

**BROOKLYN LAW SCHOOL**

**MEMORANDUM**

April 6, 1997

**To:** Article 1 Drafting Committee  
Chairs and Reporters for Other UCC Drafting Committees

**From:** Professor Neil B. Cohen, Reporter, Article 1 Drafting Committee

**Re:** Harmonization of Uniform Commercial Code

---

The Article 1 Drafting Committee has been assigned the tasks of identifying concepts addressed or articulated differently in different substantive Articles of the Uniform Commercial Code and exploring the advisability of harmonizing the provisions identified.

As Articles 2, 2A, and 2B continue to develop, harmonization among the provisions of those three Articles has already been identified as an important goal, and efforts are already underway to accomplish such harmonization where appropriate.

This memorandum addresses potential topics for harmonization, other than those raised only by Articles 2, 2A, and 2B. Seven significant topics are identified and discussed. In the course of this discussion, some drafting issues are noted in footnotes.

## I. CUTTING OFF PROPERTY RIGHTS OF THIRD PARTIES

The Uniform Commercial Code contains several provisions pursuant to which a purchaser takes free of claims of a third person to the property purchased. These provisions vary as to the state of mind and state of knowledge that the purchaser must have in order to take free of those competing claims. The standards include:

### A. “Good-faith Purchaser for Value”

1. Revised UCC § 2-504(b) provides:

A person with voidable rights or title acquired in a purchase from a seller that has relinquished possession or control *has power to transfer good title to a good-faith purchaser<sup>1</sup> for value* until the seller regains possession or control.

2. Revised UCC § 2A-404(b) provides:

A lessor with voidable rights or title acquired in a transaction of purchase<sup>2</sup> from a transferor that has relinquished possession or control *has power to transfer a good leasehold interest<sup>3</sup> to a good-faith subsequent lessee for value* until the seller regains possession or control, but only to the extent provided in subsection (a).

### B. “Buyer in Ordinary Course of Business”

Two provisions give a buyer in ordinary course of business title to the goods bought free of the claims of a third person. While the definition of buyer in ordinary course of business is still in flux, the heart of the definition is stable — a buyer in ordinary course of business is “a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind.

---

<sup>1</sup>In the phrase “good-faith purchaser,” “good-faith” is hyphenated and used as an adjective. As defined, though, it is not hyphenated, and used as a noun. Should this be “a person who purchases in good faith”?

<sup>2</sup>How is this different from a “purchase”?

<sup>3</sup>Should this term be defined?

1. Revised UCC § 2-504(d) provides:

The entrusting of possession of goods to a merchant that deals in goods of that kind gives the merchant *power to transfer all rights and title of the entruster and to transfer the goods free of any security interest perfected by the entruster under Article 9<sup>4</sup> to a buyer in the<sup>5</sup> ordinary course of business.*

2. Revised UCC § 9-316(b) provides:

A buyer in ordinary course of business takes free of a security interest created by the buyer's seller, even if the security interest is perfected and even if the buyer knows of its existence.

**C. “Lessee in the Ordinary Course of Business”**

1. Revised UCC § 2A-404(d) provides:

*A subsequent lessee in the ordinary course of business<sup>6</sup> from a lessor that is a merchant dealing in goods of that kind to which the goods were entrusted by the existing lessee of that lessor of that lessor before the interest of the subsequent lessee became enforceable against that lessor obtains, to the extent of the leasehold transferred, all rights to the goods of that lessor and the existing lessee, and takes free of the existing lease contract.*

2. Similarly, Revised UCC § 9-317 provides:

*A lessee of goods in ordinary course of business takes the leasehold interest free of a security interest in the goods created by the lessor even though the security interest is perfected and the lessee knows of its existence.<sup>7</sup>*

---

<sup>4</sup>If the reference to a security interest “perfected by the entruster” is intended to refer to a security interest granted by the merchant, this might be misinterpreted as limiting the effect of UCC § 9-307(1), which provides that a buyer in ordinary course of business takes free of any security interest created by its seller, not only a security interest in favor of the entruster. If the reference to a security interest “perfected by the entruster” is intended to include a security interest granted by a debtor other than the seller, though, the intent of the provision is unclear. Why would there be a need for an Article 2 rule about the title acquired by a person who buys from a merchant to whom a secured party has entrusted its collateral but not for an Article 2 rule about the title acquired by a person who buys from a secured party who is itself a merchant?

<sup>5</sup>Should we defer to common usage and add “the” to this phrase in Articles 1, 2, and 9?

<sup>6</sup>This term “lessee in ordinary course of business” (without “the”) is defined in revised UCC § 2A-102(18). the definition is parallel to that of “buyer in ordinary course of business.”

<sup>7</sup>Are the slight differences in wording between this section and § 9-316 intended to have substantive effect?

**D. “Good Faith and Without Knowledge of Violation”**

Revised UCC § 2B-507(b) provides:

A security interest created by a licensor or a transfer of ownership under a security interest in information or in copies of the information, is subordinate to a non-exclusive license which was:

- (1) authorized by the secured party
- (2) executed before the security interest was perfected; or
- (3) <sup>8</sup> in the ordinary course of the licensor’s business *to a licensee who acquired the license in good faith and without knowledge that it was in violation of the security interest.*

**E. “Holder in Due Course”**

Under UCC § 3-306, a holder in due course takes free of claims of property or possessory right in the instrument. UCC § 3-302 defines holder in due course. The definition includes not only good faith, but Article 3 “value” (which, unlike Article 1 value, does not include unperformed promises) and lack of notice as to defenses to the instrument (as well as claims to it).

**F. Due Negotiation**

Under UCC § 7-502(1), a holder to whom a negotiable document of title has been duly negotiated acquires, *inter alia*, title to the document and to the goods. UCC § 7-501(4) states that a document has been duly negotiated when it is negotiated to a holder who purchases in good faith<sup>9</sup>, without notice of claims or defenses to the document, and for (Article 1) value.

**G. “Protected Purchaser”**

Under UCC § 8-303(b), a protected purchaser acquires its interest in a security free of any adverse claim. A “protected purchaser” is defined in § 8-303(a) as:

---

<sup>8</sup>Parallelism suggests that a past tense verb is missing at the beginning of paragraph (3).

<sup>9</sup>Should this be defined to include “the observance of reasonable commercial standards of fair dealing” ?

a purchaser of a certificated or uncertificated security, or of an interest therein, who:

- (1) gives [Article 1] value;
- (2) does not have notice of any adverse claim<sup>10</sup> to the security; and
- (3) obtains control of the certificated or uncertificated security.

#### **H. Acquisition for Value and Without Notice**

UCC § 8-502 provides:

An action based on an adverse claim to a financial asset, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who acquires a security entitlement under Section 8-501 *for value and without notice*<sup>11</sup> of the adverse claim.

#### **I. Value and Non-collusion**

UCC § 8-503(e) provides:

An action based on the entitlement holder's property interest with respect to a particular financial asset under subsection (a), whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against any purchaser of a financial asset or interest therein *who gives value, obtains control, and does not act in collusion* with the securities intermediary in violating the securities intermediary's obligations under section 8-504.

---

<sup>10</sup>Despite the use of the word "notice," "notice of an adverse claim" is defined in § 8-105, similarly to the New York non-uniform definition utilized in both Articles 3 and 8, as (i) knowledge of the claim, (ii) awareness of facts sufficient to indicate a significant probability that it exists and deliberate avoidance of information that would establish the claim, or (iii) when there is a duty imposed by statute or regulation to investigate whether the adverse claim exists, the investigation would establish its existence.

<sup>11</sup>See footnote 10.

**J. Value and No Knowledge**

Revised UCC § 9-316(c) provides in relevant part:

A buyer of consumer goods takes free of a security interest, even if perfected, if the buyer buys without knowledge of the security interest, for value, and for the buyer's own personal, family, or household purposes, unless before the buyer's purchase the secured party filed a financing statement covering the goods.

**K. Conclusion and Recommendations**

At least ten different standards are currently utilized in order to determine whether a person takes property free of the claims of another. It is doubtful that ten different and distinguishable policies are being furthered by these various provisions. Rather, it is likely that the number of different standards could be reduced. The relevant Drafting Committees should consider grouping rules that further identical (or very similar) policies and harmonizing the rules within each group.

As a starting point for this consideration, I would suggest the following groupings:

**1. Buyer/lessee/licensee in ordinary course of business.**

Create one unified concept of buyer/lessee/licensee in ordinary course of business, perhaps called "transferee in ordinary course of business" or "purchaser in ordinary course of business. Place in Article 9 a single rule indicating the circumstances under which such a person takes his or her interest free of a security interest in the property purchased. Harmonize §§ 2-504(d) and 2A-404(d) and use the unified term in both.

**2. Negotiable instruments, negotiable documents of title, securities and financial assets**

Harmonize the rules that determine when a purchaser takes free of adverse claims to a negotiable instrument (§§ 3-302, 3-306), negotiable document of title (§§ 7-501(4), 7-502(1)), and certificated or uncertificated security (§§ 8-105, 8-303, 8-502 *but not* 8-503(e)<sup>12</sup>). Admittedly, this is a delicate point inasmuch as Article 8 is still under consideration in a large number of states and Article 3 remains a few states away from complete adoption. Yet, the view has been expressed by at least one person close to the Article 8 drafting process that there is no policy reason to distinguish the circumstances under which one should take free from an adverse claim to a security under Article 8 and an instrument under Article 3; rather, the differing rules are merely the product of different drafting committees. If the rules are to be harmonized, the criteria for taking free could be:

- a. Article 3 value (i.e., not unperformed promises). A taker who has not performed its promise can protect itself against loss from an adverse claim simply by not performing.
- b. Lack of Article 1 notice (as opposed to § 8-105 notice) of the adverse claim (and, in the case of Articles 3 and 7, defenses). A party with notice of an adverse claim does not have a well-founded expectation that it is acquiring good title to the property purchased, and it is accordingly harder to argue that such a person has superior equities to the true owner of the property.
- c. Good faith. Consideration should be given, however, to deleting the requirement of good faith as largely redundant. Most Article 3 cases concerning whether a person qualifies as a holder in due course, for example, do not clearly distinguish “good faith” from “without notice.

---

<sup>12</sup>Section 8-503(e) appears to manifest a policy distinct from the other two Article 8 provisions, and need not be harmonized with them.

## II. SHELTER PRINCIPLES

The Uniform Commercial Code contains several “shelter principles — that is, rules that allow a person who has acquired property free of the claim to it of another person to transfer that property to a third person free of the same interest. The principles differ significantly, however.

### A. Article 2

Revised UCC § 2-504(a) provides, in relevant part, that “a purchaser of goods acquires rights and title identical to those the transferor had or had power to transfer. Taken literally, this would seem to mean that once a person owns goods free of an interest of another person, any transferee from the first person would also be free of that interest — without any requirement of, for example, value, good faith, or lack of notice. Note 3 to the January 24, 1997 draft of Revised Article 2, however, suggests that this literal interpretation of subsection (a) may not be intended. That comment provides:

An assumption is that the “shelter principle is in operation. Thus, if goods are entrusted to a merchant for repair and the merchant sells them to a non-merchant, the non-merchant has power to transfer good title *to a good faith purchaser for value*.

If § 2-504(a) were applied, however, the non-merchant, who takes free under § 2-504(d), would be able to transfer good title to *any* purchaser, regardless of good faith or value.

### B. Article 3

UCC § 3-203(b) provides:

Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument, including any rights as a holder in due course, but the transferee cannot acquire rights of a holder in due course by a transfer, directly or indirectly, from a holder in due course, if the transferee engaged in fraud or illegality affecting the instrument.

Thus, under this section, a party guilty of fraud or illegality cannot launder away that taint. Otherwise, though, there is no apparent requirement that the sheltered transferee have taken in good faith, for value, or without notice of a party’s claim or defense.



**C. Article 7**

UCC § 7-504(1) provides:

A transferee of a document, whether negotiable or non-negotiable, to whom the document has been delivered but not duly negotiated, acquires the title and rights which his transferor had or had actual authority to convey.

Here, there is no anti-laundering rule; nor is there any requirement of good faith, value, or lack of notice.

**D. Article 8**

Article 8 has two sections that contain shelter principles. In addition, there is one case in which a purchaser takes free of an adverse claim for which no shelter principle is provided.

**1. UCC § 8-302**

UCC § 8-302 provides, in relevant part:

(a) Except as otherwise provided in subsections (b) and (c), upon delivery of a certificated or uncertificated security to a purchaser, the purchaser acquires all rights in the security that the transferor had or had power to transfer.

(c) A purchaser of a certificated security who as a previous holder<sup>13</sup> had notice of an adverse claim does not improve its position by taking from a protected purchaser.

Thus, this shelter provision, like that in Article 3, contains an anti-laundering rule. This anti-laundering rule, however, is stricter than the Article 3 rule inasmuch as it applies even in the absence of fraud or illegality.

**2. UCC § 8-510(b)**

UCC § 8-510(b) provides:

If an adverse claim could not have been asserted against an entitlement holder under Section 8-502, the adverse claim cannot be asserted against a person who purchases a security entitlement, or an interest therein, from the entitlement holder.

---

<sup>13</sup>This term is undefined for purposes of Article 8.

This section has no anti-laundering principle. By stating only that the adverse claim cannot be asserted against a person who purchases from the entitlement holder who takes free under § 8-502, though, there may be an implication that a subsequent purchaser from the purchaser protected by this section does not similarly take free of the adverse claim.

### **3. UCC § 8-510(a)**

UCC § 8-510(a) provides that “an action based on an adverse claim to a financial asset or security entitlement . . . may not be asserted against a person who purchases a security entitlement, or an interest therein, from an entitlement holder, if the purchaser gives value, does not have notice of the adverse claim, and obtains control. No shelter rule is provided whereby the purchaser protected by § 8-510(a) can transfer the security entitlement free of the adverse claim. In light of the two explicit shelter rules in Article 8, this might be interpreted as meaning that one who gets good title pursuant to § 8-510(a) cannot pass that good title along to transferees.

### **E. Article 9**

Revised UCC §§ 9-316 through 9-318 provide that buyers, lessees, and licensees in ordinary course of business take free of security interests created by their sellers, lessors, and licensors, respectively. There is no explicit indication in Article 9 that those who take free of such security interests can transfer the property free of such interests. While that ability is assumed for buyers in ordinary course of business under current Article 9 (and can probably be supported by current UCC § 2-403), the matter is one that causes a great deal of confusion.

### **F. Conclusion and Recommendations**

The Uniform Commercial Code is very inconsistent concerning shelter principles. Sometimes they are explicitly stated; other times they are not. Moreover, the shelter they provide depends on a variety of conditions. There is no need for this chaotic situation. Article 1 should provide a general rule that purchasers obtain all rights of their transferors, except as provided in anti-laundering principles in Articles 3 and 8. Those anti-laundering principles should be harmonized

and consideration should be given to making the anti-laundering rule part of the general rule. If so, the rule might read as follows:

A transferee of property acquires rights and title identical to those the transferor had or had power to transfer, except that:

- (1) a transferee of a limited interest acquires rights and title only to the extent of the interest transferred;
- (2) a transferee that, as a previous transferor, was subject to an adverse claim to the property, does not acquire the property free of that claim.

### **III. ASSIGNABILITY OF RIGHT TO PAYMENT FOR GOODS SOLD OR LEASED OR INFORMATION LICENSED**

When a person who has a right to payment pursuant to a sale, lease, software contract or license of information assigns that right, either absolutely or as security for an obligation, Article 9 as well as Article 2, 2A or 2B, supplies relevant rules. Those rules are not always consistent in either substance or articulation.

The right to payment for, *inter alia*, goods sold or leased is an “account” (Revised UCC § 9-103(a)). If the seller grants a security interest in such an account, that transaction is governed by Article 9 (Revised UCC § 9-112(a)(1)); furthermore, most sales of accounts are within the scope of Article 9. (Revised UCC § 9-112(a)(3)). Thus, when a seller/lessor/licensor assigns its right to payment by the buyer/lessee/licensee, Articles 2, 2A or 2B and Article 9 are implicated.

(It should be noted, in this regard, that under revised UCC § 9-113(7), an assignment by the seller, lessor, or licensor to an assignee who is to perform the assignor’s duties is excluded from the

scope of Article 9. Thus, this discussion is directed only to situations in which the assignee will not perform the assignor's duties.)

Three questions of interest arise in this situation:

1. If the contract creating the account does not contain a restriction on transfer or assignment, is the assignment effective?
2. If the contract creating the account contains a restriction on transfer or assignment, is the assignment effective?
3. If the contract creating the account contains a restriction on transfer or assignment, does an assignment in violation of the restriction give rise to liability for breach?

Articles 2, 2A and 2B, on one hand, and Article 9, on the other hand, provide answers to these questions that are not entirely consistent.

**A. If the contract creating the account does not contain a restriction on transfer or assignment, is the assignment effective?**

As to this question, Articles 2 and 2B would likely validate the assignment, but the issue might be debatable in particular cases. Revised UCC § 2-503(a) provides that

All rights of a seller or buyer, including a right to damages for breach of the whole contract or a right arising out of the assignor's due performance of its entire obligation, may be assigned unless the assignment would materially change the duty of the other party, increase the burden or risk imposed on that party by the contract, or impair that party's likelihood of receiving return performance.

Thus, it would appear that, in cases in which a seller assigns the right to payment before fulfilling its own obligations, it would be open to the buyer to claim that the assignment is ineffective or not allowed because the assignment increases the likelihood that the seller will not perform those obligations. A similar analysis applies for UCC § 2B-502(a).

Articles 2A and 9 are silent on this issue. Thus, the answer for Article 2A is unclear<sup>14</sup>, and Article 9 would appear to be subject to Articles 2 and 2B<sup>15</sup>.

**B. If the contract creating the account contains a restriction on transfer or assignment, is the assignment effective?**

As to this question, the answers vary. Current Article 2 only validates assignments made in violation of anti-assignment clauses in the case of assignments of “a right to damages for breach of the *whole* contract or a right arising out of the assignor’s due performance of his *entire* obligation. UCC § 2-210(2). Thus, under this rule, an anti-assignment clause in a contract providing for periodic delivery of goods by the seller and corresponding periodic payments for those goods by the buyer would prevent the seller’s assignment of the rights to payment for individual deliveries of goods (prior to completion of the entire contract).

Revised Article 2, though, appears to override most, but perhaps not all, prohibitions on assignments of the right to payment. Revised UCC § 2-503(e) states that “if a contractual<sup>16</sup> term prohibits the assignment of rights otherwise assignable under subsection (a), the assignment is effective . . . . Of course, it would still remain open for the buyer to argue, in a case in which the seller has not yet fully performed, that the seller’s right to payment was not assignable under subsection (a) because the assignment increases the likelihood that the seller will not perform its obligations.

---

<sup>14</sup>This may simply be a matter of drafting. Revised UCC § 2A-403(b) provides that a transfer prohibited in the lease agreement is “otherwise effective. If a *prohibited* transfer is effective, it would seem that a transfer that is not prohibited would also be effective.

<sup>15</sup>Revised UCC § 9-404(h) provides that a term prohibiting an assignment is ineffective. This language is not as strong as that in revised UCC § 2A-403(b), though, since it does not provide that the assignment is effective; it may only mean that the assignment is subject to whatever rules govern in the absence of an anti-assignment clause.

<sup>16</sup>Query whether this should be articulated as “if a term in the agreement prohibits . . . . After all, this provision tells us the legal effect of the factual agreement.

Revised Article 2A, on the other hand, makes any assignment effective notwithstanding an anti-assignment clause (at least in cases in which there is no delegation of duties to the assignee). See Revised UCC § 2A-403(b); see also revised UCC §§ 2A-403(d), 9-405.

Revised Article 2B invalidates anti-assignment clauses. See revised UCC § 2B-503(b)(1). As with Article 2, however, the question remains, however, whether a particular assignment might be ineffective, even in the absence of the anti-assignment clause, because of revised § 2B-502(a).

Revised Article 9 also makes anti-assignment clauses ineffective. See revised UCC §§ 9-404(h), 9-405. Inasmuch as section 9-404(h) does not, however, explicitly make such assignments effective, it might be possible to argue that such assignments are nonetheless subject to sections 2-503(a) or 2B-502(a).

**C. If the contract creating the account contains a restriction on transfer or assignment, does an assignment in violation of the restriction give rise to liability for breach?**

Article 2 makes an assignment that is in breach of an anti-assignment clause a breach of contract for which damages are recoverable. See Revised UCC § 2-503(e).

In contrast, Article 2A provides that an anti-assignment clause is ineffective to the extent that it prohibits the creation or enforcement of a security interest in the lessor's interest (unless there is also a delegation of duty). See Revised UCC § 2A-403(d). Presumably, breach of an "ineffective anti-assignment clause would not give rise to damages. (Note, in this regard, that subsection (f), which covers remedies, is made subject to subsection (d).)

Article 2B provides that an anti-assignment clause that prohibits creation of a security interest in an account or general intangible for money due is ineffective. As with Article 2A, this would seem to preclude damages for breach of such a clause.

Article 9 also makes anti-assignment clauses ineffective and, presumably, precludes damages for their breach.

#### **D. Conclusion and Recommendations**

There is a good deal of inconsistency and confusion arising from the various articulations of the rules concerning assignments of right to payment arising from transactions governed by Articles 2, 2A, and 2B. All four Articles should speak in one voice and, in the absence of policies unique to a particular Article, provide that:

1. In the absence of an anti-assignment clause, an assignment of the right to payment is effective.
2. Even if there is an anti-assignment clause, an assignment of the right to payment is effective.
3. An assignment of the right to payment in breach of an anti-assignment clause can never give rise to damages owed by the assignor or assignee.
4. The fact that an assignment violates an anti-assignment clause does not, in itself, create a defense to the obligor's duties to the assignee under the assigned contract.

#### **IV. DEFERENCE TO CONSUMER OR OTHER LAW**

Three Articles of the Uniform Commercial Code expressly subordinate their rules to consumer law or other state law.

##### **A. Article 2**

Current UCC § 2-102 provides that this Article does not “impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers. Revised Article 2 repeats the deference to consumer protection law, albeit worded quite differently, and adds a

reference to certificate of title laws. See Revised UCC § 2-104(a)(2). The references to farmers or other specified classes of buyers, though, have disappeared.

**B. Article 2A**

Revised Article 2A is similar to revised Article 2.

**C. Article 2B**

Article 2B defers to a number of other laws. According to UCC § 2B-104(a), Article 2B rules are subject to:

- (1) a law of this State establishing a right of access to or use of information by compulsory licensing or public access, or a similar law;
- (2) a law of this State regulating purchase or licenses of rights in motion pictures by exhibitors; and
- (3) a consumer protection law of this State.

While paragraphs (1) and (2) are probably unique to Article 2B, it is unclear why the reference to consumer protection law does not refer to statutes and decisions as is the case with Articles 2 and 2A.

**D. Other Articles**

Revised Article 9, in § 9-115, is a section in which states can list other statutes to which Article 9 defers. The remaining Articles of the UCC do not explicitly subordinate their rules to other state law. It is not clear whether this might be interpreted as meaning that consumer protection laws, for example, are subordinate to the rules in the other Articles.

**E. Conclusion and Recommendations**

Consideration ought to be given to stating consistently in each Article the extent to which the rules in that Article defer to other law. If the policy of deferral is to exist throughout the Uniform Commercial Code, consideration also ought to be given to moving the deferral to consumer protection law to Article 1.



**V. NEGOTIABLE INSTRUMENTS THAT ARE ALSO SECURITY CERTIFICATES**

A writing that constitutes a negotiable instrument as defined in UCC § 3-104, but which is also a “security certificate” because it is a certificate representing a security as defined in UCC § 8-102(a)(15), is governed by Article 8 and not by Article 3. See UCC § 8-103(d). While this makes quite a bit of sense for purposes of those rules in Article 8 that determine property rights in the negotiable instrument/security certificate, this ouster of Article 3 leaves the security certificate without the benefit of some Article 3 rules that do not relate to property rights.

At least three questions are left unanswered for security certificates:

**A. If the security certificate is a debt instrument that would otherwise be governed as a note under Article 3, what is the statute of limitations for bringing suit on it?**

Article 3 provides a statute of limitations in § 3-118; there is no statute of limitations in Article 8.

**B. To whom is the obligation of the issuer to pay money owed?**

Article 3 provides an explicit answer in § 3-412; Article 8 provides no answer.

Article 8 provides rules governing defects going to the security’s validity, which may not cover the same situations.

**Conclusion and Recommendations**

Consideration should be given to having the rules in Article 3 other than those governing property rights in the instrument apply to negotiable instruments governed by Article 8.

Also, the term “holder” is used in Article 8 (e.g., § 8-302(c)), but is defined in Article 1 only for purposes of negotiable instruments and documents of title. Arguably, the definition still applies to negotiable instruments governed by Article 8 and not Article 3, but the definition clearly does not cover other security certificates. Either the Article 1 definition should be augmented or a definition of “holder” should be placed in Article 8. Inasmuch as the Article 1 definition, as it now stands, consists of the definition of “holder” for negotiable instruments purposes attached to the definition of holder for Article 7 purposes, perhaps clarity would be best served by moving each definition to its appropriate Article and removing the definition from Article 1 altogether.

## VI. FAITHLESS FIDUCIARIES

Both Article 3 and Article 8 have provisions that determine when one who takes from a faithless fiduciary is deemed to have notice of the property claim of the person represented by the fiduciary. The provision in Article 3 is more detailed, reflecting the various roles fulfilled by the different types of negotiable instruments. The most important difference, though, is in the general principle.

### A. Article 3

UCC § 3-307(b)(1) provides:

*Notice of breach of fiduciary duty by the fiduciary is notice of the claim of the represented person.*

### B. Article 8

UCC § 8-105(b) provides, in relevant part, that:

a person who *knows* that a representative has transferred a financial asset . . . in breach of fiduciary duty has notice of an adverse claim.

### C. Conclusion and Recommendations

Is there a policy reason that one who takes an instrument from a fiduciary under Article 3 should be more easily deemed to have notice of an adverse claim than one who takes a financial asset

under Article 8? Perhaps the markets governed by Article 8 have greater need of certainty, even at the cost of cutting off property claims of owners. Yet, the Article 8 rule has not been justified on this ground. Harmonization between these two rules ought to be considered. Inasmuch as one who has notice of the breach of fiduciary duty cannot be said to have a well-founded expectation that the property transferred to it is free of adverse claims, I would suggest that the harmonized standard be one utilizing notice, rather than knowledge.

## **VII. STATUTES OF LIMITATIONS**

There are statutes of limitations in Articles 2 (four years; see revised § 2-814), 2A (four years; see revised § 2A-715), 2B (later of four years or one year after discovery), 3 (generally three or six years; see § 3-118), 4 (three years), and 5 (one year; see § 5-115). The remaining Articles have no statute of limitations.

Several questions are raised:

### **A. Should Articles 2, 2A, and 2B be harmonized?**

The answer is probably yes.

### **B. Should the limitations periods all be the same?**

Putting Article 5 aside as reflecting a distinct policy, it is not entirely clear why similar causes of action should have different limitations periods. For example, consider a buyer's obligation to pay for goods sold. If the buyer simply does not pay, the action on the buyer's obligation to pay must be brought within four years. If the buyer pays with a check that is dishonored, however, action on the check must be commenced within three years after dishonor. If the buyer gives a note for the goods, though, an action on the note must be commenced within six years after the due date or demand.

### **C. Should the remaining Articles have statutes of limitations?**

At least some of the remaining Articles create duties that do not exist independent of the statute, but which are not accompanied by a statute of limitations. For example, Article 9 imposes several duties on secured parties, some of which may be enforced by an action seeking monetary recovery; yet Article 9 contains no statute of limitations. Consideration should be given to including in Article 1 a statute of limitations for causes of action arising under the Uniform Commercial Code for which no other statute of limitations is provided.