate for an international bank to operate as a branch should include a review of wholesale demand deposits from larger corporates that depend on the branch for banking services.

CP11/24 also sets out the PRA's expectations of firms' booking arrangements in light of prudent risk management when dealing with changes to international booking models that run the risk of fragmentation of that management across entities and jurisdictions. In particular, the PRA has observed international firms operating split desks whereby trading in the same entity takes place from more than one location and management of the product is similarly split. In light of the higher operational risks associated with such splitting, CP11/24 is setting out proposals for characteristics of acceptable split desk models, including:

- single business heads accountable for consolidated management of split desks;
- market risk limits which are allocated per legal entity;
- a proportional numerical and seniority split of traders;
- a single and consolidated independent risk management oversight; and
- the ability to pool collateral between entities.

The End of LIBOR

September 12, 2024

The FCA has confirmed that it will not be extending its requirement for ICE Benchmark Administration Limited to continue publishing the 1-, 3- and 6-month US dollar LIBOR settings in synthetic form beyond the end of September 2024.