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Rational Retroactivity in a Commercial Context

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INTRODUCTION

Imagine the following hypothetical:[1] A driver parks and leaves her car in a public space where there is no parking meter in which coins must be deposited or any sign prohibiting or placing restrictions on parking. When the driver later returns to her car, however, she discovers that a meter has been installed during her absence, and a parking ticket is now lodged between her wiper and windshield. Should the driver be required to pay?[2] In such circumstances, the easy answer is no. But why not? What barriers, if any, should there be to governmental efforts at enforcing the ticket against the unsuspecting citizen?

Quite apart from any potential constitutional issues,[3] we might be tempted to say more generally that there is something fundamentally unfair

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1. My "hypothetical" is not entirely hypothetical. *See Meters & Tickets Appear*, RICH. TIMES DISPATCH, June 22, 2005, at A2.

2. The hypothetical and discussion in the text implicitly assume that the meter was installed for the first time after the car was parked. In actuality, the meter had been temporarily removed during construction, and when it was replaced, the car was ticketed. This difference is of little importance to the driver, who in either case, would have been acting on the reasonable belief that she was permitted to park where she did without having to pay. Thus, if either a new law is retroactively applied to past conduct or an existing law, which is effectively impossible to discover, is prospectively applied, individuals may be affected in a troublesome way. Fortunately for the driver in this case, the city's revenue department decided not to enforce the parking ticket.

3. There are express provisions in the Federal Constitution against retroactive laws. Both Congress and the states are prohibited from passing ex post facto laws or bills of attainder, *see* U.S. CONST. art. I, §§ 9-10, and the states may not pass laws which impair the obligation of contract, *see id.* § 10. Similar prohibitions can also be found in the constitutions of several states. *See generally* Comment, Campbell v. Holt—*A Rule or an Exception?*, 35 YALE L.J. 478, 482 n.16 (1926). Moreover, the historical policy against retroactivity has occasionally found expression in the due process clauses of the federal and state constitutions. *See* Bryant Smith, *Retroactive Laws and Vested Rights*, 5 TEX. L. REV. 231, 237 (1927) ("[I]t is the custom now for courts to stay within the constitution and, in the absence of an express prohibition of retroactive laws, to apply the due process clause."). Notwithstanding the protection afforded by the federal and state constitutions against retroactive legislation, no court has ever held that the protection is absolute. *See* 2 NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION § 41.05, at 368 (5th ed. 1992) ("Even where a constitution explicitly and unqualifiedly prohibits the enactment of retrospective statutes, the courts usually strike down only those statutes whose retroactivity results in measurable unfairness."). Although a detailed discussion of the constitutional dimension to the subject of retroactivity is beyond the scope of this Article, it may be assumed that none of the suggestions offered herein would be constitutionally impermissible.

about government altering the rules that govern past conduct. The reason for the traditional disrepute in which retroactively applicable laws have been held comes through quite clearly in the following set of propositions:

> (1) Individuals commonly act so as to achieve advantageous results.
>
> (2) Retroactive laws change the legal results of acts after these acts have been performed.
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> (3) Therefore retroactive laws defeat reasonable expectations and are undesirable.[4]

It should therefore come as no surprise that familiar objections to retroactive legislation have been part and parcel of the American lawmaking process.[5] Just some of the pejorative epithets used to denounce retroactive lawmaking include, "a violation of fundamental principles," "repugnant to the common principles of justice and civil liberty," against "natural right," and contrary to "the principles of general jurisprudence."[6]

An important caveat should perhaps be interposed here. It is worth noting that the historical antipathy towards the retroactive application of legislation should be distinguished from the traditional norm of applying common law decisions retroactively.[7] For example, such an approach has long characterized the evolution of tort doctrine.[8] When a court overrules a precedent or provides a new, more expansive interpretation of existing tort law, the decision reaches back as far as the applicable statute of limitations allows. This is a striking feature of the notion—now seemingly debunked—that courts do not make law but merely engage in the practice of finding or interpreting the law.[9] In any case, there can be little doubt that the retroac-

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4. W. David Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking*, 48 CAL. L. REV. 216, 219 (1960).

5. *See* 2 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1398, at 272 (5th ed. 1891) ("Retrospective laws are, indeed, generally unjust; and, as has been forcibly said, neither accord with sound legislation, nor with the fundamental principles of the social compact."). *See generally* Ray H. Greenblatt, *Judicial Limitations on Retroactive Civil Legislation*, 51 NW. U. L. REV. 540, 540-44 (1957) (discussing the history of the bias against retroactive legislation).

6. Smith, *supra* note 3, at 237 (internal quotation marks omitted).

7. *See* Jill E. Fisch, *The Implications of Transition Theory for Stare Decisis*, 13 J. CONTEMP. LEGAL ISSUES 93, 98 (2003) ("When a court overrules a precedent, the new legal rule is applied retroactively to all pending and future cases. . . . In contrast, statutory changes and constitutional amendments generally apply prospectively."). Slawson offers a possible explanation positing that, unlike legislation, "[j]udicial rule-making is the product of reasoning from generally accepted premises, not fiat, and therefore its course may be predicted with some confidence." Slawson, *supra* note 4, at 245.

8. *See, e.g.*, Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509, 598-602 (1986); Gary T. Schwartz, *New Products, Old Products, Evolving Law, Retroactive Law*, 58 N.Y.U. L. REV. 796, 816-18 (1983).

9. Kyle D. Logue, *Legal Transitions, Rational Expectations, and Legal Progress*, 13 J. CONTEMP. LEGAL ISSUES 211, 240 n.60 (2003) ("It is sometimes suggested that the prevailing norm of applying common law decision[s] retroactively stems from the pre-realist traditional understanding of the role of common law courts as finding or interpreting the law rather than making it."). Today, no one would seriously doubt that courts do, indeed, make law and that this lawmaking function beneficially permits

tive application of judicial lawmaking, like legislative lawmaking, can profoundly alter the legal status of prior actions for better or worse.[10] This is conspicuously so when rules change so abruptly as to surprise or confuse the regulated parties. We might readily imagine, for example, that a decision to permit innocent victims of crime who are injured by the use of a firearm to recover damages from firearm manufacturers would substantially affect the profitability of these firms, regardless of the source of the law change. Holding to a false distinction between judicial and legislative law in the discussion of retroactivity may therefore unnecessarily cloud the issue.[11]

Our simplified parking meter example is an amusing case of recent vintage in which it seems obviously unjust to fine individuals for past behavior made impermissible later under a new directive. Yet retroactive legal change, a common and unavoidable everyday occurrence, does not always produce results so clearly undesirable or unfair. Courts and legislatures alike must constantly respond to the pervasive problem of changed circumstances. Because social needs and mores evolve over time, legal principles should and must change as well. New developments involving technological capacity, economics, or even the international situation may give rise to legal obsolescence. In these circumstances, statutory change is a valuable corrective. Moreover, although courts should generally follow precedent in the interests of stability,[12] wrong or outdated decisions ultimately should not stand in the way of "better" law.[13] In short: Legal change is both necessary and inevitable.[14]

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the common law to evolve so as to correct for a world of changing conditions. *See, e.g.*, S. Pac. Co. v. Jensen, 244 U.S. 205, 221 (1917) (Holmes, J., dissenting) (observing that "judges do and must legislate"); Jabez Fox, *Law and Fact*, 12 HARV. L. REV. 545, 548 (1899) (recognizing that judicial legislation "is inherent in the strict performance of judicial duty"); Philip B. Kurland, *Jurisdiction of the United States Supreme Court: Time for a Change?*, 59 CORNELL L. REV. 616, 618 (1974) (observing that the ability of courts to make law "is the genius of the common law system that we inherited from our English forbears").

10. *See* BORIS I. BITTKER, FEDERAL TAXATION OF INCOME: ESTATES AND GIFTS ¶ 3.3.4, at 3-28 (1981) (noting that "expectations can be upset by judicial decisions and administrative rulings as well as by legislative action").

11. *See* Bryant Smith, *Retroactive Laws and Vested Rights II*, 6 TEX. L. REV. 409, 414-15 (1928) ("The distinction between retroactive laws made by the courts and those made by the legislatures, is a distinction of practicability and not a distinction of justice. That the one should provoke judicial epithets while the other is taken for granted, would indicate that the consideration of the subject has been sentimental rather than scientific.").

12. Predictability is the most common justification for adhering to precedent. *See* David Lyons, *Formal Justice and Judicial Precedent*, 38 VAND. L. REV. 495, 496 (1985) ("The reason most often given for the practice of precedent is that it increases the predictability of judicial decisions."); Earl Maltz, *The Nature of Precedent*, 66 N.C. L. REV. 367, 368 (1988) ("The most commonly heard justification for the doctrine of stare decisis rests on the need for certainty in the law."). Without predictability, individuals would be unable to plan their affairs—business or otherwise—without taking an undue risk. *See* Lewis F. Powell, Jr., *Stare Decisis and Judicial Restraint*, 47 WASH. & LEE L. REV. 281, 286 (1990) (noting that predictability of outcome "is especially important in cases involving property rights and commercial transactions").

13. One implicit assumption in this Article and in the theoretical work of contemporary commentators is that the particular change in the law—whether common law or statutory—actually improves the law when judged by an appropriate normative objective. Yet it may sometimes turn out that the opposite is true. *See infra* notes 52-53 and accompanying text.

14. As Richard Epstein comments:

Consider the process of periodic adjustments to the Uniform Commercial Code (U.C.C. or the Code) to adapt the Code to fundamental changes in society. Within the past twenty years, the National Conference of Commissioners on Uniform State Laws (N.C.C.U.S.L.) and the American Law Institute (A.L.I.) have drafted initially or revised every substantive article of the Code.[15] Although the particular impetus for the drafting projects has varied somewhat from one to the next, the basic objective throughout has been to prevent the Code from becoming outdated. Moreover, even those basic features of commercial activity that have not themselves changed dramatically over the years may now operate in a radically different environment. For example, the core content of Article 2 (Sales) has remained largely unchanged since the promulgation of the *1957 Official Text of the Code.* The same cannot be said, however, of commercial and consumer law generally or of the technological environment in which many transactions now take place. Some of the more obvious changes include the common law development of a theory of strict products liability that overlaps the Code, the enactment of federal and state consumer protection legislation, and the growing use of electronic methods of contracting.[16] In addition to these efforts to keep the Code responsive to contemporary needs, legislatures have enacted auxiliary statutes covering limited subjects which have not been consolidated into the Code.[17]

In these circumstances, it is not surprising that academic interest in transition policy, broadly defined, has deepened in recent years.[18] If one accepts Louis Kaplow's view that a transition issue arises "whenever actors make decisions whose effects may be influenced by government policies that are not known with certainty at the time the decisions are made,"[19] transition

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> Transitions are not only fixed features of our everyday lives. They are also fixed features of our legal and social environment. It goes without saying that the pressures of social and technological: the plow often cry out for readjustments in legal policy. In some instances, it is necessary to correct previous mistakes in policy. In other cases, it is necessary to adapt old legal rules to new technologies farming, the printing press, the railroad, the radio or the Internet. We, therefore, witness a constant procession of incremental changes through the common law, and larger systematic changes through regulation, taxation and the modification of liability rules.

Richard A. Epstein, *Beware of Legal Transitions: A Presumptive Vote for the Reliance Interest*, 13 J. CONTEMP. LEGAL ISSUES 69, 69 (2003).

15. *See* U.C.C. Articles 1 (2001), 2 (2003), 2A (2003), 3 (2002), 4 (2002), 4A (1989), 5 (1995), 6 (1989), 7 (2004), 8 (1994), and 9 (2001). *See* U.C.C. advisory panel preface, at III.

16. *See* Edith Resnick Warkentine, *Article 2 Revisions: An Opportunity to Protect Consumers and "Merchant/Consumers" Through Default Provisions*, 30 J. MARSHALL L. REV. 39, 78 (1996).

17. For example, recognizing that inappropriate law could hinder the development of electronic commerce and that the impact of new technologies extends beyond the scope of the Code to other types of transactions, N.C.C.U.S.L. completed the Uniform Electronic Transactions Act in 1999. *See* Uniform Law Commissioners, Uniform Electronic Transactions Act, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-ueta.asp (last visited Feb. 28, 2007).

18. Important writings on transition issues include: DANIEL SHAVIRO, WHEN RULES CHANGE: AN ECONOMIC AND POLITICAL ANALYSIS OF TRANSITION RELIEF AND RETROACTIVITY (2000); Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. PA. L. REV. 47 (1977); Kaplow, *supra* note 8; Saul Levmore, *Changes, Anticipations, and Reparations*, 99 COLUM. L. REV. 1657 (1999).

19. Louis Kaplow, *Transition Policy: A Conceptual Framework*, 13 J. CONTEMP. LEGAL ISSUES

policy is a matter of universal importance that is not limited solely to cases in which a new law alters the legal status of past conduct[20] but is inclusive of all situations in which there is a risk that the future consequences of present conduct might be altered in some unknown way by a change in government policy.[21] In this sense, transition issues are ubiquitous. We live in a world of legal change, and our actions frequently have consequences that extend into the future.[22] Kaplow illustrates the pervasiveness of transition issues by using the example of a thirty-year municipal bond.[23] When originally purchased by the bondholder, the interest is tax exempt. Five years later, Congress repeals the exemption. Even if the repeal is nominally prospective (i.e., the taxpayer is allowed to retain the benefits of the exemption that operated for the first five years of ownership), the repeal would cost the bondholder the value of the tax exemption for the remaining twenty-five years, a cost not anticipated at the time of purchase. Thus all investment activity, the value of which depends on what occurs in the future, implicates issues of transition policy.[24]

Transition policy concerns about the desirability and legitimacy of applying new rules to past behavior, moreover, are inseparable from consid-

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161, 165 (2003).

20. *See* Stephen R. Munzer, *Retroactive Laws*, 6 J. LEGAL STUD. 373, 373 (1977) (defining a law as "retroactive if it alters the legal status of acts that were performed before it came into existence"); *see also* Charles B. Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 HARV. L. REV. 692, 692 (1960) (offering the definition that a "retroactive statute is one which reaches back to attach new legal rights and duties to already completed transactions").

21. Michael Graetz constructs a similar model of retroactivity. *See* Graetz, *supra* note 18, at 49 ("For purposes of analysis it is essential to recognize the similarity in impact between a change which is nominally retroactive, and affects the value of transactions that occurred in the past, and one which is nominally prospective, but also has an effect on the value of past transactions.").

22. David Slawson, for example, believes that it is a mistake to assume

> that an act, once done, achieves its legal results instantaneously and full-blown. In fact, this is rarely the case, especially in property and contract transactions. A purchaser of property obtains a cluster of legal relations which project indefinitely into the future. A party to a contract does likewise. And all kinds of less formal relationships are entered, modified, or terminated with a view of both the present and future legal consequences of such action.

Slawson, *supra* note 4, at 219. This same observation, but with even more force, has been made by Frederick Schauer. *See* Frederick Schauer, *Legal Development and the Problem of Systemic Transition*, 13 J. CONTEMP. LEGAL ISSUES 261 (2003). Schauer states:

> [I]t is not implausible to suggest that the problem of legal transition is the problem not only of all of law, but also of all of life, for few actions are devoid of future consequences, and few forms of behavior can be known with certainty to be immune from possible future legal change.

Id. at 263.

23. *See* Kaplow, *supra* note 8, at 516. The bond hypothetical was also earlier suggested by Graetz. *See* Graetz, *supra* note 18, at 57-58.

24. This is what Schauer means when he says:

> Under this capacious conception of a transition issue, a transition issue arises whenever I purchase an asset which on resale might (or might not be) taxed in some way, whenever I acquire property whose ownership might (or might not be) unlawful at some point in its now-predicted useful life, whenever I commit to an enterprise that might (or might not) in the future be more (or less) regulated than it is now, and in general whenever I engage in an extended or consequential activity whose duration or whose consequences extend across a possible period of legal change.

Schauer, *supra* note 22, at 263.

erations of mechanisms that might be employed to mitigate gains and losses experienced by those who acted in reliance on laws no longer in effect.[25] The menu of transition policy choices ranges from no relief whatsoever to options such as partial or delayed implementation, grandfathering, compensation, and taxation.[26] In recent years, for example, several scholars have propounded the notion that there should be no transition relief following a rule change that is itself beneficial.[27] According to this view, the norm of choice should generally be one of pro-retroactivity, identical to the norm that governs judicially adopted legal changes. In a nutshell, these scholars maintain that the retroactive application of new legal rules without transition relief hastens their implementation, increases the *ex ante* incentive of private parties to efficiently anticipate beneficial legal changes, and thus encourages socially desirable behavior.[28] The risk of uncompensated transition losses may be mitigated by self-insurance or through a system of commercial insurance that would likely develop.[29]

To this point, the discussion has not differentiated among the various contexts in which transition issues are presented. Although, as has been noted, such issues can arise whenever the government acts, scholars have tended to confine their discussions to three specific contexts: taxation, tort liability, and government takings. But the same concerns and effects are not presented in all contexts. In choosing either to favor or disfavor the norm of retroactivity, one must determine the optimal background condition considering several factors. For example, if the application of a retroactivity norm is efficient because it creates the right incentives in a particular context, the converse might be true when, in a different context, the incentive effect would be nonexistent or negligible.

This Article focuses on the commercial law context. While transition issues have previously received scant attention,[30] this area of the law is proceeding at an accelerating rate,[31] making transition policy crucially important at this time. In particular, this Article will consider the plausibility and implications of a retroactivity norm in the commercial law context by exam-

25. It is important to note that legal change creates winners as well as losers. *See* Kaplow, *supra* note 19, at 167 ("[T]ransition gains are as ubiquitous as transition losses and to a substantial extent call for symmetric analysis.").

26. For a brief overview of these transition mechanisms, see Kaplow, *supra* note 19, at 186-90.

27. The classic work that takes such a position is Kaplow, *supra* note 8, at 516. But Kaplow's analysis was, in fact, spurred by the earlier effort of Graetz. *See* Graetz, *supra* note 18; *see also* SHAVIRO, *supra* note 18; Levmore, *supra* note 18, at 1658 n.2.

28. Levmore refers to this new view of transition policy as "anticipation-oriented." The old view, which tended toward a bias against retroactivity, he calls "reliance-oriented." Levmore, *supra* note 18, at 1658-59. For more on the "new" view, see *infra* notes 34-53 and accompanying text.

29. *See* Kaplow, *supra* note 8, at 520-66. The norm of retroactivity assumes, however, that markets are perfect and therefore risks and incentives can be efficiently addressed. However, given the possibility of failures in the insurance market, such as moral hazard problems and transaction costs, government mitigation of transition losses may be appropriate. *See id.* at 536-50.

30. One exception is U.C.C. Article 9. Given its nature, it should come as no surprise that concurrent with each substantial revision, consideration was given to transition issues. *See, e.g.*, U.C.C. § 9-701 to -709 (2005); *infra* notes 130-137 and accompanying text.

31. *See supra* notes 15-17 and accompanying text.

ining the recent revisions and amendments to Articles 1 and 2 of the Code. Two claims will be advanced: The incentive-based analysis of retroactivity issues in other contexts does not necessarily comport with the realities of commercial law, and consideration of both expectations and incentives demonstrates that commercial law is more amenable to a rule-by-rule application of the retroactivity norm. Part I will briefly examine the consequentialist framework that undergirds modern attempts to deal with the problems of legal transitions and will explain why this approach is insufficient to shape a universal norm regarding the retroactivity of commercial law reform.[32]

The discussion will demonstrate why an incentive-based analysis is subject to particular criticism with respect to certain subsets of commercial law rules, without attempting to evaluate the overall merits of the "new" view. Part II will describe in summary form judicial decisions that have filled the voids left by legislation silent as to transition matters. It will also describe the ways in which the drafters of the Code have, over the years, responded to the problem of retroactivity. Part III will first recount the traditional reliance- or expectations-based[33] rationale for transition policy. It will then examine and explain, within the context of U.C.C. Articles 1 and 2, when parties would rationally and predictably rely on the law and when they would not, as a means of demonstrating why reliance-based policy may at times be undesirable in commercial law contexts. It will then put forth a proposed framework for determining the retroactive applicability of commercial law changes. Finally, Part IV will test the soundness of the proposed framework by applying it to four examples of official changes in the Code, in order to conclude that specific outcomes should dictate when changes in commercial law should be applied retroactively and when they should not. This approach is what this Article refers to as "rational retroactivity."

I. THE NEW VIEW OF RETROACTIVITY AND ITS QUESTIONABLE APPLICATION TO COMMERCIAL LAW CHANGES

Economic theorists have made considerable progress in explaining why there should be a policy of no relief for losses occasioned by unexpected legal change. Many have concluded that there should be such a policy across the board. To summarize briefly the substantial literature, the advantage of a clear norm of pro-retroactivity is that it induces rational actors to invest and/or to insure in a way that maximizes social welfare. The central idea can be illustrated by considering the following three cases:

32. *See* Logue, *supra* note 9, at 216 n.5 (observing that the form of consequentialism that dominates normative law and economics scholarship, called "welfarism," evaluates alternative public policies on the basis of their ability to maximize social welfare).

33. This Article uses the terms "reliance" and "expectations" interchangeably. That is, if we say that a person has relied on a law (i.e., made a decision based on that law), then there will be an expectation that the legal consequences that follow from that decision will be as anticipated.

Case 1. Smith decided to invest in a plant producing aerosol cans at a time when science suggested only a modest probability that they would be environmentally dangerous. As scientific investigation proceeded, the government came to realize that the risk of environmental damage to the ozone layer dramatically exceeded any benefit consumers would derive from aerosol cans and banned them, without compensating Smith.[34]

Case 2. Jones decided to build an office building at a time when it seemed that there was only a modest probability that the government would decide it needed this parcel of land, along with many other contiguous parcels, to build an airport. Later, however, a study showed that this area would be ideal for an airport, so the government condemned the land, tore down the buildings, and built an airport that constituted the highest and best use for the land. It did not compensate Jones for his investment in the office building.[35]

Case 3. In 1986, section 2057 of the Internal Revenue Code granted an estate tax deduction for half the proceeds of "any sale of employer securities by the executor of an estate" to "an employee stock ownership plan" (ESOP). Carlton, as executor, used estate funds to purchase shares of MCI Communications for $11,206,000 and then resold them two days later to the MCI ESOP for $10,575,000. Notwithstanding an economic loss of $631,000, Carlton claimed a deduction of $5,287,000. In 1987, after the transaction had been completed, section 2057 was retroactively amended to allow the deduction only for estates of decedents who owned the securities in question immediately before the death of the decedent.[36]

As to Case 1, the aerosol cans investor, the "welfarist" or "consequentialist" rationale might proceed like this: Companies have an informational advantage regarding the safety of the products they produce and should be aware of the risk that government regulators may step in to protect consumers by changing the law.[37] If the government has committed in advance to a clear policy of retroactivity without compensation, then, logically, the rational Smiths of this world would shelve their dangerous products today in

34. This example is borrowed from Christopher T. Wonnell, *The Noncompensation Thesis and its Critics: A Review of this Symposium's Challenges to the Argument for Not Compensating Victims of Legal Transitions*, 13 J. CONTEMP. LEGAL ISSUES 293, 293 (2003).

35. *Id.* at 293-94.

36. Case 3 restates the basic facts of *United States v. Carlton*, 512 U.S. 26, 28-29 (1994), where the Supreme Court held that the 1987 amendment's retroactive application to Carlton's 1986 transaction did not violate due process.

37. *See, e.g.*, Levmore, *supra* note 18, at 1671 (suggesting that because tobacco companies have an informational advantage over regulators, "their anticipation of legal change is therefore to be encouraged").

order to avoid liability tomorrow when the new rules take effect.[38] Forcing manufacturers to anticipate beneficial rule changes compounds the efficiency of new rules by causing an internalization of costs both *ex ante* and *ex post* with the likely outcome of safety maximization.

Given the limitations that might be expected to confront manufacturers who would be forced to try to discern future government action, under this rationale, a fairness issue arises as to whether it is really appropriate to apply new rules that the parties could not have foreseen or anticipated. The consequentialists' response to such fairness objections has been sophisticated indifference on the basis that the future is always uncertain. In their view, legal uncertainty is no different from any other form of uncertainty that might affect the success or failure of a business. For example, among the market risks that might beset the typical business are problems "concerning how well a product will sell, how soon competitors will imitate innovations, or how much necessary inputs will cost in the future."[39] To the consequentialists, it is not the form of risk that matters; rather, in all cases, risk must be confronted and dealt with by investors and managers in the most economically efficient way.

Consideration of Case 2, the airport taking, reveals similar efficiencies resulting from the application of a norm of retroactivity. Once again, the consequentialist view stresses the central importance of encouraging private actors to anticipate future government action in planning their conduct (i.e., the importance of producing proper incentives). If the government takes the land, the investment in the office building proves worthless; hence, it would have been socially preferable for Jones to have invested in some other enterprise. The analysis concedes that things might have turned out differently for Jones—that there was always the possibility that the government would *not* take the land—but places the onus on Jones to take both future-world possibilities into account when making his investment decision. After all, Jones would have been expected to consider the prospect that his building might be destroyed by other events, such as a fire or earthquake, when deciding whether the investment was worthwhile. An investor who decides to go forward notwithstanding these risks has an economic incentive to diminish the probability or magnitude of the potential loss by purchasing private insurance. The anticipation-based consequentialist view rejects the notion that the risk of a government taking should be treated differently.[40] A regime that promised government compensation for the loss of Jones's building would induce him to ignore and, therefore, not to internalize the possibility that the government might decide to appropriate his property. That, in turn, would give rise to the "moral hazard" problem of overinvestment.[41] It

38. A rule of retroactivity can affect only the behavior of those parties who act in *ex ante* anticipation of *ex post* legal enforcement of new rules to past conduct.

39. Kaplow, *supra* note 8, at 600.

40. *See, e.g.*, Kaplow, *supra* note 8, at 527-33.

41. "Moral hazard" refers to the adverse incentives that arise when a person is insulated from losses.

is plausible to suggest, and the consequentialists do, that the only solution to this adverse incentive, and one that leads to an efficient level of investment, is to expose Jones to the full costs and benefits of his decision.[42]

A similar point about the importance of producing desirable *ex ante* incentives is demonstrated in a more obvious way in Case 3, the estate tax example. Here, Congress's purpose in enacting section 2057 was to "create an 'incentive for stockholders to sell their companies to their employees who helped them build the company rather than liquidate, sell to outsiders or have the corporation redeem their shares on behalf of existing shareholders.'"[43] Unfortunately, it soon became obvious that the absence of a decedent-stock-ownership requirement resulted in the deduction's broad availability to virtually any estate, at an estimated loss to the government of up to $7 billion in anticipated revenues over a five-year period.[44] Congress had inadvertently created a tax loophole that was quickly exploited by Carlton and others. Presumably, Carlton engaged in this particular purchase and sale transaction with full knowledge that Congress had not contemplated such a strategic use of section 2057.[45] Thus, if taxpayers are well informed about tax loopholes, Case 3 is much the same as Case 1. In both, an informational asymmetry is being exploited. In terms of overall social welfare maximization, in these circumstances, an almost formulaic prescription for generating inefficient behavior is created by failing to give new rules retroactive effect. In short, only if it is known that any rule change would be applied retroactively might a taxpayer in Carlton's position have the *ex ante* incentive to forego the deduction and thereby minimize the loss of social welfare that otherwise might result from this tax law glitch.[46]

This is typically the result of insurance. Justice Stevens, for example, understood the moral hazard problem inherent in the Court's decision to compensate a landowner who was denied the right to build on his beachfront lot. *See* Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1070 n.5 (Stevens, J., dissenting) ("Even measured in terms of efficiency, the Court's rule is unsound. The Court today effectively establishes a form of insurance against certain changes in land-use regulations. Like other forms of insurance, the Court's rule creates a 'moral hazard' and inefficiencies: In the face of uncertainty about changes in the law, developers will overinvest, safe in the knowledge that if the law changes adversely, they will be entitled to compensation.").

42. Kaplow observes:

> [T]he incentives question is in essence an application of the analysis typically used in connection with externalities. Externalities refer to costs borne by third parties. Simply put, government compensation creates an externality that otherwise would not be present. Compensation shifts part of the long-run cost of private investment to the government and thus distorts an otherwise efficient decisionmaking process. It is socially desirable for investors to take into account the prospects for government reform; compensation eliminates this incentive by insulating investors from an important element of downside risk.

Kaplow, *supra* note 8, at 531.

43. United States v. Carlton, 512 U.S. 26, 31 (1994) (quoting JOINT COMM. ON TAXATION, 99TH CONG., TAX REFORM PROPOSALS: TAX TREATMENT OF EMPLOYEE STOCK OWNERSHIP PLANS (ESOPS) 37 (Joint Comm. Print 1985)).

44. *Id.* at 32.

45. *See, e.g.*, Richard Lavoie, *Deputizing the Gunslingers: Co-opting the Tax Bar into Dissuading Corporate Tax Shelters*, 21 VA. TAX REV. 43, 65 (2001) (noting that "[t]he typical . . . tax shelter is a tremendously complex and convoluted transaction" and that I.R.S. agents may be poorly equipped to recognize them).

46. *See* Logue, *supra* note 9, at 231-35.

A corollary to the consequentialist argument that risk is risk, regardless of its source, applies to Case 3 as well.[47] This is the notion that if the government does not compensate for losses occasioned by other forms of market risk, there is no compelling reason why it should compensate for so-called government risk either.[48] Taxpayers can always reduce the risk of retroactive tax law changes by spreading the risk among all of the investments in their portfolio. Moreover, a policy of retroactivity preserves the symmetry of gains and losses.[49] No disgorgement of gains is required when a tax law change improves the investor's position by making her investment more valuable. Accordingly, if "winners" are permitted to retain their fortuitous gains, "losers" should not receive compensation for their unfortunate losses.[50]

These three examples—of products liability, the taking of private property, and retroactive taxation—suggest that when legal change is socially beneficial, those adversely affected by the change should not be compensated by the government. Each supports the precept that a regime adopting a norm of retroactive legal change maintains private incentives to anticipate changes which, in turn, induces efficient behavioral responses.

There are, to be sure, weaknesses in the consequentialist case for retroactivity. For example, some individuals may not be rational actors capable of fully appreciating transition risk and bringing this understanding to bear on their investment decisions.[51] Others may correctly calculate the likelihood of change and respond but do so in ways that prove less than socially optimal if the law change in question is bad rather than good.[52] Despite these potential flaws, however, the incentive argument for retroactivity pre-

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47. *See supra* notes 39-40 and accompanying text.

48. In discussing how different effective date rules regarding tax law revisions affect the efficient allocation of resources, Graetz makes just such a point:

> The risks of a change in law do not seem necessarily different in kind nor in magnitude from the risks of a change in market demand or technology. A priori, it cannot be said that the latter are less random, more predictable. Absent any convincing empirical showing that the losses from political change are disproportionately distributed or more burdensome on productive output than market-reflected changes, efficiency criteria seem not to require delayed or grandfathered effective dates. In fact, efficiency may demand that persons expect changes in the law. In the market context, only behavior that takes into account probabilities of change is treated as reasonable. Reasonable expectations in the political context may, likewise, consist of only those which assess some subjective probability of change in the law.

Graetz, *supra* note 18, at 65-66.

49. Kaplow, *supra* note 8, at 552-55.

50. *See id.* at 553 (stressing that the "argument for providing transitional relief to losers, who do not 'deserve' their losses, which are caused by 'bad luck,' also suggest that the government should 'tax' gainers, who do not 'deserve' their gains, which are 'fortuitous'").

51. *See, e.g.*, Logue, *supra* note 9, at 225 (suggesting that "the same cognitive quirks that affect consumers' assessments of product risks, and of risks more generally, will affect individuals' guesses about the likelihood of legal change, the nature of the change, and the way in which transition costs and benefits will be handled").

52. *See, e.g.*, Epstein, *supra* note 14, at 72 (arguing that "[t]he time, expense, and uncertainty created by the development and implementation of new legal rules should always tilt the scale in favor of the status quo").

sents a coherent basis for reappraising the historical animus towards retroactive legislation.[53]

Even if we accept the validity of the incentive-based arguments for pro-retroactivity in the cases outlined above, unique considerations arise in the context of commercial relationships and changes in the rules that govern them. One can point to features in the process of contracting and enforcement, for example, that suggest strongly that the pro-retroactivity norm might not be suitable. Indeed, even Kaplow asserts that transition policy is inherently complex and that it would be wrong to claim that one transition policy is *always* more efficient than another.[54] To illustrate the poor fit between a policy of consistent pro-retroactivity and legal changes in a commercial context, we may distinguish three salient features of commercial law.

First, much of commercial law trades on the distinction between default rules and immutable rules. A default rule is a term that will govern the rights and obligations of the parties upon the happening of a certain contingency in the event that the parties have neglected to address the contingency specifically by contract: they fill the gaps in the parties' agreement. Because parties may, in the first instance, contract out of default rules, the nature and form of default rules are consistent with the principle of freedom of contract. This principle, popular among contract theorists in the nineteenth and early twentieth centuries, rests on the belief that respect for personal autonomy is a necessary complement to both the liberal political state and a free-market economy[55] and has been put forth as the appropriate foundational approach to the U.C.C.[56] However, the fact that a policy in favor of freedom of contract might have significant instrumental value for realizing the right to personal autonomy and other core elements of liberalism does not necessarily mean that the law recognizes and protects the parties' terms without restrictions. Rather, the Code designates certain types of provisions as immutable, as a policy-driven brake on full autonomy. The Code's immutable rules bar parties to commercial transactions from obtaining outcomes that differ from the specified provisions of the Code by contractual agreement.

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53. *See* Fisch, *supra* note 7, at 112 (noting that "[t]he conclusions of transition theory rely heavily on the core assumptions of legal improvement and rational expectations"); Logue, *supra* note 9, at 220 (pointing out that "a key assumption of the framework is that those private parties will make rational, unbiased assessments of (a) the likelihood of legal change, (b) the nature of legal change, and (c) the way in which the legal change will be applied to them").

54. *See* Kaplow, *supra* note 8, at 557 (explaining "complications in the analysis [may] call for different transition policies in different cases"); *see also* Fisch, *supra* note 7, at 113 (referring to the paradigmatic cases of tax, takings, and products liability and raising the distinct possibility "that these cases reflect the exception rather than the rule").

55. *See, e.g.*, Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 COLUM. L. REV. 1710, 1769 (1997) (asserting that the principle of freedom of contract is supported by both "the liberal-individualistic moral ideology and the utilitarian-economic ideology").

56. U.C.C. § 1-302(a) (2005) provides that "[e]xcept as otherwise provided . . . the effect of provisions of [the Uniform Commercial Code] may be varied by agreement." Comment 1 states that "[s]ubsection (a) states affirmatively at the outset that freedom of contract is a principle of the Uniform Commercial Code . . . ." *Id.* § 1-302 cmt. 1.

For example, freedom of contract never meant that courts could not intervene in order to protect parties from the consequences of unfortunate or unfair transactions. Thus, section 1-302 provides that "[t]he obligations of good faith, diligence, reasonableness, and care prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement."[57] Nevertheless, notwithstanding the inclusion of certain key immutable rules, the Code consists predominantly of default rules, a characteristic that distinguishes it from the bodies of law from which consequentialist pro-retroactivity examples are drawn.

The argument for unbending pro-retroactivity begins to break down if one recognizes that such academic paradigms typically reflect the realities of legal fields that consist exclusively of immutable rules.[58] Few would suggest, for example, that taxation and takings are areas in which there is significant opportunity to define rights and obligations by agreement with the government. This is also true of products liability law in which entering into a sales contract providing for no seller or manufacturer liability is simply not a choice that consumers can make.[59] When all applicable rules are immutable, the consequentialist argument—that making legal changes retroactive across the board would optimize incentives so as to maximize social welfare—has merit. As will be seen though, the same cannot be said of commercial law, in which most of the applicable rules are default rules.

An understanding of why retroactive application of commercial law changes might not always produce the desired incentives might begin with recognition of the reasons why default rules exist. One important reason is that defaults reduce contract formation costs by substituting a so-called hypothetical bargain for a nonexistent real one. That is, if the parties have intended to contract but have not agreed with respect to a term that is essential to a determination of their rights and duties, the default rule fills the gap in their contract with a term that the parties would presumably have agreed to

57. U.C.C. § 1-302(b). It should be noted, however, that this section does permit the parties to "determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable." *Id.*; *see also* U.C.C. § 9-602 (2001) (limiting the freedom of contract in the context of Article 9. Also not without restriction is freedom *from* contract. For example, U.C.C. section 4-103(b) (2002) departs from the rule that a contract between two parties cannot bind a third party by stating that "Federal Reserve regulations and operating circulars, clearing-house rules, and the like have the effect of agreements . . . whether or not specifically assented to by all parties interested in items handled." *Id.* § 4-103(b).

58. *See* Kaplow, *supra* note 19, at 175 (noting that "[w]hen discussing legal rules, most analysts have in mind rules that are binding, or at least that subject violators to fines or fees that are not optional").

59. Some commentators have found this forced feature of products liability law difficult to justify. *See, e.g.*, J. Mark Ramseyer, *Products Liability Through Private Ordering: Notes on a Japanese Experiment*, 144 U. PA. L. REV. 1823 (1996). Ramseyer comments:

> Modern products liability law may be well-established, but it is notoriously hard to justify. Essentially, it imposes on consumer sales contracts a broad panoply of nonwaivable terms. It forces sellers (or manufacturers) in specified consumer sales contracts to agree to compensate buyers (and specified third parties) for specified damages caused by specified defects in specified products. Restated, it forces sellers to bundle insurance contracts with the goods they sell.

Id. at 1824.

if the matter had been considered and negotiated.[60] The parties may have left this gap in their contract either because the particular contingency was overlooked or because it was so unlikely to occur that it was more efficient to choose the default rule than to negotiate a term *ex ante*.[61] The latter explanation may account for contract gaps even in those cases where the default provision seems clearly to be not what the parties would have wanted. Hence it cannot be confidently said that the parties left gaps in their agreement because of the form taken by the default provision. In other words, it seems likely that, regardless of the substance of the default rule, rational transactors might not behave differently.[62] To the extent that this observation holds true, a policy of retroactivity that presumes the parties will behave in a manner that is consistent with the standard incentive-based model of transition relief fails.[63]

A second feature of commercial law that may justify a transition policy different from that advocated within the economic literature is that, in commercial transactions, two parties rather than one must anticipate legal change and make behavior adjustments accordingly. That is, in commercial law contexts, there are restraints of cognition and cost not encountered in the torts, tax, and takings areas.[64] One of the main reasons that the paradig-

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60. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1433 (1989) (stating that the default term should be "the term that the parties would have selected with full information and costless contracting"); Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 971 (1983) (explaining that "the preformulated rules supplied by the state should mimic the agreements contracting parties would reach were they costlessly to bargain out each detail of the transaction"); Alan Schwartz, *Proposals for Products Liability Reform: A Theoretical Synthesis*, 97 YALE L.J. 353, 361 (1988) (stating that the default rule should reflect "the contract that most well-informed persons would have adopted if they were to bargain about the matter").

61. *See* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 92-93 (1989). Specifically:

> Contracts may be incomplete because the transaction costs of explicitly contracting for a given contingency are greater than the benefits. These transaction costs may include legal fees, negotiation costs, drafting and printing costs, the costs of researching the effects and probability of a contingency, and the costs to the parties and the courts of verifying whether a contingency occurred. Rational parties will weigh these costs against the benefits of contractually addressing a particular contingency. If either the magnitude or the probability of a contingency is sufficiently low, a contract may be insensitive to that contingency even if transaction costs are quite low.

Id.

62. *See id.* at 93 (suggesting that "as transaction costs increase, so does the parties' willingness to accept a default that is not exactly what they would have contracted for"). The discussion in the text is not meant to suggest that contracting parties never respond to defaults. Consider the type of default rule that Ayres and Gertner refer to as a "penalty default." *Id.* at 95-101. This is a term that the parties would not want in order to encourage the parties to reveal information to each other or to third parties. *Id.* The most conventional example of such a default is the holding in *Hadley v. Baxendale*, [1854] 156 Eng. Rep. 145 (Exch. Div.) and U.C.C. section 2-715(2)(a) (2003), that the promisor is liable for only foreseeable consequential damages. Thus, the promisee is given the incentive to reveal business information to the promisor. Ayres & Gertner, *supra* note 61, at 101-04. The fact that some defaults are designed to create incentives does not detract from the point, however, that a legal field comprised mainly of defaults does not fit neatly within the incentives-based model of retroactivity.

63. *See* Kaplow, *supra* note 19, at 176 (suggesting that when it comes to defaults "determining appropriate transition rules reflects different concerns").

64. Others have made similar observations. *See* Fisch, *supra* note 7, at 115.

matic areas of torts and tax are well-suited to serve as poster children for the incentive-based model is that often the legal change responds to a perceived glitch in the law in a way that, at least as far as the affected parties are concerned, is exceedingly blunt. To the extent a change is curative of a tax loophole, for example, its coming is foreseeable. Indeed, much of tax planning has been described as "planning around warts in the law."[65] When the cure comes, the wart is removed and the loophole is simply and straightforwardly closed. In the world of commercial law reform, things are seldom that simple.

In commercial law contexts, even if the parties can easily anticipate a change, the form that the change will take may be highly uncertain. For example, when the Article 2 revision project began, it was arguably obvious to all observers that steps would be taken to provide sufficiently clear guidance to courts and to ensure fair results to purchasers and licensees of computer information and "smart goods" containing computer information. It was less obvious, though, what those steps would be and who would take them. Initially, N.C.C.U.S.L. and the A.L.I. decided to proceed with a "hub and spoke" approach that would have reconfigured Article 2 into a central hub of general principles with parts or hubs devoted separately to the special incidents of sales of goods on one hand and computer information transactions on the other.[66] After considerable effort to implement this complex drafting strategy failed, it was abandoned and a new drafting committee was appointed to produce a new Article 2B of the Code. This proposed article would have governed all contracts for the sale, licensing, development, distribution, maintenance, documentation, and support of computer software; it too was eventually abandoned. In 1999, N.C.C.U.S.L. decided that instead of incorporating this uniform law within the Code, it would be more appropriate to promulgate it as a freestanding statute, to be named the Uniform Computer Information Transactions Act (U.C.I.T.A.), for adoption by the states.[67] This was the approach ultimately taken. However, U.C.I.T.A. has been almost uniformly rejected by the states,[68] and N.C.C.U.S.L. is no longer recommending its adoption.[69] This means that in most jurisdictions, the relevant source of state law governing software transactions today may be the common law.

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65. David A. Weisbach, *Ten Truths about Tax Shelters*, 55 TAX L. REV. 215, 225 (2002).

66. For valuable discussions of the hub and spoke idea, see Marion W. Benfield, Jr. & Peter A. Alces, *Reinventing the Wheel*, 35 WM. & MARY L. REV. 1405 (1994) and Raymond T. Nimmer, *Intangibles Contracts: Thoughts of Hubs, Spokes, and Reinvigorating Article 2*, 35 WM. & MARY L. REV. 1337 (1994).

67. For a brief history of Article 2B and the reasons why the project was transformed into U.C.I.T.A., see Fred H. Miller & Carlyle C. Ring, *Article 2B's New Uniform: A Free-Standing Computer Information Transactions Act*, U.C.C. BULL., June 1999, at 1, 2-4.

68. The only states to have adopted U.C.I.T.A. are Virginia and Maryland. MD. CODE ANN., COM. LAW II § 22-101 (LexisNexis 2005); VA. CODE ANN. § 59.1-501.1 (2006).

69. *See* Daniel A. DeMarco & Christopher B. Wick, *Now UCITA, Now You Don't: A Bankruptcy Practitioner's Observations on the Proposed Uniform Computer Information Transactions Act*, AM. BANKR. INST. J., May 2004, at 34, 34.

Like its predecessor, amended Article 2 deals with "transactions in goods."[70] The major change in the scope of the rules involves the definition of "goods," which has been amended so as to explicitly exclude "information."[71] An Official Comment explains this new exclusion by stating that "the sale of 'smart goods' such as an automobile is a transaction in goods fully within this article even though the automobile contains many computer programs."[72] Then, in the next commentary breath, we are told that "[w]hen a transaction includes both the sale of goods and the transfer of rights in information, it is up to the courts to determine whether the transaction is entirely within or outside of this article, or whether or to what extent this article should be applied to a portion of the transaction."[73] The distinction between pure goods and mixed goods/information transfers raises questions as to just what it is that makes an automobile an obvious case for total inclusion within Article 2. Is it that the goods portion of the transaction predominates?[74] What if the jurisdiction uses a "gravamen test" for determining the applicability of Article 2, and the gravamen (essence) of the action involves the software?[75] If an automobile is an easy case, what about VCRs, DVDs, television sets, Palm Pilots, digital cameras, video game machines, and a host of kitchen appliances that now rely on software? Does the method of delivering software matter? For example, would software in an automobile still be covered by Article 2 if it were purchased separately and then downloaded into or electronically delivered to the automobile? If questions such as these are still under active debate, it seems absurd to suggest that parties to a software transaction in 1987[76] could have predicted with any degree of accuracy the future form and substance of the law. Thus, at least

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70. U.C.C. § 2-102 (2005).

71. *Id.* § 2-103(1)(k).

72. *Id.* § 2-103 cmt. 7.

73. *Id.*

74. The courts often are called upon to determine whether a particular transaction is within the scope of Article 2. This is frequently the case when the transaction involves both goods and non-goods components. Courts refer to these transactions as "mixed" or "hybrid" transactions. The "predominant purpose" test is the typical approach pursued by courts. If the court finds that a transaction is predominantly a sale of goods, then Article 2 is applied to the whole. For a collection of cases involving sale and non-sale components, see David Frisch, Fairfax Leary, Jr. & John D. Wladis, *Uniform Commercial Code Annual Survey: General Provisions, Sales, Bulk Transfers, and Documents of Title*, 41 BUS. LAW. 1363, 1365-68 (1986).

75. A minority of courts will apply Article 2 to the goods aspect of the transaction and non-Code law to the non-goods aspect, regardless of which is the dominant factor or purpose. This is commonly referred to as the "gravamen" approach. Thus, if the essence (gravamen) of an action is associated with a transfer of rights in information, the court will apply non-Code law in deciding the case. *See, e.g.*, Foster v. Colo. Radio Corp., 381 F.2d 222 (10th Cir. 1967).

76. Although the task of revising Article 2 officially began in 1991 with the appointment of a drafting committee under the auspices of N.C.C.U.S.L. and the A.L.I., its unofficial beginning was several years earlier. In 1987, Geoffrey C. Hazard, then director of the A.L.I., asked professors Charles W. Mooney and Richard E. Spiedel to investigate the need to update Article 2. As a result of this preliminary study, the Permanent Editorial Board for the Uniform Commercial Code (PEB), with the approval of N.C.C.U.S.L. and the A.L.I., appointed a "Study Group" to make recommendation as to whether Article 2 should be revised. The Study Group submitted a Preliminary Report in the fall of 1990, and an executive summary was submitted to the PEB in the spring of 1991.

in the commercial law context, the assumption that private parties can fully anticipate legal change appears unrealistic.

Similarly, legal uncertainty can exist even when a future legal provision is easily foreseen. Consider the fact pattern in the well-known case of *Williams v. Walker-Thomas Furniture Co.*[77] The seller, the operator of a retail furniture store in a low income neighborhood, used a form installment sales contract for purchases made on credit. The form contract provided for a security interest in the item purchased and further provided that until the buyer's debt for all items purchased was fully repaid, any payments made would be applied pro rata over all outstanding accounts. The effect of this cross-collateral clause was to give the seller the right to repossess *all* purchased items if the buyer failed to make payment at any time before the entire debt for all was fully paid. Let us assume that the seller was aware that the Code would soon become law in her jurisdiction[78] and that it would include a codification of the concept of unconscionability.[79] Assume further that the seller was aware that the Code, once enacted, would apply retroactively to preexisting contracts. Would this knowledge necessarily have induced the seller to anticipate the new law and respond by ceasing to use the draconian cross-collateral clause? Owing to the nature of the legal change, it is not at all clear that it would have or should have this effect.

The virtue of an open-ended standard of indefinite scope such as the doctrine of unconscionability is the discretion that it gives courts to decide cases in a manner that is sensitive to the realities of modern commercial life. With its textual simplicity, it aims to build a world of jurisprudence[80] by requiring the supplement of judicial interpretation: It is only through case law that guidance and clarity as to what is and what is not unconscionable can be obtained.[81] Of course, one consequence of this lawmaking delegation to the courts is substantial post-adoption uncertainty. Whether a contract or clause will be deemed unconscionable is often highly contestable and difficult to predict. It is only after a period of judicial interpretation in a variety of commercial contexts that the standard will take on a content that provides the necessary guidance to transactors.[82] Certainly, where substantial *post*-adoption uncertainty is to be expected, the anticipation of a legal change of this nature is even less likely to guide pre-adoption conduct well. The seller

77. 350 F.2d 445 (D.C. Cir. 1965).

78. The Code was first adopted by the District of Columbia in 1965. *Id.* at 448.

79. It was the inappropriate use of doctrines such as such as fraud, duress, and undue influence that led Karl Llewellyn and the drafters of Article 2 of the Code to codify for the first time the concept of unconscionability.

80. *See generally* Robert Braucher, *The Unconscionable Contract or Term*, 31 U. PITT. L. REV. 337 (1970); John P. Dawson, *Unconscionable Coercion: The German Version*, 89 HARV. L. REV. 1041 (1976); M.P. Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757 (1969); Arthur Allen Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967).

81. The Code provides that the question of unconscionability is an issue of law for the court to decide. U.C.C. § 2-302 cmt. 3 (2005).

82. *See, e.g.*, Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 611 (1992) (stating that "[t]o the extent laws are promulgated as standards, predictability will be enhanced by precedent to the extent precedent transforms standards into rules").

in the above hypothetical may or may not be later told that the cross-collateral clause in her contracts is unconscionable.[83] If the outcome is unpredictable, the appropriateness of the seller's potential response to the anticipated legal change is unpredictable as well. Thus, when an economic approach to transitions prescribes policy based on the incorrect assumption that a particular legal change can be accurately anticipated, it is likely to predict behavior poorly and channel policy in misguided directions.

If the ability of a single party to anticipate and price the risk of legal change is sometimes questionable, the prospect of two parties doing so efficiently is highly unlikely.[84] The paradigm examples used in transition analysis may support pro-retroactivity only in the chosen contexts and others that similarly require only one party to be properly incentivized. In both the software and unconscionability examples, though, the uncertainty that results from legal change adds to the negotiation costs associated with consensual transactions by altering the context within which those negotiations take place. Cost is always a function of risk, and legal uncertainty that makes unclear the content or application of the law that will govern the parties' relationship increases the risk of frustrated expectations. To reduce this risk to an acceptable level, the parties must develop the informational basis necessary for determining the likelihood that change will occur and the substance of that change. Without a cost-effective method for accomplishing this, certain socially beneficial projects will be abandoned.[85] In this way, then, a policy of retroactivity in every case could unintentionally undermine the vitality of a well-functioning economic system.

This brings us to a third feature of commercial law that calls into question the wisdom of such an approach. To illustrate this feature, consider the recent revision of Article 9 of the U.C.C. Suppose that in 1997, prior to the approval of revised Article 9, a secured party extended credit to a debtor and received a security interest in the debtor's equipment, pursuant to a

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83. In *Walker-Thomas*, the court of appeals rejected the seller's argument that the unconscionability doctrine was inapplicable because the contracts in question were entered into prior to the enactment of the Code. Although the court refused to apply the Code retroactively, it held that the doctrine could be applied as a matter of common law. 350 F.2d at 448-49. The case was then remanded for findings on the issue of unconscionability. *Id.* at 450. In his dissent, Judge Danaher was of the opinion that because of many aspects of public policy involved in a case of this sort, the court should await corrective legislation by Congress. *Id. But see In re* MacDonald, 100 B.R. 714, 721 (1989) (finding that a cross-collateral clause was common in the industry and therefore not unconscionable), *rev'd*, No. Civ. A. 89-369 LON, 1992 WL 12044050 (D. Del. Apr. 13, 1992).

84. *See* Fisch, *supra* note 7, at 114 (suggesting that "the ability of private actors to anticipate and price the risk of legal change outside of torts and tax may be overstated").

85. *See* Michael P. Van Alstine, *The Costs of Legal Change*, 49 UCLA L. REV. 789 (2002). The author comments:

> The new moment of uncertainty also will translate into increased negotiation costs. For consensual transactions, uncertainty about the legal infrastructure broadens the range of issues in need of private resolution. In so doing, a new body of law may introduce friction into the negotiation of transactions within its scope. The resultant increase in the costs of private ordering will make some socially desirable transactions less efficient and deter others altogether.

Id. at 830.

written security agreement.[86] The debtor was incorporated in Virginia, had plants in North Carolina, West Virginia, and Maryland, and had its corporate headquarters in North Carolina. Equipment was located at each plant. The secured party wishing to perfect its security interest by filing a financing statement would have looked to Article 9 for guidance as to the correct state(s) in which to file. Under the version of Article 9 in effect in 1997, a situs test applied for "ordinary" goods: the financing statement had to be filed where the goods were physically located.[87] The secured party would, therefore, have been required to file in North Carolina, West Virginia, and Maryland. Revised Article 9, at that time poised for approval, is radically different. Revised section 9-301(1) states the general rule that with respect to nonpossessory security interests, the law of the location of the debtor governs issues of perfection. The location of a corporate debtor is the place of incorporation.[88] So, under revised Article 9, the correct filing jurisdiction would be Virginia.

Given the consequences of misfiling, no reasonable secured party would, under any circumstances, have anticipated the adoption of Revised Article 9 and responded by filing *only* in Virginia.[89] A secured party foolish enough to do such a thing would have been leaving its security interest unperfected and allowing it to remain so until the new act took effect.[90] Consequently, during this period, the security interest would have been subject to defeat by the claims of several different types of claimants. Only a secured party who ignored the likelihood of the change and filed a financing statement where required under current law could have received maximum protection.[91] The general lesson is that parties cannot safely anticipate certain law changes, irrespective of the desirability of the changes themselves or the certainty of retroactive application of the new laws. Even though here

86. Although revised Article 9 had an effective date of July 1, 2001, *see* U.C.C. § 9-701 (2005), the Article was approved by its sponsors (the A.L.I. and N.C.C.U.S.L.) in 1998. *See id.* § 9-101 cmt. 2. Thus from the perspective of transactors in 1997, revised Article 9 was truly a future event.

87. *See id.* § 9-103(1)(b) (1997).

88. U.C.C. § 9-307(e) states that a "registered organization" organized under state law is located in the state of organization. "Registered organization" is defined in section 102(a)(7) to include corporations.

89. Of utmost concern to a secured party is that conflicting claims to the collateral could come ahead of its security interest. In many cases, a security interest's priority over conflicting claims to the collateral will depend on whether the security interest is "perfected." *See, e.g.*, U.C.C. §§ 9-317, 9-322 (2005). Moreover, a debtor's trustee in bankruptcy can assume the seniority of a hypothetical judicial lien creditor and set aside security interests that are unperfected when the debtor enters bankruptcy. *See* 11 U.S.C. § 544(a)(1) (2000). The most common method for perfecting a security interest is to file a financing statement. *See* U.C.C. § 9-310(a). A financing statement that is filed in the wrong place is insufficient to perfect a security interest.

90. Part 7 of revised Article 9 contains a set of detailed rules that govern the transition from prerevision law to full application of the revised Article. *See* U.C.C. § 9-705(b) (providing that an anticipatory filing under revised Article 9 becomes effective to perfect a security interest when the revised Article takes effect).

91. Nor would the secured party necessarily have to refile once the statute changes. Section 9-705(c) continues the effectiveness of financing statements that are filed in the proper state and office under former Article 9. The period of continued effectiveness is until June 30, 2006, or the time it would cease to be effective under the law of the former jurisdiction, whichever is earlier.

the legal change might have been certain to apply retroactively once enacted, there remained the need for the protection afforded by the old law until enactment of the new one. The secured party could not have safely left itself open to a challenge to the legal effectiveness of its financing statement during the interim between its receipt of the security interest and the enactment of the new rule. For these types of cases, the effect of an inflexible retroactivity norm will be to encourage both anticipation of the law change (filing a financing statement in the proper jurisdiction under the new law) and reliance on the old law (filing a financing statement in the proper jurisdiction under the old law). Put this way, it is difficult to see how such an inefficient "cover-all-bases" strategy engendered by the incentive- or anticipation-based perspective would produce social gain. By now, it seems clear that the tort, tax, and takings examples supporting a transition policy of pro-retroactivity application leave troublesome issues unresolved when the contextual framework shifts to commercial law. Although the foregoing analysis does not support the efficiency of retroactive implementation of legal change in commercial law cases, neither does it prove the inefficiency of such a norm in every case. There may very well be valid normative justifications for treating some commercial law changes in a manner consistent with a transition rule of retroactivity. What the above discussion does illustrate, however, is the need to tailor transition policy to the nature of the particular category of legal change at issue.

II. A POSITIVIST VIEW OF LEGISLATIVE RETROACTIVITY

Having examined the pro-retroactivity norm, the assumptions that support this view of legal transitions, and the ways in which these assumptions fail to reflect adequately the structure of the commercial law environment, we turn now to an examination of judicial pronouncements on retroactivity and statutory responses to the issue by the drafters of the Code.

A. Legislative Retroactivity and the Courts

Courts often assert that the prospective or retroactive reach of a statute is no more than a question of legislative intent.[92] Indeed, there can be little doubt that all but the constitutional musings would disappear from the case reports if legislative intent were clearly expressed. Consider, for example, the Maine Legislative Drafting Manual, which addresses the issue of retroactivity and provides that "[a] bill that has a retroactive application should be drafted with caution. Courts generally will not give a law retroactive application unless the intent of the Legislature to make it retroactive is clear

92. *See, e.g.*, Hassett v. Welch, 303 U.S. 303, 313 (1938); Kolster v. I.N.S., 101 F.3d 785, 788 (1st Cir. 1996); Aka v. Jefferson Hosp. Ass'n, Inc., 42 S.W.3d 508, 518 (Ark. 2001); Andersen Consulting, L.L.P. v. Gavin, 767 A.2d 692, 703-04 (Conn. 2001); Metro. Dade County v. Chase Fed. Hous. Corp., 737 So. 2d 494, 499 (Fla. 1999).

and unambiguous."[93] The manual then goes on to give the following illustration of what is meant by a clear and unambiguous statement of intent: "This Act applies retroactively to January 1, 1980."[94] If legislatures heeded such advice, the courts would seldom be called upon to decide questions of retroactivity. As a general matter, though, legislatures often neglect to articulate their intentions this precisely or even in a manner that reflects that the issue of potential retroactivity of the statute was considered. As a result, conclusions regarding legislative intent may be intrinsically unstable.[95]

In response to this legislative indeterminacy, judicial opinions espouse standards and presumptions that purport to guide the quest for legislative intent.[96] The general position of most courts is that in the absence of clear intent to the contrary, it is presumed that the statute was designed to be applied prospectively.[97] Because this presumption is untethered to any particular constitutional norm, it is not intuitively obvious why it should be the preferred canon of statutory construction.[98] Indeed, it is striking that courts often revert to the crude notion that prospective application of new statutes is necessary as a matter of fairness with little or no elaboration.[99] If an explanation is offered for why retroactive application would be unfair, it is usually that people should be able to rely on existing law and to conform their conduct accordingly.[100] An obvious shortcoming of this conclusory approach is that there is no balancing of opposing policies and legislative objectives that might militate in favor of a contrary opinion.

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93. LEGISLATIVE COUNCIL, ME. STATE LEGISLATURE, MAINE LEGISLATIVE DRAFTING MANUAL, pt. II, at 14 (rev. ed. 1994).

94. *Id.*

95. As one would expect when the judicial quest is for legislative intent, courts sometimes rely on indicators that may be less than convincing, if only because of the difficulty in obtaining more reliable measures of intent. *Compare* Goodwin Bros. Leasing, Inc. v. Nousis, 366 N.E.2d 38, 41 (Mass. 1977) (the words "no action shall be maintained" indicates that a retroactive application was intended), *with* Dillon v. Coughlin, 539 N.Y.S.2d 880, 885 (N.Y. Sup. Ct. 1989) (noting that the use of the word "shall" indicates that prospective application was intended), *aff'd*, 550 N.Y.S.2d 115 (N.Y. App. Div. 1989).

96. In several states, courts are guided by statutes that dictate the prospective application of legal change unless the new law clearly, by express language or necessary implication, indicates that the legislature intended a retroactive application. *See, e.g.*, KY. REV. STAT. ANN. § 446.080(3) (LexisNexis 1999); LA. REV. STAT. ANN. § 1:2 (2003); MINN. STAT. ANN. § 645.21 (West 1947); *see also* UNIF. STATUTE & RULE CONSTR. ACT § 8 (1995), 14 U.L.A. 488 (2005).

97. *See, e.g.*, U.S. Fid. & Guar. Co. v. U.S. *ex rel.* Struthers Wells Co., 209 U.S. 306, 314 (1908) (recognizing that "[t]he presumption is very strong that a statute was not meant to act retrospectively, and it ought never to receive such a construction if it is susceptible of any other").

98. *See* Julian N. Eule, *Temporal Limits on the Legislative Mandate: Entrenchment and Retroactivity*, 1987 AM. B. FOUND. RES. J. 379, 432-33 (observing that "on numerous occasions, the presumption of prospectivity continues to be summoned up in the original English sense—purely as a maxim of favored statutory construction and divorced from the presumption in favor of constitutionality").

99. *See, e.g.*, U.S. Olympic Comm. v. Toy Truck Lines, Inc., 237 F.3d 1331, 1334 (Fed. Cir. 2001); S.C. Dep't of Revenue v. Rosemary Coin Machs. Inc., 528 S.E.2d 416, 418 (S.C. 2000); *see also* Eule, *supra* note 98, at 433 (discussing *Bennett v. New Jersey*, 470 U.S. 632 (1985), and concluding that the presumption of prospectivity "seems to enjoy a life of its own, although the Court fails to provide us with a rationale for such rule where constitutional constraints are not at play").

100. *See, e.g.*, N.L.R.B. v. St. Luke's Hosp. Ctr., 551 F.2d 476, 483-84 (2d Cir. 1976) ("Normally the presumption against retroactivity is designed to protect reasonable reliance on prior settled law while permitting the new law full prospective effect.").

Arguments for prospectivity grounded in fairness are less convincing when the statutory change is "procedural" rather than "substantive." As commonly understood, a statute effects a substantive change if it creates or alters rights, duties, and obligations and a procedural change if it addresses the methods of enforcement of rights, duties, and obligations.[101] It has frequently been said that because procedural rules do not abrogate substantive rights, they may be applied retroactively without fear of disturbing expectation interests, even without clear legislative intent.[102] Reliance on such sterile classifications seems suspect, however, since both procedural and substantive statutes may in fact affect past transactions and a decision based solely on the statute's classification may merely dictate a conclusion without adequate justification.[103] It is instructive, for example, to consider the reasoning of the Supreme Court of Maine in *Sinclair v. Sinclair*.[104] In that case, mortgagors instituted foreclosure proceedings but failed to comply with a statute that required that the mortgagee be given notice of her right to cure the default. The mortgagees argued that because the statute mandating notice was enacted after the mortgage was executed, it was never intended to apply retroactively to them. In rejecting the mortgagees' contention, the court explained why an analysis based on the classification of statutes as substantive or procedural should be discredited:

> The issue before us today is a prime example of the limitations of an analysis that relies on the elusive distinction between substance and procedure. We could declare that section 6111 affects the substantive rights of the mortgagee of a preexisting mortgage and presumptively will not apply to a preexisting mortgage. On the other hand, we could declare that section 6111 affects only the procedural mechanism of a foreclosure action commenced after its effective date and presumptively will apply to that action. Applying a label

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101. *See, e.g.*, Weyant v. MacIntyre, 438 S.E.2d 640, 642 (Ga. Ct. App. 1993); *In re* Kaul, 4 P.3d 1170, 1171 (Kan. 2000).

102. *See, e.g.*, Landgraf v. USI Film Prod., 511 U.S. 244, 275 (1994) (concluding that "[c]hanges in procedural rules may often be applied in suits arising before their enactment without raising concerns about retroactivity"). But even a procedural statute will not be applied retroactively if it has so-called "retroactive impact." It would have retroactive impact "if it (1) impairs rights that a party possessed when it acted, (2) increases a party's liability for past conduct, or (3) imposes new duties with respect to transactions already completed." Schweikert v. AG Serv. of Am., Inc., 823 N.E.2d 213, 217 (Ill. App. Ct. 2005). It has been broadly stated that "curative" statutes are another brand of statute to be given retroactive effect. *See, e.g.*, Fasching v. Kallinger, 546 A.2d 1094, 1096 (N.J. Super. Ct. App. Div. 1988). A statute of this type "amends a previous law which is unclear or which does not effectuate the actual intent of the Legislature in adopting the original act." *Id.*

103. *See* Robert C. Feldmeier, *The Illinois Supreme Court's Latest Last Word on Statutory Retroactivity*, 92 ILL. B.J. 260, 265 (2004) (labeling the distinction between substance and procedure as "elusive"); Gene A. Maguire, *Retroactive Application of Statutes: Protection of Reliance Interests*, 40 ME. L. REV. 183, 204 (1988) (concluding that "the distinction between substantive and procedural statutes admits of no bright line").

104. 654 A.2d 438 (Me. 1995).

> foretells the result but does not materially contribute to a principled decision.[105]

The court then reviewed the legislative purpose for enacting the notice provision and concluded that the legislature intended for the statute to have a retroactive effect on preexisting mortgagor/mortgagee contractual relationships.[106]

Another common formulation, related to the proposition that substantive changes to the law should not be applied retroactively, asserts that a statute will not be given retroactive effect if interferes with vested rights.[107] This standard, too, is subject to manipulation for the simple reason that it is not always clear what rights may be considered "vested."[108] The sample of reported cases collected by Bryant Smith in which courts have rejected the contention that a statute, if applied retroactively, would destroy vested rights, leaves one with the firm impression that there may very well be other explanatory variables at work.

> [W]hat shall be said of a law that extinguishes an existing attachment lien, or changes existing estates tail into fees simple, or joint tenancies into tenancies in common, or confirms an invalid tax assessment, or imposes an inheritance tax after the death of the deceased, or denies a statutory penalty after the right to the penalty has already accrued? More difficult than these, what of a law that makes past acts a ground for divorce, so that a spouse who before the law could have successfully defended a divorce action is now liable to an adverse judgment in such a proceeding, or a law that, without his consent, makes a husband of one who theretofore was unmarried? What of a law that validates a defective deed and

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105. *Id.* at 439-40.

106. *Id.* at 440. Other examples abound of the eely nature of the substance/procedure distinction. For example, is a change to the relevant statute of limitations period a substantive or a procedural matter? On the one hand, the change could be viewed as procedural because the statute does "not have the effect of changing the legal significance of prior events or acts." Dobson v. Quinn Freight Lines, Inc., 415 A.2d 814, 816 (Me. 1980). On the other hand, retroactive application of a shorter limitations period may completely bar the assertion of an existing claim and therefore be viewed as substantive. *See, e.g.*, Cecilian Bank v. Sarver, No. 2002-CA-000076-MR, 2003 WL 23005721, at *1 (Ky. Ct. App. Dec. 24, 2003) (holding that the addition of a limitations section to Article 3 of the U.C.C. was substantive).

107. *See, e.g.*, *Ex parte* F.P., 857 So.2d 125 (Ala. 2003); City of Hartford v. Freedom of Info. Comm'n., 518 A.2d 49 (Conn. 1986); Sturm, Ruger & Co., Inc., v. City of Atlanta, 560 S.E.2d 525 (Ga. Ct. App. 2002); Raymond v. Jenard, 390 A.2d 358 (R.I. 1978).

108. *See* Berkley Condo. Ass'n, Inc. v. Berkley Condo. Residences, Inc., 448 A.2d 510, 515 (N.J. Super. Ct. Ch. Div. 1982) (observing that "the term . . . 'vested rights[]' tends to be conclusory"); *In re* Santore, 623 P.2d 702, 706 (Wash. Ct. App. 1981) (stating that "vested right" is merely a "conclusory label"). Indeed, John Austin made this very same point more than one hundred years ago:

> When it is said that the Legislature ought not to deprive parties of their "vested rights," all that is meant is that the rights styled "vested" are sacred or inviolable, or are such as the parties ought not to be deprived of by the Legislature. The phrase is either purely an identical proposition or begs the question at issue.

2 JOHN AUSTIN, LECTURES ON JURISPRUDENCE OR THE PHILOSOPHY OF POSITIVE LAW 256 (Robert Campbell ed., Jersey City: Frederick D. Linn & Co. 1875).

> thereby transfers the ownership of land from A to B, or harder still, what of a law that, by legitimizing an illegitimate child, takes property from an heir who before the law had a perfect title in every respect and for all purposes, and gives it to a remote purchaser from the illegitimate? If the term "vested" means anything at all, some of these laws certainly take away vested rights and yet such laws have been sustained.[109]

Reported retroactivity disputes thus fall into two general categories of cases: Those in which a legislative intent argument is central to the court's decision and those in which a surrogate for intent—such as the substance/procedure dichotomy—is relied upon. Since the need to apply either methodology exists only because the legislature has imperfectly expressed its intent, if at all, and both rely on mutable criteria, it is clear that caution must be exercised in interpreting outcomes. While a full discussion of the cases is beyond the scope of this Article, they suggest that a court's own policy preference is an important and significant explanation for a decision whether to give a statute retroactive effect or not.[110] It was into this judicial morass that Karl Llewellyn and his U.C.C. reporters and drafters stepped.

B. Legislative Retroactivity and the Code

From its inception, the Code embraced the norm that retroactive application of its new provisions would generally be undesirable. Section 10-101 provides that the Code "applies to transactions entered into and events occurring after [its effective date]."[111] This section must be read in conjunction with the saving provision contained in section 10-102. It reads:

> Transactions validly entered into before the effective date . . . and the rights, duties and interests flowing from them remain valid thereafter and may be terminated, completed, consummated or enforced as required or permitted by any statute or other law amended or repealed by this Act [the Code] as though such repeal or amendment had not occurred.[112]

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109. Smith, *supra* note 3, at 245-46.

110. *See* Maguire, *supra* note 103, at 189 ("The problem with applying the court's general, all-purpose method of statutory construction to retroactivity problems is that it creates too great an opportunity for the court to read its own policy preferences into the statute where the Legislature has expressed its intent at all ambiguously.").

111. U.C.C. § 10-101 (1962).

112. U.C.C. § 10-102. A number of jurisdictions found it advisable to expand and modify section 10-102 to address certain issues regarding the continued effectiveness of pre-Code secured transactions. *See, e.g.*, CONN. GEN. STAT. ANN. § 42a-10-102 (West 2002 & Supp. 2005); OHIO REV. CODE ANN. § 1301.15 (LexisNexis 2002); 1961 N.H. LAWS 122; 1964 N.Y. LAWS 1390. Thus, it was recognized early on that different transition rules might be necessary for different commercial law issues. For further discussion of the possibility that a single transition rule might not always be the best way to deal with the many rule changes that result from a revision or amendment of a U.C.C. article, see *infra* notes 183-184

It is interesting to note that the term "transactions," as used in both sections, and the term "events," as used in section 10-101, are nowhere defined in the Code. In its 1956 report relating to the Code, The New York Law Revision Commission expressed concern that post-Code transactions had the potential to disturb contractual or property rights antedating the transaction.[113] For example, when the issuance of a negotiable instrument predates the Code, what law would govern if it were "negotiated, presented, extended, discharged, dishonored or collected [after the Code's effective date]?"[114] Consider also a pre-Code contract modified after the Code's new modification rules have gone into effect. Does the modification receive the saving grace of section 2-209(1) that abrogates the pre-existing duty rule by making good faith contract modifications enforceable without consideration?[115] Given the number, variety, and outcomes of reported cases involving the Article 10 transition provisions, one can discern a clear bias against applying the Code to transactions that were initiated prior to its adoption.[116]

For instance, in *Empire Life Insurance Co. of America v. Valdak Corp.*,[117] a secured transaction involving pledged stock was entered into before the effective date of the Code. The foreclosure sale, however, occurred after the effective date of the Code. Under pre-Code law, the standard for judging the validity of the foreclosure sale was significantly different from the Code's standard of "commercial reasonableness."[118] Prior law required only a disposition of the collateral in "good faith."[119] The district court tried the case under the assumption that the Code governed the foreclosure, but the Fifth Circuit disagreed. The appellate court found inescapable the conclusion that, because the security agreement was executed before the effective date of the Code, it was "governed by the prior law, even as to those aspects of the transaction, including the foreclosure, that took place after the effective date of the Code."[120] In other words, the court held that the post-Code foreclosure was not an "event" that made applicable the Code's new standard of commercial reasonableness.[121]

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and accompanying text.

113. *See* STATE OF N.Y., LAW REVISION COMM'N, REPORT RELATING TO THE UNIFORM COMMERCIAL CODE 32 (1956).

114. *Id.*

115. *Id.*

116. Recall that courts have never hesitated to give a statute retroactive effect if it deals with practice or procedure. *See supra* notes 101-106 and accompanying text. This distinction between substantive and procedural continues to persist under the Code. *See, e.g.*, United Sec. Corp. v. Bruton, 213 A.2d 892, 893 (D.C. 1965) (holding that section 3-307(3), placing the burden of proof on the person claiming holder in due course status, applies to all proceedings after its effective date). But there is the usual problem of determining whether a change is, in fact, procedural. *Compare* Ohio Brass Co. v. Allied Prods. Corp., 339 F. Supp. 417, 424 (N.D. Ohio 1972) (the statute of limitations provided for in section 2-725 is procedural and applies retroactively), *with* Hall v. Gurley Milling Co., 347 F. Supp. 13, 15 (E.D.N.C. 1972) (section 2-725 is substantive and will not be applied retroactively).

117. 468 F.2d 330 (5th Cir. 1972).

118. *See* U.C.C. § 9-504 (2005).

119. *Valdak*, 468 F.2d at 334.

120. *Id.* at 333.

121. Interestingly, this is not the statutory position taken by revised Article 9 in which the general

The same sort of restrictive scope given to the Article 10 words "transactions" and "events" in *Empire Life* is also found in cases in which the post-Code occurrence is independent of either party's activities. In *Florida Power & Light Co. v. Westinghouse Electric Corp.*,[122] for example, the parties entered into two pre-Code contracts whereby Westinghouse agreed to furnish Florida Power and Light (FPL) with the equipment and fuel necessary to construct and operate a nuclear power plant.[123] FPL had no choice but to purchase fuel from Westinghouse but was allowed to choose among three alternative arrangements.[124] After the Code was adopted in Florida, Westinghouse notified FPL that Westinghouse was excused from having to perform these two contracts by reason of the failure of presupposed conditions (commercial impracticability), as provided in U.C.C. section 2-615.[125] Specifically, it was Westinghouse's contention that its performance had been made impracticable by the failure of the uranium market to remain stable in price or quantities available.[126] The district court held that the U.C.C. did not apply retroactively to contracts entered into prior to the Code's effective date, and hence, the case was governed by the common law of excuse in Florida.[127] On appeal, the Fourth Circuit agreed.[128] The court held that neither Westinghouse's contractual default, nor the election by FPL of its fuel service option, nor the alleged failure of presupposed conditions could be considered an "event" under section 10-101.[129]

The above cases strongly suggest that the time-honored presumption against retroactive application of legislation was the predominant defining approach taken by courts at the birth of the Code.[130] A stark contrast

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transitional rule is one of retroactivity. Section 9-702(a) provides, broadly, that the Revised Text "applies to a transaction . . . within its scope, even if the transaction . . . was entered into . . . before [the Effective Date]." U.C.C. § 9-702(a).

122. 579 F.2d 856 (4th Cir. 1978).

123. *Id.* at 857.

124. In addition to the two contracts mentioned in the text, FPL was also given an option to purchase equipment and fuel for a second plant. The option to purchase was exercised after the Code took effect. This, according to the Fourth Circuit, was an "event" so as to make the Code the applicable source of law. According to the court, once the option was exercised, a new post-Code contract resulted. *See id.* at 859-60. Similarly, in *A. J. Armstrong Co. v. Janburt Embroidery Corp.*, 234 A.2d 737 (N.J. Super. Ct. Law Div. 1967), the parties, after the Code's adoption, refinanced a promissory note and chattel mortgage that were executed prior to the effective date of the Code. The parties were presumed to have contracted in the light of the law (i.e., the Code) as it existed at the time of the refinancing. *Id.* at 742.

125. *Florida Power & Light*, 579 F.2d at 858.

126. *Id.*

127. *Id.*

128. *Id.* at 859.

129. *Id.* at 863.

130. This conclusion is supported by a host of other cases. *See, e.g.*, Wilson v. Prudential Ins. Co., 396 S.W.2d 300, 301-02 (Ark. 1965) (post-Code grant of security interest in fixtures did not make Code applicable in dispute between fixture financer and pre-Code real estate mortgagee); Peachtree News Co. v. MacMillan Co., 145 S.E.2d 666, 667 (Ga. Ct. App. 1965) (post-Code tender of goods was not an "event" that changed the tender rules in effect at the time the time the Code took effect); *In re* 49 Madison Grocery Corp., 3 U.C.C. Rep. Serv. 90, 92 (N.Y. Sup. Ct. 1966) (post-Code assignment for the benefit of creditors was not an "event" that made the Code applicable to pre-Code transactions by the assignor). Despite this general anti-retroactivity bias, there are decisions that do apply the Code retroactively. *See, e.g.*, B & H Warehouse, Inc. v. Atlas Van Lines, Inc., 348 F. Supp. 517, 523 (N.D. Tex.

emerges, however, when one examines the transition rules that were put into place to respond to the far-reaching changes made by the 1972 revisions of Article 9.

Article 9, it may be recalled, was the first article to be significantly revised after the drafters put the finishing touches on the 1962 Official Text, which became the first generally adopted version of the Code. The work of the Article 9 Review Committee began in 1967 and culminated in the 1972 Official Text. Along with substantive changes to the Code, the drafters added a new Article 11 to govern the transition to the new version. Although section 11-102 preserves the principle of section 10-102—i.e., that pre-Code law should apply to pre-Code transactions,[131]—section 11-103 adopted a radically different approach for determining which law should apply to secured transactions that were entered into under the prior version of the Code. The principle is one of almost complete retroactivity. The explanation for this remarkable policy shift is provided in the discussion of section 11-102: "A different principle is set forth in this Article 11 for transition problems between the [old Code] and the [new Code], because the changes are not nearly as great. That principle is that the [new Code] governs (with minor exceptions)."[132]

One is left to ponder exactly what motivated the drafters of the 1972 Official Text to take a position contrary to the usual treatment of legislative retroactivity. Could it really be that a retroactive approach was chosen because the changes wrought by the new text were not great? If this assertion is to be believed, then it would follow that the scale would be tipped in favor of retroactivity whenever statutory changes are either few in number or fall below some indeterminate standard of significance. In this decisional setting, the reliance and expectations of affected transactors would be largely ignored—a curious approach, indeed, for sophisticated drafters. An alternative explanation has been offered by William Hawkland: "Convinced of the merits of these amendments, the drafters of Article 11 were eager to have them apply wherever possible."[133] It seems implausible, though, that the drafters could have produced the Code initially and at other times made changes to it without a strong belief in the merits and desirability of the underlying substantive law. Perhaps the drafters were merely following the

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1972) (holding because stock, purchased pre-Code, was transferred post-Code, the Code applied to transfer restrictions), *rev'd on other grounds*, 490 F.2d 818 (5th Cir. 1974); Gen. Elec. Credit Corp. v. R. A. Heintz Constr. Co., 302 F. Supp. 958, 968 (D. Or. 1969) (finding the Code governed the rights of a buyer who purchased goods after the effective date of the Code as against a party who had a pre-Code security interest in those same goods).

131. The purpose of section 11-102 is to make clear that the Article 10 transition rules are being maintained in order to provide the appropriate rules in those states in which the Code has been on the books for a relatively short period of time and pre-Code transactions are still being litigated. *See* U.C.C. § 11-102 introduction (1972).

132. *Id.* One minor exception to this new principle of retroactivity is that the "[old U.C.C.] shall apply to any questions of priority if the positions of the parties were fixed prior to the effective date of [new UCC]." U.C.C. § 11-107.

133. 10 HAWKLAND, U.C.C. SERIES § 11-103.01 [Art. 11], at 7 (2002).

Supreme Court's lead in exhibiting a greater willingness to tolerate retroactive legislation where the object of the legislation in question is to alter an existent statutory scheme rather than to fill a statutory void.[134] Their motivations and rationales may never be fully understood.

Whatever the reason(s) for the retroactive treatment of changes to Article 9,[135] however, with one exception, the drafters have traveled a different path with regard to subsequent evolutionary changes to the Code. Within the past two decades, numerous U.C.C. drafting committees have had the opportunity to consider the appropriate transition policy that should govern revisions and amendments to articles other than Article 9.[136] Given the efforts at drafting Articles 10 and 11, one might have expected to see rather extensive analysis of the rationale for and permissible limits of retroactivity. Yet the body of recently amended and revised articles frustrates that expectation. As to current Articles 1, 3, 4, 4A, and 6, the statutory silence has been deafening: they simply do not address the transition problems between the old Code and new Code. It is difficult to determine whether this hands-off approach was taken by design or merely resulted from inattention. In view of the long history of judicial bias against retroactivity, though, the failure of the statute to speak will surely be viewed as an endorsement of the case law status quo. In other words, a statutory change that does not specify retroactive treatment is almost certain to signal approval of a transition policy favoring prospective application only. Indeed, this is precisely the manner in which most courts have applied the changes.[137]

By contrast, an explicit policymaking effort against retroactivity can be seen in current Articles 2, 2A, 5, and 7.[138] Section 2-803 exemplifies this effort. It reads as follows:

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134. *See, e.g.*, Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32, 38 (1940) (holding a statutory amendment restricting stock withdrawal rights constitutional because "[w]hen [Veix] purchased into an enterprise already regulated in the particular to which he now objects, he purchased subject to further legislation upon the same topic"); *see also* Eule, *supra* note 98, at 452 ("Retroactive statutes constructed on vacant lots have ironically fared worse with the courts than retrospective efforts to alter prior statutory schemes.").

135. Recall that the drafters of the 1998 version of Article 9 were also of the opinion that there was no need to further defer its application. *See supra* note 121. This is not to suggest that every provision in revised Article 9 was intended to apply retroactively without transition relief. There are grandfathering and grace periods aplenty. *See generally* HARRY C. SIGMAN & EDWIN E. SMITH, THE TRANSITION RULES OF REVISED ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE (2001). This booklet is available free of charge from CT Corporation.

136. *See supra* note 15.

137. *See, e.g.*, *In re* Chi. Coastal Motor Express, Inc., No. 92-60070, 1992 WL 309184, at *8 (Bankr. N.D. Ind. June 3, 1992) (holding the 1987 Official UCC Text of section 1-201(37)(b) may not be applied retroactively); Choo Choo Tire Serv., Inc. v. Union Planters Nat'l Bank, 498 S.E.2d 799, 801 (Ga. Ct. App. 1998) (holding the 1990 Official UCC Text of sections 3-103 and 3-302 may not be applied retroactively); Cecilian Bank v. Sarver, No. 2002-CA-000076-MR, 2003 WL 23005721, at *1 (Ky. Ct. App. Dec. 24, 2003) (holding the 1990 Official UCC text of section 3-118 may not be applied retroactively); Carelli v. Hall, 926 P.2d 756, 762 (Mont. 1996) (holding the 1990 Official UCC Text of section 3-403 may not be applied retroactively). *But see* Carnegie Bank v. Shalleck, 606 A.2d 389, 397 (N.J. Super. Ct. App. Div. 1992) (holding the 1990 Official Text of section 3-112 must be applied retroactively).

138. *See* U.C.C. §§ 2-803 (2003), 2A-603 (2003), 5-115 cmt. 3 (1995), 7-703 (2003).

> (1) This [Act] applies to a transaction within its scope that is entered into on or after the effective date of this [Act].
>
> (2) This [Act] does not apply to a transaction that is entered into before the effective date of this [Act] even if the transaction would be subject to this [Act] if it had been entered into after the effective date of this [Act].[139]

While section 2-803 sets forth a clear rule, no official comment is included to explain the drafting committee's underlying theory of legal transitions or to offer additional guidance about how to approach this critically important and pervasive problem. Indeed, there is no evidence to indicate that this provision was even considered by the entire drafting committee.[140]

The two simple statutory patterns elaborated above (i.e., silence and explicit non-retroactivity) would have failed to predict the significantly different policy option chosen by those responsible for the 1994 Official Text of Article 8. The general transition rule for Revised Article 8 is that the new law is to be given full retroactive effect with respect to all transactions that fall within its substantive coverage, without regard to the date upon which those transactions took place.[141] The justification for this approach is revealed in the Official Comment following section 8-603:

> The revision of Article 8 should present few significant transition problems. Although the revision involves significant changes in terminology and analysis, the substantive rules are, in large measure, based upon the current practices and are consistent with results that could be reached, albeit at times with some struggle, by proper interpretation of the rules of present law. Thus, the new rules can be applied, without significant dislocations, to transactions and events that occurred prior to enactment.
>
> The enacting provisions should not, whether by applicability, transition, or savings clause language, attempt to provide that old Article 8 continues to apply to "transactions," "events," "rights," "duties," "liabilities," or the like that occurred or accrued before the effective date and that new Article 8 applies to those that occur or accrue after the effective date. The reason for revising Article 8 and

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139. U.C.C. § 2-803.

140. The author of this Article was the American Bar Association advisor to the Article 2 Drafting Committee from the inception of the project in 1991 through 1999. To the author's knowledge, not once during this period was the issue of transition policy raised by anyone associated with the project.

141. This transition rule follows from the statement in section 8-601 that "This [Act] takes effect [on whatever date is selected by the enacting jurisdiction]." Old Article 8 will continue to apply in only two situations. It will be the law to be applied to in lawsuits actually commenced prior to the effective date of revised Article 8 and, in some cases, to security interests in investment property that were perfected under the pre-1994 version of the statute. *See* U.C.C. § 8-603(a)-(b) (1994).

> corresponding provisions of Article 9 is the concern that the provisions of old Article 8 could be interpreted or misinterpreted to yield results that impede the safe and efficient operation of the national system for the clearance and settlement of securities transactions. Accordingly, it is not the case that any effort should be made to preserve the applicability of old Article 8 to transactions and events that occurred before the effective date.[142]

The rationale expressed in the foregoing Comment generates significant and robust implications and provides foundational substance for a general theory of when commercial law changes should be applied retroactively. The next Part of this Article begins the task of building and applying such a theory.

III. A THEORY OF TRANSITION POLICY FOR COMMERCIAL LAW CHANGES

As noted in the Introduction, retroactive legislation has long been viewed with disfavor by courts and commentators alike.[143] Traditional normative criticism of retroactivity has rested on two related assertions: Fairness mandates giving people the opportunity to know in advance what laws will govern their affairs and prohibits changing the rules in midstream,[144] and retroactive laws defeat the legitimate expectations of the persons affected.[145] Writing in 1875, John Austin commented that "[w]herever expectations have been raised in accordance with the declared purpose and concession of the State, to disappoint those expectations by recall of the concession without a manifest preponderance of general utility is . . . pernicious."[146] In order to construct a rational model of transition policy for commercial law, it is first helpful to explore the assertions underlying this normative critique of retroactivity in a commercial setting.

A. Sheltering Expectations: The Common View

At their core, commercial transactions involve "deals." The principle end of such deals is to secure a value-maximizing exchange of property. Consider, for example, a simple contract for the purchase and sale of a lawn mower for $200. Presumably, for this voluntary exchange to occur, it must

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142. U.C.C. § 8-603 cmt.

143. *See supra* notes 4-6 and accompanying text.

144. *See, e.g.*, SINGER, *supra* note 3, § 41.02, at 341 ("It is a fundamental principle of jurisprudence that retroactive application of new laws is usually unfair. There is general consensus that notice or warning of the rule should be given in advance of the actions whose effects are to be judged." (footnotes omitted)).

145. *See, e.g.*, Eule, *supra* note 98, at 437 ("The objection to retroactivity that is most often observed searching for a constitutional home is one that is concerned with fulfilling citizens' expectations."); Stephen R. Munzer, *A Theory of Retroactive Legislation*, 61 TEX. L. REV. 425, 425 (1982) ("A common view holds that retroactivity is not often justifiable. This view rests on the ideas that it is undesirable to upset expectations and that it is contrary to the rule of law to change legal rules in the middle of the game.").

146. AUSTIN, *supra* note 108, at 256.

benefit both parties—the seller must value $200 more than the lawn mower and the buyer must value the lawn mower more than $200. Further, all such deals involve a number of risks. For example, there is the risk that either the buyer or the seller might be dishonest or otherwise fail to perform. If the buyer wrongfully refuses to pay for the lawn mower or the seller wrongfully refuses to deliver it, the aggrieved party may have to face the vagaries, uncertainties, and delays of the judicial system in order to obtain relief. There is also the risk that the lawn mower will be damaged or lost before delivery is made to the buyer. Finally, there is the risk that the lawn mower will not perform as expected. Given these and other risks, the practical task facing the contracting parties is to shape the transaction so that the burdens and risks are allocated in a manner acceptable to each.[147] In order to do so effectively, it is absolutely essential that the parties have a basic understanding of the law applicable to the contract. If the parties cannot feel secure at the outset that a court will act in a specific, predictable fashion if presented with a particular question, a coherent contract will not be possible. Legal unpredictability will hinder, rather than facilitate, commerce. Neither the buyer nor the seller of the lawn mower will be able to accurately price his or her performance. As a result, deals will tend to be less efficient, and some mutually beneficial deals would likely not take place at all.[148] Moreover, lawyers will be unable to advise clients while deals are still in the process of being shaped.

One of the most interesting and important manifestations of the generally accepted view that a central purpose of commercial law is to protect reasonable expectations is the current debate concerning Llewellyn's contextual orientation to sales law.[149] The participants in this debate recognize that there are two competing ways of interpreting a contract: the formalist way and the antiformalist way. The formalist way or approach (or, because its advocates would have us return to the formalist days of yore, perhaps the more accurate description is the neoformalist approach)[150] views the contract as being limited only to the words on the page, infused with whatever

147. If the parties have failed to address a particular contingency in their contract, it may be normatively correct to provide them with a default rule that they most probably would have chosen for themselves at the time of contracting had they thought about the matter.

148. Others have made similar observations. *See, e.g.*, Eule, *supra* note 98, at 440 ("Advance planning is necessary for economic development. Investments that will be legally as well as financially speculative are less likely to be undertaken. Those who rely on existing law are undoubtedly entitled to certain assurances that their interests will not be undervalued or ignored by future lawmakers."). Without predictability, individuals would be unable to plan their affairs—business or otherwise—with any degree of certainty. *See infra* note 12.

149. *See, e.g.*, Omri Ben-Shahar, *The Tentative Case Against Flexibility in Commercial Law*, 66 U. CHI. L. REV. 781 (1999); Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710 (1999); James W. Bowers, *Incomplete Law*, 62 LA. L. REV. 1229 (2002); Robert E. Scott, *The Uniformity Norm in Commercial Law: A Comparative Analysis of Common Law and Code Methodologies*, *in* THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 149 (Jody S. Kraus & Steven D. Walt eds., 2000).

150. *See* William J. Woodward, Jr., *Neoformalism in a Real World of Forms*, 2001 WIS. L. REV. 971, 1004 (noting that there has been a "flurry of neoformalism in contracts scholarship").

meaning can be derived from an ordinary dictionary.[151] The antiformalist approach (Llewellyn's idea of the correct way) sees a contract as a contextual text with room to accommodate all surrounding circumstances, including past dealings, trade customs, and the pattern of contract performance.[152] The formalist approach promises to respect the parties' expectations by keeping judges in check. All it asks is "that the court respect the literal and explicit terms of the contract"[153] rather than embark on a search for business norms that may or may not exist,[154] may or may not be discoverable,[155] may or may not be efficient,[156] and may or may not have been within the contemplation of the parties.[157] The antiformalist position, on the other hand, is premised on the belief that "parties develop expectations over time against the background of commercial practices and that if commercial law fails to account for those practices, it will cut against the parties' actual expectations."[158]

The debate might be amenable to resolution if more empirical information were available to help answer a host of issues raised by the neoformalist analysis. For example, it is an empirical question whether attributing a dictionary meaning to the contract is more likely to accord with what the parties actually intended than an inquiry that entails a reference to external facts and circumstances.[159] Indeed, even Professor Scott acknowledges that "[i]t is clear that more analysis, both theoretical and empirical, is required

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151. *See id.* at 975-76.

152. The Code definition of "Agreement" reads: "'Agreement', as distinguished from 'contract', means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in Section 1-303." U.C.C. § 1-201(b)(3) (2001).

153. Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847, 851 n.12 (2000).

154. *See* Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1808-11 (1996).

155. *See* Eric A. Posner, *A Theory of Contract Law Under Conditions of Radical Judicial Error*, 94 NW. U. L. REV. 749, 753-54 (2000).

156. *See* Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697, 1724 (1996).

157. *See id.* at 1711-13.

158. PEB Commentary No. 10, Section 1-203 (Feb. 10, 1994), *reprinted in* SELECTED COMMERCIAL STATUTES 1382 (Thompson/West 2006). Comment 1 to U.C.C. section 1-303 ("Course of Performance, Course of Dealing, and Usage of Trade") clearly expresses Llewellyn's realism. It provides:

> The Uniform Commercial Code rejects both the "lay-dictionary" and the "conveyancer's" reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.

U.C.C. § 1-303 cmt. 1 (2001).

159. *See* Bowers, *supra* note 149, at 1238 ("It is an empirical question whether traders' use of language always conforms so tightly with the dictionary meaning so that a rigidly formalistic interpretive technique, determining the true content of the parties' promises from the dictionary meaning of the words in their promises alone, is the strategy least likely to reach erroneous conclusions about what they really promised each other."); *see also* Robert A. Hillman, *Comment: More in Defense of U.C.C. Methodology*, 62 LA. L. REV. 1153, 1157-60 (2002) (suggesting other issues of an empirical nature).

before anyone can safely call for radical reform."[160] Although a full discussion of the neoformalist-antiformalist debate is beyond the scope of this Article, it does serve as an instructive reminder that one of the key objectives of a commercial law system is to establish a method of resolving controversies with due regard to the settled expectations of the parties. Having acknowledged the significance of the parties' expectations, transition policy must account for this normative goal.

B. Sheltering Expectations: The Less Common View

Not only does protecting settled expectations produce a result believed to be morally just,[161] but it also serves the instrumentalist goal of promoting market transactions which, in a capitalistic society, are the primary means of allocating resources from less to more valuable uses. To some, however, the notion that reliance on existing legal rules plays a significant role in governing the day-to-day behavior of commercial transactors is particularly problematic.

This skepticism is the result of recognizing that a significant degree of indeterminacy remains in the law and that unexpected legal outcomes due to unanticipated contingencies cannot be altogether eliminated even by the most careful statutory drafting. Nor would skillful drafters want to risk the perils associated with writing in terms too particular.[162] The drafters of the U.C.C., aware that codification sometimes fails because of the excessive rigidity of statutory commands and cognizant of the wide variety of contexts in which the Code would be applied, aimed to craft it so as to provide a desirable degree of flexibility in implementation.[163] In addition, interpretation

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160. Scott, *supra* note 149, at 175.

161. *See* SINGER, *supra* note 3, § 41.05, at 370 ("One of the fundamental considerations of fairness recognized in every legal system is that settled expectations honestly arrived at with respect to substantial interests ought not be defeated.").

162. Apart from the inevitable indeterminacy of statutory formulations, *see* Anthony D'Amato, *Counterintuitive Consequences of "Plain Meaning,"* 33 ARIZ. L. REV. 529, 530-34 (1991), inherent in any piece of legislation is what Professor Hart has called an "indeterminacy in . . . aim." H.L.A. HART, THE CONCEPT OF LAW 128 (1961). To make this point, Hart posits an ordinance barring vehicles from a public park. *Id.* at 125. Although it may be clear that, if the purpose of the law is to maintain peace and quiet, then the legislature intended to banish cars, buses, and motorcycles; it is unclear whether any other "vehicles" were intended to be excluded:

> We have initially settled the question that peace and quiet in the park is to be maintained at the cost, at any rate, of the exclusion of these things. On the other hand, until we have put the general aim of peace in the park into conjunction with those cases which we did not, or perhaps could not, initially envisage (perhaps a toy motor-car electrically propelled) our aim is, in this direction indeterminate. We have not settled, because we have not anticipated, the question which will be raised by the unenvisaged case when it occurs: whether some degree of peace in the park is to be sacrificed to, or defended against, those children whose pleasure or interest it is to use these things.

Id. at 126.

163. This point is made by Grant Gilmore with considerable force:

> [I]t is a matter of vital importance that the Code as a whole be kept in terms of such generality as to allow an easy and unstrained application of its provisions to new patterns of business behavior. Commercial codification cannot successfully overparticularize: the penalty for be-

of the Code is sometimes complicated by new technological developments and evolving business practices,[164] creating genuine problems for those who must apply it.[165] Finally, the interpretative task can be confounded by the use of undefined terms.

Consider the "basis of the bargain" requirement for an express warranty under U.C.C. section 2-313. Under the precursor to Article 2, the Uniform Sales Act, actual reliance by the buyer on a statement or other representation concerning the goods was a necessary element in an express warranty case.[166] By contrast, section 2-313 omits any reference to reliance, instead requiring in each instance that the representation be a "part of the basis of the bargain"[167] between buyer and seller. Was this substitution intended as a means of avoiding the requirement that the buyer show reliance in every case involving breach of express warranty?[168] If buyer reliance on representations (made by promise, affirmation, description, model, or sample) were no longer essential to recovery, then section 2-313 would indeed have worked a revolution in the law. The nature of related case law has been described, however, as

> manifesting a split of authority between those cases which insist upon a showing of reliance and those which reject that requirement. The confusion is much deeper. . . . [S]ome courts initially state that reliance is required, only to later suggest that in fact it is not or may not be required. Other courts initially state that reliance is not required, but proceed to suggest that it is required, either expressly or

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ing too precise is that the statute will have to keep coming in for repairs (and amendment is a costly, cumbersome and unsatisfactory process) or else become a dead-letter.

Grant Gilmore, *On the Difficulties of Codifying Commercial Law*, 57 YALE L.J. 1341, 1355 (1948). From its inception, the Code was perceived to be "a semi-permanent and infrequently-amended piece of legislation." U.C.C. § 1-103 cmt. 1 (2001). In particular, the drafters "intended to make it possible for the law embodied in the Uniform Commercial Code to be applied by the courts in the light of unforeseen and new circumstances and practices." *Id.*

164. For a catalogue of commercial innovations that have arisen since the adoption of the Code, see John F. Dolan, *Changing Commercial Practices and the Uniform Commercial Code*, 26 LOY. L.A. L. REV. 579 (1993).

165. For example, in the course of assessing the ability of paper-based legal requirements to accommodate technological change, a number of difficult issues arise. One is whether the electronic message can be brought within the definitions of "written" or "writing," *see* U.C.C. § 1-201(43), and "signed," *see id.* § 1-201(37), in order to satisfy the section 2-201 Statute of Frauds requirements. There seems to be little consensus on the proper disposition. For a collection of views, see Sharon F. DiPaolo, Note, *The Application of the Uniform Commercial Code Section 2-201 Statute of Frauds to Electronic Commerce*, 13 J.L. & COM. 143 (1993). This uncertainty has led the drafters of amended Article 2 to revise the statute to make it medium neutral. Instead of a signed writing, the statute may be satisfied by a signed record. *See* U.C.C. § 2-201 (2003).

166. *See* UNIF. SALES ACT § 12 (1906). An affirmation of fact or promise created an express warranty under the Uniform Sales Act only "if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods, and if the buyer purchases the goods relying thereon." *See id.*

167. U.C.C. § 2-313(2)(b).

168. What the drafters of the Code intended by the phrase "basis of the bargain" has been a source of perpetual confusion. *See, e.g.*, 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 9-5, at 618-28 (5th ed. 2006).

> through some kind of inducement. Moreover, these cases may very well cite each other as authority.[169]

It is not my purpose here to explore what the drafters intended; rather, I invoke the confused state of the law on this issue simply to demonstrate that oftentimes certainty and predictability cannot always be realized in our legal system.[170] Sometimes legislative views cannot plausibly be ascertained in a way that cleanly resolves issues of statutory interpretation, many of which were unforeseen when the statute was enacted. The choice of rules or their application must often make reference to considerations of both fact and policy, about which reasonable minds may differ.

For these reasons, the antipathy towards retroactive legislation cannot always be defended as a prudential response to the societal need to protect legitimate expectations. Rather, the claim that retroactive application would invariably produce injustice or hardship is undermined by the fact that several possible outcomes could result from a judicial determination, depending upon which of multiple contingencies arises. It follows that since there is no consistently "right" answer to legal questions, it would be foolish to assume that transactors always rely on existing law.

This is not to suggest that the basic principles of commercial law are not fixed and immutable, however. While there may be quibbling, for example, about whether the U.C.C. section 2-201 Statute of Frauds has been satisfied in a particular case, there can be no doubt that (absent an exception) the statute must be satisfied if the contract price in a sales transaction is $500 or more.[171] Disputes are clearly resolved by a core body of stable, predictable commercial law rules. Yet as to whether people enter into transactions relying on those rules, empirical evidence suggests that such considerations may be less relevant to the day-to-day practices of commercial transactors than one might guess. Stewart Macaulay, in a famous and often-cited article, had this to say about the real world of commercial practice:

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169. John E. Murray, Jr., *"Basis of the Bargain": Transcending Classical Concepts*, 66 MINN. L. REV. 283, 304 (1982) (footnotes omitted).

170. The interpretation and application of statutory law have no monopoly on the element of unpredictability. Jerome Frank made the same point with regard to case law more than seventy-five years ago:

> Legal predictability is plainly impossible, if, at the time I do an act, I do so with reference to law which, should a lawsuit thereafter arise with reference to my act, may be changed by the judge who tries the case. For then the result is that my case is decided according to law which was not in existence when I acted and which I, therefore, could not have known, predicted or relied on when I acted.
>
> If, therefore, one has a powerful need to believe in the possibility of anything like exact legal predictability, he will find judicial lawmaking intolerable and seek to deny its existence.
>
> Hence the myth that the judges have no power to change existing law or make new law: it is a direct outgrowth of a subjective need for believing in a stable, approximately unalterable legal world—in effect, a child's world.

JEROME FRANK, LAW AND THE MODERN MIND 34-35 (1935).

171. *See* U.C.C. § 2-201 (2002). Amended section 2-201 increases the threshold amount of $500 to $5,000. *See* U.C.C. § 2-201 (2005).

> Contract planning and contract law, at best, stand at the margin of important long-term continuing business relations. Business people often do not plan, exhibit great care in drafting contracts, pay much attention to those that lawyers carefully draft, or honor a legal approach to business relationships. There are business cultures defining the risks assumed in bargains, and what should be done when things go wrong. People perform disadvantageous contracts today because often this gains credit that they can draw on in the future. People often renegotiate deals that have turned out badly for one or both sides. They recognize a range of excuses much broader than those accepted in most legal systems.[172]

Thus while perhaps counterintuitive, it nevertheless seems a valid conclusion that, if many legal rules are indeterminate and/or there is an observed dichotomy between commercial law and commercial practice, then an expectation model of retroactive lawmaking makes little sense. The countervailing notion, however, is that a model under which courts and legislatures are free to insist upon retroactivity without restriction contradicts the deeply felt and widely held intuition that the content of commercial law does matter. Moreover, notwithstanding the dichotomy between law and practice, there can be no doubt that this is the case. While some may admit to doing what they do without concern for the legal consequences of their actions, the same is not true for those who seek the assistance of legal counsel.[173] Llewellyn himself recognized the existence of "counsellor's rules"—rules that, from the counsellor's perspective, were used to shape the transaction. He stated the proposition succinctly: "[T]he counsellor has found that there are some solid, settled, clear rules on which he can build; they are safe, they are bedrock. But there are not as many of them as one might wish."[174] If some people can reasonably claim to have relied on one or more rules at some point during the life of a commercial transaction, proponents of the expectation model would not disturb those settled expectations by retroactively applying new rules. Yet given that commercial practice is often not aligned with reliance on existing law, is there a place for retroactive

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172. Stewart Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465, 467-68. Macaulay's conclusion is supported by other studies. *See* Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 WIS. L. REV. 1, 5 (suggesting that "it is a delusion to assume that commercial conduct is primarily controlled by what is 'legal'" (citing James J. White, *Contract Law in Modern Commercial Transactions, An Artifact of Twentieth Century Business Life?*, 22 WASHBURN L.J. 1, 19 (1982))); White, *supra*, at 2 (conducting an empirical study of chemical and pharmaceutical companies and offering the "thesis that contract law is a much less significant determinant of commercial behavior in complex transactions than the typical law student, contracts professor, or lawyer dares believe").

173. For the suggestion that those who can claim to have relied on existing law are the wealthy and well educated, see Munzer, *supra* note 145, at 446-47, recognizing that the entrenchment effects of a prospective approach to legislation tends "to favor the wealthy, well-educated, and well-informed who were able, in particular by using astute counsel, to consolidate rights in contracts drafted in observance of specific rules of contract law."

174. K.N. Llewellyn, *The Modern Approach to Counselling and Advocacy—Especially in Commercial Transactions*, 46 COLUM. L. REV. 167, 168 (1946).

application of some rules? If so, where should the retroactive/prospective line be drawn?

We might be tempted to propose drawing the dividing line solely on the basis of whether or not the new law effects a change to a "bedrock" rule. However, while this approach would make sense if all that mattered were the evils associated with a disruption of expectations, there are other considerations. One is the risk of legal ossification if the law is frozen simply because people might have relied on particular rules when structuring their affairs.[175] In addition to expectations alone, the dividing line between retroactivity and prospectivity should take into account the need for the law to keep pace with developing commercial practices and fundamental changes in society.[176] For this reason, concern for expectations has never been an absolute barrier to change resulting from judicial decisions and administrative rulings.[177] There is nothing distinctive about legislative change that requires a special set of constraints.

The nature and magnitude of reliance, even on a bedrock rule, should also play a role in the determination of where to draw the line between retroactive and prospective application in setting transition policy. For example, it has been suggested that *The Legal Tender Cases* provide us with a compelling situation for the application of precedent in the interests of stability, even if the price paid for that stability is to endorse wrong decisions.[178] It was far too late in the game for the Court to disrupt the country's economic system by deciding, even rightly, that the Constitution precluded the use of paper money as legal tender.[179] As contexts differ, the nature and extent of reliance effects do too, so that every decision need not be the same. Moreover, there is often a connection between the probability of retroactive reform and the extent of reasonable reliance. That is, if parties are given notice that rules might be altered with retroactive effect, familiar objections to retroactivity are considerably weakened. One of the best examples of this point is the set of "don't rely" statutes and constitutional provi-

175. *See* Eule, *supra* note 98, at 438 (citing LON L. FULLER, THE MORALITY OF LAW 60 (1964)) ("[I]f every time individuals relied on existing law in arranging their affairs, they were made secure against any disruptive alteration of the legal landscape, the result would necessarily be entrenching."); Greenblatt, *supra* note 5, at 567 ("Retroactivity is always an aspect of the broader problem of weighing the interests in stability against the constant demands for change inherent in the flux of modern life.").

176. *See supra* notes 16-17 and accompanying text.

177. *See supra* notes 7-10 and accompanying text; *see also* Richard J. Pierce, Jr., *Reconciling* Chevron *and Stare Decisis*, 85 GEO. L.J. 2225, 2245 (1997) ("In most contexts . . . including judicial decisions to reverse or overrule agency precedents, courts rarely take any action to protect the reliance interests that have been created by the precedent."); Samuel Williston, *Change in the Law*, 69 U.S. L. REV. 237, 239 (1935) ("To the extent that social needs and mores change, legal principles should change [too]."). Moreover, if sheltering expectations were of paramount importance, one would think that, unless notice were given in advance of its adoption, no new law should take effect until some reasonable period after its promulgation. *See* Smith, *supra* note 11, at 420.

178. *See* Pierce, *supra* note 177, at 2244.

179. *See id.* ("The Court would be behaving in an extraordinarily irresponsible manner if it overruled a precedent in circumstances in which its decision destroyed trillions of dollars of investments made in reliance on that precedent.").

sions pertaining to corporations.[180] This body of law announces, in advance, that all rules governing corporations are subject to retroactive change, which is likely to inhibit reliance. Some commentators suggest, therefore, that there is a circularity to any analysis based on reliance and expectations: If it is probable that laws will apply prospectively, reliance is justified and expectations are fulfilled; if it is probable that laws will apply retroactively, reliance on existing law is hazardous, and expectations, having been shaped accordingly, are fulfilled in this case as well.[181] While this observation may depend too heavily on potentially faulty premises—that the transition policy for all laws will be the same and that there is always minimal reliance on laws that are subject to change[182]—it does lend support to a valid proposition that may guide transition policy. That proposition is that the inherent reasonableness of expectations and reliance on a law in a particular context should influence the transition policy associated with that law and context.

C. Summary: Balancing the Factors

As has been seen, while many commentators—including courts—have regarded a prohibition against the retroactive application of commercial law changes as crucial to the protection of rational expectations and the promotion of reliance on existing rules of law, such a prohibition is not always warranted by fundamental notions of fairness and efficiency. The first step in formulating a new conceptual framework for transition policy is to abandon the premise that the law of commercial transactions consists solely of bedrock rules that unequivocally guide behavior. Rather, commercial law frequently involves indeterminate rules or standards that are abstract and open-ended. By incorporating such concepts as commercial reasonableness and good faith, the drafters of the Code purposefully designed it so that (particularly, for example, in Article 2) the "rule of law" has meaning only by reference to the particular setting and circumstances within which the commercial transactors do business. The court's role in this schema is not to apply rules laid down in advance but to apply the Code so as to give content to commercial norms.[183] Perhaps the biggest challenge, then, in the pro-

180. *See generally* Slawson, *supra* note 4, at 231-33.

181. *See, e.g.*, Kaplow, *supra* note 19, at 170.

182. The premise that there is always minimal reliance on laws that are subject to change is faulty, in short, because anticipating that laws might change generally is not the same as anticipating "the particular subject or nature of the change." Eule, *supra* note 98, at 440 (explaining that even in the area of tax legislation where retroactivity is becoming the norm, certain expectations can still be legitimate). Expectations can still be frustrated by a surprising change. *See id.*

183. Article 2 requires a court to familiarize itself with relevant commercial practices. It does this by utilizing flexible standards, such as commercial reasonableness and good faith, rather than rules that purport to capture and solidify prevailing practices and norms. Each dispute between a seller and buyer is placed in its functional setting where the parties are expected to find and prove relevant "habits," i.e., trade usage or practices, as part of the agreement. Under these standards, the court is given flexibility (at some cost to certainty and administrability) to resolve the new or unique dispute. Moreover, standards are thought to reduce the gap be-

posed process of deciding whether laws should apply retroactively is to distinguish rules that can be characterized as bedrock rules from those that cannot. More is required, however, because even if the change *is* to a so-called bedrock rule, retroactivity could still be optimal if, for example, the reform of the law is needed to correct rules that operate unjustly or no longer conform to current business practice. Delaying such rules would be an unacceptable cost to a strict expectations model, even if applied only to bedrock rules. Moreover, if the probable strength of reliance on a rule—even a bedrock rule—is not great, no significant rational barrier exists as to retroactive application of a change to that rule. The aim, then, is to ensure that an appropriate balance is struck between security of expectations and the need to keep the law responsive to contemporary needs.

Thus, the process of selecting the appropriate transition policy in each instance will require the institution—court or legislature—to consider a combination of factors, which are not necessarily to be given equal weight in each case, and which should be evaluated in the context of the specific statutory change. There should be no one inflexible transition rule applied across the board. A rule of general application is inappropriate because optimal decisions always involve a very rule-specific assessment of the relevant factors. Instead, legislators in particular should incorporate within the statute specific rules governing applicability that flow from consideration of the relevant factors.[184] While this proposed jurisprudence of statutory commercial law transitions may not be perceived as "simple" or "clear cut," it is both rational and coherent. This Article will now apply the proposed framework to several recent changes to U.C.C. Articles 1 and 2.

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tween law and practice and to insure that decisions are practical and responsive to the needs, proven in the particular case, of the parties and the relevant business community.

PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, PEB STUDY GROUP UNIFORM COMMERCIAL CODE ARTICLE 2: PRELIMINARY REPORT 9 (1990) (footnotes omitted). Some find no fault in this drafting style. *See, e.g.*, Peter A. Alces, *Roll Over, Llewellyn?*, 26 LOY. L.A. L. REV. 543, 546 (1993) (arguing that the open-ended drafting style of Article 2 helps guide courts toward the best results). Others, however, grimly contemplate the prospect of cases with unpredictable outcomes. *See, e.g.*, Richard Danzig, *A Comment on the Jurisprudence of the Uniform Commercial Code*, 27 STAN. L. REV. 621, 630 (1975) ("[T]he Llewellyn approach seems paradoxically to undermine that very certainty and consistency in the law that the Uniform Commercial Code was dedicated to obtaining.").

184. Theoretically, the transition issue could be allocated to either the judiciary or legislature. The advantage, however, of a legislative decision is that it would provide uniformity and eliminate the need for parties to engage in before-the-fact speculation about the application of new law. Not only would it be preferable for the transition decision to be made by the enacting legislature, but the decision need not be the same for all aspects of the new law. Perhaps the best evidence that legislative bodies are capable of this type of lawmaking is the recently enacted Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (to be codified as amended in scattered sections of 11 U.S.C., 12 U.S.C., and 18 U.S.C.). The Act provides, in section 1501, a general effective date 180 days from the date of enactment. *See id.* § 1501. Section 1501 further provides that the Act's amendments are applicable only to cases filed on or after the effective date. *See id.* There are, however, numerous provisions of the Act for which there is an exception to the general effective date. For example, section 1404 excepts from discharge certain debts relating to securities. *See id.* § 1404. Section 1404 makes the amendment retroactively effective to July 30, 2002. *See id.*

IV. THE PROPOSED FRAMEWORK APPLIED: SOME EXAMPLES

Several recent changes to U.C.C. Articles 1 and 2 serve as useful illustrations of the application of the proposed framework for identifying the optimal transition rule for commercial law change.

A. Example 1: Choice-of-Law

Revised U.C.C. Article 1 makes significant changes to traditional choice-of-law doctrine outside the context of conventional consumer transactions.[185] One such change requires that deference be accorded to the parties' agreement when domestic law is selected,[186] except to the extent that their choice is contrary to a fundamental policy of the jurisdiction whose law would otherwise govern in the absence of a contractual designation.[187] Under this approach, the key issue ceases to be the existence of a "reasonable relation" between the transaction and the contractually selected jurisdiction (as in former Article 1) and instead becomes whether the default jurisdiction's conflicting policy is "fundamental" or something less. In the vast majority of cases there will be no conflict with fundamental policy, so the parties' choice will be given effect.

Under the proposed framework, this new choice-of-law rule should be applied retroactively to existing contracts. Consider, for example, the case of a contract entered into prior to the effective date of revised Article 1, which incorporated a choice-of-law decision that courts would not have recognized and protected because of the absence of a reasonable relation between the transaction and the contractually designated jurisdiction. Here, applying new Article 1, with its expanded menu of choice-of-law options, would have the salutary effect of fulfilling, rather than defeating, reasonable expectations: Unless it could be demonstrated that a fundamental countervailing policy were implicated, the state law chosen by the parties would be applied.[188]

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185. If one of the parties to the transaction is a consumer, a choice-of-law agreement is not effective to deprive the consumer of the protection of a non-variable consumer protection rule of the jurisdiction where either (1) the consumer resides or (2) where both the contract and delivery were made. *See* U.C.C. § 1-301(e) (2001).

186. *See id.* § 1-301(a)(2). If the law chosen is that of a country other than the United States, the drafters curiously require that the transaction bear a reasonable relationship to a foreign jurisdiction (but not necessarily to the chosen jurisdiction). *Id.* § 1-301(c)(2).

187. *See id.* § 1-301(f).

188. The protection of expectations is the historical justification for the retroactive application of curative laws. *See* Smith, *supra* note 11, at 418 ("[A] retroactive law may give effect to as well as defeat reasonable human expectations. Such, indeed, is the peculiar design of that class of retroactive laws which is denominated 'curative.'"). Revised Article 1 is by no means the only revised or amended article in which one can find changes whose application will protect legitimate expectations. For example, amended Article 2 drops the series of sections that define particular mercantile terms. *See* U.C.C. §§ 2-319 to -324 (2003). The reason given is that these definitions are "inconsistent with modern commercial practices." U.C.C. § 2-319 legislative note and comment (2003). Hence, one assumes that regardless of when the contract was formed, the old definitions probably do not reflect the understanding of the parties.

B. Example 2: Contract Formation

One Code section that nearly everyone agrees could use some retooling is section 2-207, the so-called battle of the forms provisions. This section has produced hundreds of cases and has been the subject of enough academic commentary to fill a small library.[189] Indeed, section 2-207 was once introduced to a continuing legal education audience as follows:

> [O]ne of the problems in this field, which has always been the delight of law professors—for all I know the delight of law students—is the so-called battle of the forms where seller and buyer, each dedicated to his own brand of insanity, exchange forms which have nothing whatever to do with each other and then ask counsel, "Well, where are we?" That was a problem that Professor Llewellyn dearly loved, and he put in a long section in Article 2 which has been, generally, hailed by the academic community as nothing less than Magna Charta and, as far as I can tell, generally hailed by members of the practicing bar as probably the end of civilization as we know it.[190]

One reason for the difficulty with section 2-207 is that it attempts to do double duty, by addressing both contract formation issues and how to identify the terms of the resulting contract, if any. Amended Article 2 separates these matters. The issue of contract formation is the province of amended sections 2-204 and 2-206. Amended section 2-206(3) preserves the policy of former section 2-207(1) by providing that "[a] definite and seasonable expression of acceptance in a record operates as an acceptance even if it contains terms additional to or different from the offer."[191] Under amended section 2-204, "[a] contract for sale of goods may be made in any manner sufficient to show agreement, including offer and acceptance, conduct by both parties which recognizes the existence of a contract, the interaction of electronic agents, and the interaction of an electronic agent and an individual."[192]

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189. *See, e.g.*, Douglas G. Baird & Robert Weisberg, *Rules, Standards, and the Battle of the Forms: A Reassessment of § 2-207*, 68 VA. L. REV. 1217 (1982); John E. Murray, Jr., *Section 2-207 of the Uniform Commercial Code: Another Word About Incipient Unconscionability*, 39 U. PITT. L. REV. 597 (1978); Charles M. Thatcher, *Battle of the Forms: Solution by Revision of Section 2-207*, 16 U.C.C. L.J. 237 (1984); Gregory M. Travalio, *Clearing the Air After the Battle: Reconciling Fairness and Efficiency in a Formal Approach to U.C.C. Section 2-207*, 33 CASE W. RES. L. REV. 327 (1983).

190. PETER F. COOGAN ET AL., ADVANCED ALI-ABA COURSE OF STUDY ON BANKING AND SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 108 (transcript of ALI-ABA sponsored Continuing Legal Education seminar) (remarks by Grant Gilmore). For a similar viewpoint, see Thatcher, *supra* note 189, at 239, stating: "To say that Section 2-207 is no model of simplicity or clarity would be to understate the matter considerably. The judicial opinions and scholarly commentary document an ongoing struggle to comprehend an unnecessarily complex and opaque statute."

191. U.C.C. § 2-206(3) (2005).

192. U.C.C. § 2-204(1).

Only after it has been determined that a contract has been formed does it become necessary to resort to amended section 2-207, the scope of which has been broadened to encompass all sales contracts, not just those that arise in a "battle of the forms" setting. Under amended Article 2, in addition to those terms that are drawn from the Code itself, the contract now consists of those terms that are contained in the records of both parties or to which the parties have agreed. Preference is no longer given to either the first or last form.

The obvious indeterminacy of former section 2-207 suggests that it would not have been entirely rational for contracting parties to have had an *ex ante* expectation that their deal would be deemed to exist or that its terms would be enforced as anticipated. Thus, former section 2-207 could not have been categorized as a bedrock rule, reliance on which warranted bolstering by protection from retroactive change. Consider, for example, the inadequacy of former section 2-207 with respect to "layered" or "rolling" contracts. These are agreements viewed as having been reached over time rather than at a discrete moment, a concept originating with the *Hill v. Gateway* line of cases.[193] One particularly striking feature of these cases is that the courts could not even agree on whether former section 2-207 was the proper section to apply.[194] Under the proposed framework, since former section 2-207 was "broken" and amended Article 2 would provide the fix, its application should not be delayed: In a context where the inadequacies of the current statute make reliance impossible, retroactive application of the new law will extend benefits that outweigh its costs.

C. Example 3: Obligations to Remote Purchasers

Former Article 2 did not, by its own terms, address warranties made directly to remote (non-privity) purchasers. Amended sections 2-313A and 2-313B fill this gap. Section 2-313A creates warranty-type liability (called an "obligation") where the seller (typically the manufacturer) authorizes a third party (typically the retailer) to deliver the warranty to the purchaser at the time the goods are purchased.[195] Section 2-313B creates an obligation where the seller makes a representation, including advertisements, to the general

193. Hill v. Gateway 2000, Inc., 105 F.3d 1147 (7th Cir. 1997). The issue in these cases usually boils down to the issue of whether the buyer's failure to return goods (or software) after receipt constitutes acceptance of the terms inside the box.

194. *Compare id.* at 1150 (holding 2-207 to be inapplicable and hence additional terms accompanying goods are accepted by not returning the goods), *with* Step-Saver Data Sys., Inc. v. Wyse Tech., 939 F.2d 91, 105-06 (3rd Cir. 1991) (holding that additional terms accompanying goods become part of contract only if incorporated under 2-207). How will "rolling" contracts be decided under amended section 2-207? On the one hand, comment 1 emphatically states, "This section applies to all contracts for the sale of goods . . . ." U.C.C. § 2-207 cmt. 1. The issue would, therefore, be whether opening a box or using the goods constitutes the buyer's assent to the seller's terms. On the other hand, comment 5 would send a court to the common law. *See id.* § 2-207 cmt. 5. The amended section may be a step in the right direction, but notwithstanding its apparent simplicity, 2-207 is a safe bet to bedevil courts for years to come.

195. U.C.C. § 2-313A.

public, and the remote purchaser buys the goods with knowledge of that representation.[196] These new sections do not change what most courts are already doing, even in cases where the buyer makes no claim for personal injury, property damage, or other tort-like harm.[197] Rather, they codify the judicial status quo to achieve greater certainty.

To test whether these new Code sections should operate retroactively under the proposed framework, we must recognize the policy justification for the continuing erosion of the privity doctrine, a trend which began long before the Code was originally drafted.[198] Not only does eliminating a privity requirement produce a result perceived as just, it also serves the instrumentalist goal of encouraging remote sellers to respond with safer and better products.[199] This is especially true if the remote seller has actually taken steps to communicate with the remote purchaser. Barkley Clark and Christopher Smith state the policy justification succinctly:

> [I]t makes policy sense to ignore vertical privity as a defense where a manufacturer makes an express warranty (normally in writing) that is intended to follow the product into the hands of the ultimate purchaser, though several links removed in the chain of distribution. If affirmations of fact or promises are made regarding the goods, to whom are they beamed if not the retail purchaser?[200]

As noted earlier, retroactivity is favored by many law and economics scholars because it forces manufacturers to foresee the imposition of expanded liability, and it can generally be expected that they will respond by improving product quality.[201] Even if one rejects this instrumentalist vision of dynamic efficiency, a fairness theorist might defend the retroactive application of sections 2-313A and 2-313B on the basis that the continued recognition of a privity requirement in economic loss cases unfairly limits a manufacturer's responsibility for defective products, especially in light of the heavy influence of advertising on buyer preferences in the modern marketplace. Applying these sections retroactively would at least give existing buyers the opportunity to shift their present loss to the party at fault. In this context, the proposed framework brings to bear policy considerations suggesting that retroactive application is superior: Retroactive application here is more ca-

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196. *Id.* § 2-313B.

197. *See, e.g.*, Randy Knitwear, Inc., v. Am. Cyanamid Co., 181 N.E.2d 399, 402-03 (N.Y. 1962) (notwithstanding the absence of privity between the manufacturer and consumer, the consumer may maintain a breach of warranty action for economic loss based on public advertising and on labels which accompanied the goods).

198. *See generally* Lindsey R. Jeanblanc, *Manufacturers' Liability to Persons Other Than Their Immediate Vendees*, 24 VA. L. REV. 134 (1937).

199. *See* Richard E. Speidel, *Warranty Theory, Economic Loss, and the Privity Requirement: Once More Into the Void*, 67 B.U. L. REV. 9, 35-57 (1987).

200. BARKLEY CLARK & CHRISTOPHER SMITH, THE LAW OF PRODUCT WARRANTIES ¶ 10.02[1] (1984).

201. *See supra* notes 37-38 and accompanying text.

pable of capturing the policy benefits that the drafters had hoped to achieve by creating the new sections.

D. Example 4: Warranty Disclaimers to Consumers

Like its predecessor, amended U.C.C. section 2-316 permits disclaimers of the implied warranties of merchantability and fitness. Subsection 2 continues to be a safe harbor provision, providing sellers with "magic language" guarantying the effectiveness of a disclaimer of either warranty.[202] For consumer contracts, however, the incantation has been changed and the disclaimer must now be in a record and must be conspicuous.[203] To disclaim the warranty of merchantability, the following statement is required: "The seller undertakes no responsibility for the quality of the goods except as otherwise provided in this contract."[204] To disclaim a fitness warranty, the required statement must say: "The seller assumes no responsibility that the goods will be fit for any particular purpose for which you may be buying these goods, except as otherwise provided in the contract."[205]

If the new consumer disclaimer rules were to be applied retroactively to past transactions, sellers would be most unpleasantly surprised to learn that their efforts to define and limit warranty responsibilities—guaranteed to be effective under the existing rules at the time—had been rendered a nullity by the new rules. Without a bedrock rule such as section 2-316(2), it would be impossible for sellers to accurately price their goods because they would be unable to stabilize the incidents of doing business. This need for transactional certainty explains why, in addition to the general principles contained in 2-316(3), the explicit detailed rules for disclaiming warranties in subsection (2) have always been part of the Code. While it is certainly true that buyers have an interest in protection against defective goods, sellers have an equally strong interest in being able to rely on specific statutory instructions. Accordingly, the quantum and desirability of seller reliance on current disclaimer law strongly support only prospective application of these rules.[206]

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202. U.C.C. amended section 2-316(3) continues to allow sellers, in appropriate circumstances, to effectively disclaim all implied warranties with expressions like "as is," "with all faults," or similar language that is commonly understood to disclaim warranties. U.C.C. § 2-316(3) (2005). In a consumer contract, any such disclaimer language must be conspicuously set forth in a record. U.C.C. § 2-316(2).

203. *See id.*

204. U.C.C. § 2-316(2). Current section 2-316(2) allows a disclaimer of merchantability to be effective if it mentions "merchantability" and, if in writing, is conspicuous. *See id.*

205. U.C.C. § 2-316(2). Current section 2-316(2) requires that a fitness disclaimer to be in writing and conspicuous. *See id.* The necessary language is as follows: "There are no warranties that extend beyond the description on the face hereof." *Id.*

206. For similar reasons, when Article 9 was recently revised, no sensible person would have suggested that the new rules governing perfection of security interests should have immediate retroactive effect. *See* U.C.C. § 9-705(c) (2005) (providing that financing statements filed pursuant to former Article 9 may remain effective until June 30, 2006).

CONCLUSION

A predominantly legislative approach to commercial lawmaking compels the consideration of the appropriate transition option that should apply. Although the importance of this issue has been discussed in other contexts, it has previously received little attention as a feature of revisions or amendments to commercial law statutes. The salient features of these laws, as well as certain unique characteristics of commercial transactions generally, dictate a transition policy that is flexible and responsive to market realities. Unlike certain other contexts, in which expectations-based considerations may arguably justify strict adherence to a transition policy of prospective applicability only, the complexities of commercial transactions often create contexts in which absolute protection of expectations and the promotion of complete reliance on exiting rules is irrational. Similarly, a transition policy of absolute pro-retroactivity, at least arguably desirable in certain other contexts, would create an unacceptable and unjustifiable level of disruption in commercial practice. Accordingly, a transition policy incorporating both retroactive and prospective applicability is appropriate for commercial law. The dividing line between the two can be rationally and coherently delineated by examining the nature and magnitude of reliance in specific instances and identifying the purpose for the particular legal changes. When the quantum of detrimental reliance of the contracting parties is substantial and the new rule is not primarily intended to eliminate socially undesirable practices, the change should be applied prospectively. Conversely, when the benefits to be gained by replacing obsolete or undesirable practices with sound ones outweigh the minimal market disruption that may result, retroactive application is optimal. This framework of rational retroactivity, consistently applied, is responsive to both market reality and valid policy consideration. Although there are a wide variety of legal rules to which the framework might be applied, it is hoped that transition decisions might be enriched by analyses such as those undertaken in this Article.