

D R A F T

FOR DISCUSSION ONLY

Uniform Commercial Code and Emerging Technologies

Uniform Law Commission

American Law Institute January 28–29, 2022 Committee Meeting



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National Conference of Commissioners on Uniform State Laws

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~~December 10, 2021~~

January 17, 2022

Uniform Commercial Code and Emerging Technologies

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Uniform Commercial Code and Emerging Technologies

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UNIFORM COMMERCIAL CODE AND EMERGING TECHNOLOGIES

~~DECEMBER 13, 2021~~ JANUARY 17, 2022 DRAFT

Note on formatting:

The draft amendments to provisions of the UCC and official comments in this draft are marked to show changes from the current UCC official text and official comments. A few provisions of the UCC are included for convenience of reference even though no changes are proposed.

Because Article 12 is a completely new UCC article, its provisions are not underscored.

~~*At this time, we are uncertain whether new sections that appear in the draft will appear in the final Act. Accordingly, new New sections are numbered with an “A” at the end, e.g., Section 9-107A. Any necessary renumbering It is contemplated that this numbering convention will be retained for these sections that remain in the final Act. This will occur before the final draft is presented avoid the need to the ALI and the ULC for approval renumber existing sections.*~~

Reporter’s Prefatory Note to ~~December 13, 2021~~ January 17, 2022 Draft (submitted to the ALI Council)

This Prefatory Note first describes the background of the project on Emerging Technologies and the Uniform Commercial Code (~~the UCC~~) and the work to date. It then provides a brief overview of the proposed revisions to the UCC. Additional Prefatory Notes are provided below for the proposed amendments relating to payments (Articles 3, 4, and 4A), investment securities (Article 8), secured transactions (Article 9), and controllable electronic records (new Article 12).

1. Background

The Uniform Commercial Code (~~the UCC~~) has been enacted in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Since its widespread enactment in the 1960s, the UCC has been periodically revised to address changes in commercial practices.

In 2019, the Uniform Law Commission and The American Law Institute (the Sponsors) appointed a Joint Committee to consider whether changes to the UCC are advisable to accommodate emerging technologies, such as artificial intelligence, distributed ledger technology, and virtual currency. At the time when the Joint Committee was formed, invitations were sent to large groups of potential stakeholders including trade organizations, financial institutions, technology companies, government agencies, academicians, and consumer groups. The Committee currently has more than 300 observers.

The Joint Committee was initially formed as a study committee. However, the Joint Committee subsequently received the permission of the Sponsors to act as a drafting committee

1 for amendments to the UCC dealing with digital assets, bundled transactions (*i.e.*, transactions
2 involving the sale or lease of goods together with the provision of services, the licensing of
3 information, or both), and payments, as well as for certain discrete amendments to the UCC
4 unrelated to emerging technologies. For convenience, further references are to the Drafting
5 Committee.

6
7 The Drafting Committee has held the following meetings:

- 8 • October 4 and 5, 2019, in Denver, Colorado.
- 9 • January 31 and February 1, 2020, in Washington, D.C.
- 10 • Remote meetings by Zoom on May 29 and 30, July 23 and 31, September 2, and
11 December 1, 2020, and on February 1, March 9, April 27 and 29, May 3 and 10,
12 July 6, and November 5 and 6, 2021.
- 13 • Remote informal open meetings, held on June 15 and 16, 2021, for ULC
14 Commissioners and members of the Drafting Committee preliminary to the ULC
15 [Annual Meeting](#).
- 16 • ULC Annual Meeting (remote and in-person), first reading, July 13, 2021.

17
18 In addition, several small working groups have met remotely (and some continue to meet)
19 to discuss specific topics and to hear the views of various stakeholder groups. Since the 2021
20 ULC Annual Meeting the Chair, Vice Chair, Reporters, and several members of the Drafting
21 Committee have presented educational programs addressing the ongoing revision process to
22 groups including the Loan Syndication and Trading Association, the ABA Business Law
23 Section, and the American College of Commercial Finance Lawyers.

24
25 The work of the Drafting Committee is currently in the following areas concerning the
26 UCC: digital assets (controllable electronic records), electronic money, chattel paper, “bundled
27 transactions” (consisting of the sale or lease of goods together with licensing of software and the
28 provision of services as an integrated transaction), documents of title, payment systems,
29 miscellaneous UCC amendments, and consumer issues.

30
31 The Drafting Committee expects to hold at least two full meetings in 2022, with a view to
32 completing the draft of the amendments, obtaining American Law Institute approval of the draft
33 at its May 2022 annual meeting, and final approval of the Commission at its July 2022 annual
34 meeting. Members of the Drafting Committee will continue to reach out to industry groups and
35 other stakeholders [and](#) plan to continue participating in CLE presentations to educate members
36 of the bar and others.

37 38 *2. Overview of UCC Revisions*

39
40 The Drafting Committee’s charge is broad, and the resulting draft is expansive.

41
42 a. *New UCC Article 12 – Controllable electronic records, controllable accounts,*
43 *controllable payment intangibles*

44
45 The draft includes a new UCC Article 12 that would govern the transfer of property
46 rights in certain intangible digital assets (“controllable electronic records”) that have been or may

1 be created using new technologies. These assets include, for example, certain types of virtual
2 currency and nonfungible tokens (NFTs). “Control” of controllable electronic records is a central
3 organizing concept under Article 12. Controllable electronic records are defined to include only
4 those electronic records that can be subjected to control. Control is the functional equivalent of
5 “possession” of a controllable electronic record and a necessary condition for protection as a
6 good faith purchaser for value (a “qualifying purchaser”) of a controllable electronic record.
7 Article 12 confers an attribute of negotiability on controllable electronic records because a
8 qualifying purchaser takes its interest free of conflicting property claims.

9
10 Controllable electronic records also provide a mechanism for evidencing certain rights to
11 payment—controllable accounts and controllable payment intangibles. An account debtor
12 (obligor) on such a right to payment agrees to make payments to the person that has control of
13 the controllable electronic record that evidences the right to payment. Assignments and other
14 aspects of these rights to payment are governed by revisions to UCC Article 9, discussed below.
15 Because a qualifying purchaser of a controllable account or controllable payment intangible will
16 take free of competing property claims, these rights to payment also would have this attribute of
17 negotiability. Article 12 also provides some special rules with respect to the payment obligations
18 and conditions of discharge of account debtors on controllable accounts and controllable
19 payment obligations.

20
21 Article 12 includes a choice-of-law rule for the matters that it covers in connection with
22 transactions in controllable electronic records.

23
24 For a more detailed description of Article 12, see the Reporter’s Prefatory Note to Article
25 12.

26 27 *b. Secured transactions amendments – UCC Article 9*

28
29 *Article 12 conforming amendments.* The draft includes extensive amendments to UCC
30 Article 9. Several of these amendments address security interests in controllable electronic
31 records and in the rights to payment that are embedded in ~~or~~₁ or tethered to ~~controllable~~₂ controllable
32 electronic records—controllable accounts and controllable payment intangibles. Perfection (i.e.,
33 essentially third-party effectiveness) of security interests in these assets may be achieved by a
34 secured party obtaining control of the asset or filing a financing statement in the appropriate
35 state’s filing office. A security interest perfected by control has priority over a security interest
36 perfected by filing. The draft also provides special rules for the law governing perfection and
37 priority for security interests in controllable electronic records, controllable accounts, and
38 controllable payment intangibles. These rules draw on the new Article 12 choice-of-law rule.

39
40 *Chattel paper.* UCC Article 9 affords special treatment to “chattel paper” (e.g.,
41 installment sale contracts and personal property leases). The draft redefines “chattel paper” and
42 updates the Article 9 provisions applicable to this type of collateral. The new definition resolves
43 uncertainty that has arisen under the current definition and more accurately reflects the
44 distinction between the seller’s or lessor’s right to payment and the record (e.g., installment sale
45 contract or lease) evidencing that right. The new definition also resolves uncertainty that has
46 arisen when goods are leased as part of a bundled transaction involving services as well as

1 goods. This draft also addresses additional issues relating to bundled transactions. The draft also
2 provides an amended definition of “control” of an electronic copy of a record evidencing chattel
3 paper, which reflects a more accurate and technologically flexible approach than the current
4 definition.

5
6 *Money.* The draft includes a new definition of “money” in Article 1, which applies
7 throughout the UCC unless otherwise provided. It also includes amendments that define
8 “electronic money” and provide a definition of “control” of electronic money that tracks the
9 corresponding definition for control of controllable electronic records. Perfection of a security
10 interest in electronic money as original collateral must be by control, not filing. The draft
11 provides a new definition of “money” for purposes of Article 9 that excludes deposit accounts
12 (which could in the future be adopted by a government as money). The draft also updates the
13 take-free rules for transferees of money—both electronic money and tangible money—and
14 transferees of funds from deposit accounts.

15
16 For a more detailed description of the Article 9 amendments, see the Reporter’s Prefatory
17 Note to Article 9 Amendments.

18
19 *Control through another person.* Proposed revisions to the provisions on control in draft
20 §§ 9-104 (control of deposit accounts), 9-105 (control of authoritative electronic copies of
21 records, and 9-105A (control of electronic money evidencing chattel paper) and in a proposed
22 conforming modification to Section 8-106(d)(3) (control of security entitlement) address control
23 through the acknowledgment of a person in control. For similar revisions, see draft § 7-106
24 (control of electronic document of title). For a discussion of these proposed revisions, see draft §
25 12-105, Reporter’s Note 7.

26
27 *c. Payments amendments – UCC Articles 3 (negotiable instruments), 4 (bank*
28 *deposits and collections), and 4A (funds transfers).*

29
30 The draft proposes several amendments to Articles 3, 4 and 4A. The amendments relate
31 to negotiability, remote deposit capture, statements of account, the scope of Article 4A
32 (definition of payment order), and security procedures. The draft also deletes references to a
33 “writing” (which are changed to a “record”) and adopts a revised definition of “signed” for
34 specified sections of Article 4A. Many of the proposed changes are to the official comments and
35 are intended to further clarify the black letter text.

36
37 For a more detailed description of the payments amendments, see the Reporter’s
38 Prefatory Note to Payments Amendments.

39
40 *d. Other emerging technologies-related amendments*

41
42 The draft contains a revised definition of “conspicuous” in Article 1 and a revised and
43 updated draft official comment on the term. It adds to Article 1 the current standard definition of
44 “electronic” used by the ULC. It also adopts a revised definition of “signed” for Article 5 (letters
45 of credit).

1 The draft proposes a new Section 7-106, defining “control” for electronic documents of
2 title. The revised section retains the general rule and the safe harbor under the current provision
3 and adds an additional safe harbor along the lines of the revised section on control of chattel
4 paper.

5
6 Finally, the draft proposes several amendments to the official comments to Article 8
7 (investment securities) to make clear that a controllable electronic record may be a “financial
8 asset” credited to a securities account.

9
10 *e. Miscellaneous amendments*

11
12 The draft contains revised definitions for Article 9 of the terms “assignee” and
13 “assignor,” which conform to current descriptions in the official comments. It also amends the
14 definition of “person” to include a protected series established under non-UCC law.

15
16 The draft proposes to revise Section 5-116 to cure an ambiguity relating to the separate
17 status of bank branches in the current provision and to override incorrectly decided case law
18 arising from that ambiguity.

19
20 *3. Organization of the draft*

21
22 Revised provisions of the UCC text and comments appear in the order that they would
23 appear in the UCC—beginning with Article 1 and continuing through Article 12.

UNIFORM COMMERCIAL CODE AND EMERGING TECHNOLOGIES

ARTICLE 1

GENERAL PROVISIONS

Section 1-107. Section Captions.

Section captions are part of the [Uniform Commercial Code].

Official Comment

* * *

1. Section captions are a part of the text of the Uniform Commercial Code, and not mere surplusage. This is not the case, however, with respect to subsection headings appearing in Article 9 and Article 12. See Comment 3 to Section Sections 9-101, Comment 3 (“subsection headings are not a part of the official text itself and have not been approved by the sponsors.”); 12-101, Comment.

* * *

Section 1-201. General Definitions.

* * *

(b) Subject to definitions contained in other articles of the ~~the~~ Uniform Commercial Code] that apply to particular articles or parts thereof:

* * *

(10) “Conspicuous”, with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it.

Whether a term is “conspicuous” or not is a decision for the court. Conspicuous terms include the following:

~~(A) a heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and~~

~~(B) language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or~~

1 ~~set off from surrounding text of the same size by symbols or other marks that call attention to the~~
2 ~~language.~~

3 * * *

4 (16) “Document of title” means a record (i) that in the regular course of business
5 or financing is treated as adequately evidencing that the person in possession or control of the
6 record ~~it~~ is entitled to receive, control, hold, and dispose of the record and the goods the record
7 covers and (ii) that purports to be issued by or addressed to a bailee and to cover goods in the
8 bailee’s possession which are either identified or are fungible portions of an identified mass. The
9 term includes a bill of lading, transport document, dock warrant, dock receipt, warehouse receipt,
10 and order for delivery of goods. An electronic document of title means a document of title
11 evidenced by a record consisting of information stored in an electronic medium. A tangible
12 document of title means a document of title evidenced by a record consisting of information that
13 is inscribed on a tangible medium.

14 * * *

15 (16A) “Electronic” means relating to technology having electrical, digital,
16 magnetic, wireless, optical, electromagnetic, or similar capabilities.

17 * * *

18 (24) “Money” means a medium of exchange that:
19 (A) Is currently authorized or adopted by a domestic or foreign
20 government, by an intergovernmental organization, or pursuant to an agreement between two or
21 more governments.

22 (B) The term includes a monetary unit of account established by an
23 intergovernmental organization, or pursuant to an agreement between two or more countries.

~~The term does not include a medium of exchange unless it was~~ Was initially issued, created, or distributed by ~~that a domestic or foreign government or, by an intergovernmental organization,~~ or pursuant to ~~that an agreement between 2 or more governments.~~

* * *

(27) “Person” means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity. The term includes a protected series, however denominated, of an entity if the protected series is established under law other than [the [Uniform Commercial Code] that limits, or limits if conditions specified under ~~such the~~ law are satisfied, the ability of a creditor of the entity or of any other protected series of the entity to satisfy a claim from assets of the protected series.

* * *

Legislative Note:

~~1. The added second sentence of the definition of “person” would provide needed clarity as to the status of a protected series for purposes of the Uniform Commercial Code. A number of states have enacted statutes that provide for protected series within a limited liability company or other unincorporated organization. These statutes afford rights and impose duties upon a protected series and generally empower a protected series to conduct its own activities under its own name.~~

~~2. By providing that a protected series is a “person” for purposes of the enacting state’s Uniform Commercial Code, the sentence will expressly permit a protected series, whether created under the law of the enacting state or of another state, to be, for example, (a) a “seller” or a “buyer” under Article 2, (b) a “lessor” or a “lessee” under Article 2A, or (c) an “organization” and a “debtor” under Article 9, and (d) if the law under which the protected series is organized requires a public filing for the protected series to be recognized under that law, a “registered organization” under Article 9. These matters are not clear under the current Uniform Commercial Code.~~

~~3. A state should enact this the amendment regardless of to paragraph (b)(27) whether the state has enacted the Uniform Protected Series Act (2017) or otherwise recognizes a protected series under its own domestic law. Since Because the sentence applies only for purposes of under the enacting state’s Uniform Commercial Code, inclusion of the sentence in and of itself does not~~

1 require the enacting state to recognize a limit on liability of a protected series organized under
2 the law of another state or a limit on liability of the entity that established the protected series. It
3 merely clarifies the status of a protected series as a “person” for purposes of under the choice-
4 of-law and substantive law rules of the enacting state’s Uniform Commercial Code.

Official Comment

* * *

10. “Conspicuous.” Derived from former Section 1-201(10). This definition states the general standard that to be conspicuous a term ought to be noticed by a reasonable person. Whether a term is conspicuous is an issue for the court. Subparagraphs (A) and (B) set out several methods for making a term conspicuous. Requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving guidance to the party relying on the term regarding how that result can be achieved). Although these paragraphs indicate some of the methods for making a term attention calling, the test is whether attention can reasonably be expected to be called to it. The statutory language should not be construed to permit a result that is inconsistent with that test. Whether a term is conspicuous is based on the totality of the circumstances and requires a case-by-case, fact-intensive analysis.

The attributes of a reasonable person against which a term is to operate ~~can vary~~ varies depending upon the nature of the transaction and the market in which the transaction occurs. For example, assume that a merchant of goods wishes to disclaim the implied warranty of merchantability or fitness for particular purpose in its contracts for sale or lease. Depending on the particular contract, the person against which that term is to operate may be a large business buyer or lessee, a small business, or a consumer. Similarly, the determination of whether a term is conspicuous may, depending on the context, yield a different conclusion when the term ~~was~~ is the subject of negotiation or discussion than when the term ~~was~~ is used in a standard form agreement that was not the subject of such negotiation or discussion.

Presenting a term in an online record in a manner such that a reasonable person ought to notice it carries with it some uncertainties not associated with presenting the same term in a writing because the person presenting the term might not fully control the appearance of the relevant words as viewed by the person presented with the term. How a term appears depends to some extent on the equipment and settings of the reasonable person presented with the term, and a term that is conspicuous when displayed on a desktop computer might not be conspicuous when displayed on a smaller device.

The test of whether a term is conspicuous remains constant notwithstanding the different contexts referenced ~~[above-]~~. A term is conspicuous if its appearance is such that it ought to be noticed by a reasonable person against which the term is to operate. If the term is used in a form or format that is intended to operate against a group of persons, the determination is to be made with reference to a reasonable member of the group, taking into account all aspects of the transaction and the education, sophistication, disabilities, and other attributes of an average member of the group. If the term is intended to operate against a single person, it is conspicuous if it ought to have come to the attention of a reasonable person in the position of the actual

1 person against which it is to operate.

2
3 Factors that can be relevant to whether a term is conspicuous include, ~~but are not limited~~
4 ~~to~~, the following:

5
6 (i) The appearance of the text in contrast to the surrounding text. This includes the use of
7 a font of a larger size or different color, and the use of emphasis through bolding, italics, capital
8 letters, or other means. However, terms in bold, capital letters might not be conspicuous, ~~for~~
9 ~~example~~, if placed among other terms also in bold, capital letters so there is no contrast with the
10 surrounding text.

11
12 (ii) The placement of the term in the document. A term appearing ~~at in~~, or hyperlinked
13 from, text at the beginning of a document, or near the place where the person against which the
14 term is to operate must signify assent, is more likely to be conspicuous than a term in the middle
15 of a lengthy document.

16
17 (iii) The heading used, if any. A misleading heading – such as the heading “Warranty”
18 for a paragraph that contains a disclaimer of warranties – might cause a reasonable person to fail
19 to notice the language that would disclaim warranties, so that the term would not be conspicuous.

20
21 (iv) The effort needed to access the term. A term accessible only by triggering multiple
22 hyperlinks is less likely to be conspicuous than a term accessible from a single hyperlink.

23 This definition deals only with requirements ~~of~~ that a term be ~~conspicuous (or noted~~
24 conspicuously), found in particular provisions of ~~the~~ Uniform Commercial Code~~l~~. Other
25 protective doctrines designed to assure that assent is meaningful that are part of general contract
26 law may also apply. See Section 1-103(b).

27 28 **Reporter’s Note**

29 30 1. “*Conspicuous.*”

31
32 *a. Issue of fact.* Whether a term is conspicuous should be determined by the finder
33 of facts. Thus, the sentence in the definition assigning that issue to the court is deleted. Deletion
34 of the examples will facilitate a more thorough discussion of the conspicuous definition in the
35 revised official comment.

36 37 b. *Current UCC Provisions Using “Conspicuous” or “Conspicuously.”*

38
39 Article 2. Certain disclaimers of warranty (2-316(2)).

40
41 Article 2A. Certain disclaimers of warranty (2A-214(2), (3), (4)); certain terms in
42 consumer leases (2A-303(7)).

43
44 Article 3. Statement that promise or order is not negotiable (3-104(d)); certain statements
45 related to tender of instrument in full satisfaction of claim (3-311(b), (c)(1)).

Article 7. Statement that document is not negotiable (7-104(c)); statement that issuer does not know whether goods were received or conform to description (7-203(1)); statement in relation to foreclosure of warehouse's lien that goods will be advertised for sale and sold at auction (7-210(b)(2)); requirement that notice of sale be posted in conspicuous places (not used with reference to a term) (7-210(b)(5)); statement identifying document as duplicate (7-402); indication by bailee of partial delivery (7-403(c)(2)).

Article 8. Transfer restriction noted on certificate (8-204(a)).]

2. "*Document of title.*" This definition is not changed and is provided here for convenience of reference.

3. "*Electronic.*" The draft adopts the standard ULC definition.

4. "*Money.*" The definition of "money" applies to the term as used in the UCC. The definition does not determine whether an asset constitutes "money" for other purposes.

Only something currently authorized or adopted as a medium of exchange can be money. Coins and paper currency formerly issued by a government but now owned and traded only for their numismatic or historical value, and not as a medium of exchange, are not money. To be money, a medium of exchange must be initially issued, created, or distributed by a government, by ~~a governmental~~ an intergovernmental organization, or pursuant to an agreement between two or more governments. For this purpose, a currency printed or minted by a country's central bank, treasury, or other similar department, and then distributed or circulated by or on behalf of the country, is money. So too is a currency printed or minted, and then circulated, by or on behalf of several countries, such as the Euro. An electronic medium of exchange established pursuant to a country's law and initially distributed by or on behalf of the country also constitutes money, even if ownership is established or maintained through a blockchain or other system not operated by the government. In contrast, a medium of exchange initially issued, created, or distributed by one or more private parties is not money solely because the government of one or more countries authorizes or adopts it as a medium of exchange.

Note that the qualification that a medium of exchange must have been "initially issued, created, or distributed" by particular types of entities, which is used in the second sentence of this definition, is a subset of the broader, generally applicable ~~terms,~~ "limitation that the medium of exchange must be "authorized or adopted," by such entities, used in the first sentence. Updated official comments to this definition will address in more detail the meaning of the adoption or authorization of a medium of exchange.

The draft deletes the second sentence of the existing definition, which covers, *e.g.*, special drawing rights (SDRs) created by the International Monetary Fund. Despite the deletion, a monetary unit of account would be "money" if it also a medium of exchange that falls within the definition as revised. (SDRs, however, are not a medium of exchange.)

Examples: The following examples illustrate the definition of "money."

1 **[Example 1:** Nation A enacts legislation authorizing or adopting seashells as a medium
2 of exchange. Seashells do not thereby become “money” because Nation A did not
3 initially issue, create, or distribute the seashells-.]

4
5 **Example 2:** Nation B enacts legislation authorizing or adopting an existing crypto
6 currency, created on a private blockchain, as a medium of exchange. The crypto currency
7 does not thereby become “money” because Nation B did not initially issue, create, or
8 distribute the crypto currency.

9
10 **Example 3:** Nation C creates a crypto currency and authorizes or adopts it as a medium
11 of exchange. Nation ~~E’s~~ C’s crypto currency is “money.”

12
13 5. “*Person.*” Except for the new treatment of a “protected series,” the draft retains the
14 UCC’s existing definition of “person.” Although the UCC definition differs from the ULC’s
15 current standard definition, the Drafting Committee sees no reason to create uncertainty by
16 revising the UCC definition.

17
18 As the Legislative Note explains, by enacting the draft amendment, an enacting state
19 would treat a protected series, whether organized under the law of the enacting state or under the
20 law of another state, as a “person” for purposes of the UCC. The draft uses the ULC’s standard
21 language to accomplish this purpose.

22
23 *** The added second sentence of the definition of “person” would provide needed
24 clarity as to the status of a protected series for purposes of the Uniform Commercial Code. A
25 number of states have enacted statutes that provide for protected series within a limited liability
26 company or other unincorporated organization. These statutes afford rights and impose duties
27 upon a protected series and generally empower a protected series to conduct its own activities
28 under its own name.

29
30 Providing that a protected series is a “person” for purposes of the enacting state’s
31 Uniform Commercial Code will expressly permit a protected series, whether created under the
32 law of the enacting state or of another state, to be a “seller” or a “buyer” under Article 2, a
33 “lessor” or a “lessee” under Article 2A, or an “organization” and a “debtor” under Article 9, and,
34 if the law under which the protected series is organized requires a public filing for the protected
35 series to be recognized under that law, a “registered organization” under Article 9. These matters
36 are not clear under the current Uniform Commercial Code.

37
38 ***

39
40 **Section 1-204. Value.** Except as otherwise provided in Articles 3, 4, ~~and~~ 5, ~~and~~ 6,
41 ~~[6,] and 12,~~ a person gives value for rights if the person acquires them:

42 (1) in return for a binding commitment to extend credit or for the extension of

1 immediately available credit, whether or not drawn upon and whether or not a charge-back is
2 provided for in the event of difficulties in collection;

3 (2) as security for, or in total or partial satisfaction of, a preexisting claim;

4 (3) by accepting delivery under a preexisting contract for purchase; or

5 (4) in return for any consideration sufficient to support a simple contract.

6 **Reporter's Note**

7 ~~1-~~ "Value." The amendment to this section implements the policy choice described in
8 Reporter's Note ~~8~~ 9 to draft § 12-104 by making the generally applicable definition of "value"
9 inapplicable to Article 12.

10 * * *

13 **ARTICLE 2**

14 **SALES**

15 * * *

16 **Section 2-102. Scope; Certain Security and Other Transactions Excluded From**
17 **This Article.**

18 ~~(a1)~~ Unless the context otherwise requires and except as provided in subsection ~~(d)~~s (2)
19 and] (4), this Article applies to transactions in goods~~.~~.

20 ~~(b2)~~ If the predominant purpose of a transaction is a sale, this Article applies to the
21 transaction.

22 ~~(e3)~~ If a transaction includes a sale but the predominant purpose of a transaction is not a
23 sale, the provisions of this Article relating that relate solely to the goods apply.

24 ~~(d4)~~ This Article ~~it~~ does not apply to any transaction which although in the form of an
25 unconditional contract to sell or present sale is intended to operate only as a security transaction
26 nor does this Article impair or repeal any statute regulating sales to consumers, farmers, or other

1 specified classes of buyers.

2 Official Comment

3
4 **Prior Uniform Statutory Provision:** Section 75, Uniform Sales Act.

5
6 **Changes:** Section 75 has been rephrased.

7 8 **Purposes of Changes and New Matter:**

9
10 1. To make This section makes it clear that: The the Article leaves substantially
11 unaffected the law relating to purchase money security such as conditional sale or chattel
12 mortgage though it regulates the general sales aspects of such transactions. “Security
13 transaction” is used in the same sense as in the Article on Secured Transactions (Article 9).

14
15 2. In some transactions, the passing of title to goods from the seller to the buyer in return
16 for a price is part of a larger transaction. The other aspects of the transaction might involve the
17 seller providing services to the buyer or the seller transferring to the buyer rights to property
18 other than goods. When the predominant purpose of a transaction is to pass title to goods in
19 return for a price, this Article applies to the transaction.

20
21 If a transaction includes a sale of goods but the non-goods aspect of the transaction
22 predominates, pursuant to Subsection (e under subsection (3), the provisions of this Article
23 relating solely to the goods apply. These provisions include (but are not limited to) the rules
24 those relating to: warranties; under Sections 2-212, 2-313, 2-314, 2-315, 2-316, 2-317, 2-318; the
25 passing of title to and transferring rights in the goods; under Sections 2-401, 2-402, 2-403; tender
26 of delivery and risk of loss; under Sections 2-503, 2-504, 2-509, 2-510; and acceptance,
27 rejection, and cure; under Sections 2-508, 2-601, 2-602, 2-603, 2-604, 2-605, 2-606.

28
29 **Illustration.** Owner hires Contractor to replace the roof on a structure. As part of the
30 transaction, Contractor promises to remove the existing shingles and install new shingles,
31 which Contractor is providing. The transaction is in part a sale of goods because it
32 involves the passing of title to the new shingles, even though the transaction also involves
33 extensive services. If the goods aspect of the transaction predominates, the entire
34 transaction is a contract for sale and all of the provisions of this Article apply to it. If the
35 services aspect of the transaction predominates and an issue arises about whether the
36 parties reached an agreement, the provisions of this Article dealing with contract
37 formation do not apply. However, this Article’s provisions relating solely to the goods,
38 such as those on warranties, do apply.

39 Reporter’s Note

40
41
42 1. “Bundled” transactions. Article 2 currently does not specifically address the
43 application of the Article to transactions that cover both goods and non-goods, such as
44 transactions that involve the sale of goods and either the provision of services or the transfer of
45 property other than goods. (These transactions are often referred to as “hybrid,” “mixed,” or

“bundled” transactions.) This has provided courts some flexibility in deciding whether, and to what extent, this Article should be applied to such transactions.

2. “*Predominant purpose*” and “*gravamen*” approaches. As a general matter, courts have applied Article 2 to such transactions when the goods aspect of the transaction predominates and have declined to apply this Article when the non-goods aspect predominates. Subsection (~~b~~2) of the revised section adopts this “predominant purpose” approach. (This approach also is proposed in the definition of “chattel paper” in Section 9-102(a)(11)(B).) When, however, an issue relates solely to the goods aspect of the transaction, such as whether the characteristics of the goods conform to the contract, application of Article 2 to that issue is appropriate even if the goods aspect of the transaction does not predominate. This approach, sometimes referred to as the “gravamen” approach, has expressly been applied by some courts and has implicitly been adopted by others. Subsection (~~e~~3) of the revised section adopts the gravamen approach.

3. The difficulty of capturing the appropriate application of these approaches to bundled transactions in the statutory text should not be underestimated. This application is especially challenging in the context of determining which provisions of the article should be applied to which issues when the non-goods aspects of a transaction predominate. In this connection, the Drafting Committee may wish to consider whether “the provisions of this Article relating solely to the goods apply,” used in subsection (~~e~~3), adequately captures and implements the goal of the gravamen approach. An alternative approach would be to apply only the Article 2 provisions relating to the quality of goods, such as the warranty provisions (Sections 2-312 through 2-318) in such transactions.

4. The Drafting Committee will consider further whether a more flexible approach would be to address these scope issues only in the official comments. It also will consider whether only the warranty provisions might ~~me~~ be made applicable when non-goods aspects predominate, suggested in Note 3.

* * *

ARTICLE 2A

LEASES

Section 2A-102. Scope.

~~(a)1) This~~ Except as provided in subsection (~~e~~), ~~This~~3), this Article applies to any transaction, regardless of form, that creates a lease.

~~(b)2) If the predominant purpose of a transaction is to create a lease, this Article applies to~~
the transaction.

1 (e3) If a transaction includes a lease but the predominant purpose of the transaction is not
2 to create a lease, the provisions of this Article relating that relate solely to the goods apply.

3 **Official Comment**

4 * * *

5 In some transactions, the transfer of the right to possession and use of goods for a term in
6 return for consideration, i.e., a lease, is part of a larger transaction. The other aspects of the
7 transaction might involve, for example, the provision of services or a transfer of rights to
8 property other than goods. In such a situation because the transaction includes a lease, subsection
9 (e3) applies and the provisions of this Article dealing solely with the goods apply. For example,
10 these provisions include (but are not limited to) the rules those relating to: warranties, under
11 Sections 2A-211, 2A-212, 2A-213, 2A-214, 2A-215, 2A-216; risk of loss, under Sections 2A-
12 219, 2A-220, 2A-221; acceptance, rejection, and cure, under Sections 2A-509, 2A-510, 2A-511,
13 2A-512, 2A-513; and finance leases, Sections under Section 2-209; 2A-407. See generally the
14 comment to Section 2-102.

15 **Reporter's Note**

16
17
18 ~~1.~~ *“Bundled” transactions; “predominant purpose” and “gravamen” approaches.* The
19 discussion in the Reporter's Note to draft § 2-102 generally applies to this section.

20 * * *

21 **Reporter's Prefatory Note to Payments Amendments**

22
23 The changes relating to payments address both statutory text and official comments and
24 concern the following five topics:

25
26 *Negotiability.* An amendment to § 3-104 specifies that negotiability is not negated by the
27 inclusion of either a choice-of-law term or a choice-of-forum term in an instrument.

28
29 *Remote Deposit Capture.* Amendments to §§ 3-105 and 3-604, and to the official
30 comments to §§ 3-309 and 4-207, clarify that an instrument is “issued,” if a drawer sends an
31 image of and information describing an item, but never delivers the item.

32
33 *Scope of Article 4A – Definition of Payment Order.* An amendment to the official
34 comment to § 4A-104 (which includes the comments to § 4A-103) clarifies when an instruction
35 sent pursuant to a so-called “smart contract” constitutes a payment order.

36
37 *References to a “Writing.”* Amendments to §§ 4A-202, 4A-203, 4A-207, 4A-208 and
38 4A-305 change the references to a “writing” to an “authenticated record.”

Security Procedures. Amendments to §§ 4A-201 and 4A-202, and to the official comment to § 4A-203, clarify that: (i) a security procedure may impose obligations on the receiving bank, the customer, or both; (ii) a security procedure may require the use of symbols, sounds, or biometrics; and (iii) a requirement that a payment order be sent from a known email address, IP address, or phone number is not by itself a security procedure.

ARTICLE 3

NEGOTIABLE INSTRUMENTS

Section 3-104. Negotiable Instrument.

(a) Except as provided in subsections (c) and (d), “negotiable instrument” means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:

(1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;

(2) is payable on demand or at a definite time; and

(3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor; (iv) an agreement as to what a term that specifies the law that governs the instrument promise or order; or (v) an undertaking to resolve in a specified forum a dispute concerning the promise or order in a specified forum.

Official Comment

1. The definition of “negotiable instrument” defines the scope of Article 3 since Section 3-102 states: “This Article applies to negotiable instruments.” The definition in Section 3-104(a) incorporates other definitions in Article 3. An instrument is either a “promise,” defined in Section 3-103(a)(12), or “order,” defined in Section 3-103(a)(8). A promise is a written

undertaking to pay money signed by the person undertaking to pay. An order is a written instruction to pay money signed by the person giving the instruction. Thus, the term “negotiable instrument” is limited to a signed writing that orders or promises payment of money. “Money” is defined in Section 1-201(24) and is not limited to United States dollars. It also includes a medium of exchange established by a foreign government or monetary units of account established by an intergovernmental organization or by agreement between two or more nations. Five other requirements are stated in Section 3-104(a): First, the promise or order must be “unconditional.” The quoted term is explained in Section 3-106. Second, the amount of money must be “a fixed amount . . . with or without interest or other charges described in the promise or order.” Section 3-112(b) relates to “interest.” Third, the promise or order must be “payable to bearer or to order.” The quoted phrase is explained in Section 3-109. An exception to this requirement is stated in subsection (c). Fourth, the promise or order must be payable “on demand or at a definite time.” The quoted phrase is explained in Section 3-108. Fifth, the promise or order may not state “any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money” with ~~three~~ five exceptions. The quoted phrase is based on the first sentence of N.I.L. Section 5 which is the precursor of “no other promise, order, obligation or power given by the maker or drawer” appearing in former Section 3-104(1)(b). The words “instruction” and “undertaking” are used instead of “order” and “promise” that are used in the N.I.L. formulation because the latter words are defined terms that include only orders or promises to pay money. The first three exceptions stated in Section 3-104(a)(3) are based on and are intended to have the same meaning as former Section 3-112(1)(b), (c), (d), and (e), as well as N.I.L. § 5(1), (2), and (3). The final two exceptions stated in Section 3-104(a)(3) deal with choice-of-law and choice-of forum clauses. The latter of these includes an agreement to arbitrate. Subsection (b) states that “instrument” means a “negotiable instrument.” This follows former Section 3-102(1)(e) which treated the two terms as synonymous.

~~***~~

Reporter’s Note

~~1. Source. The phrase “transmission of an image of an item or information describing the item is derived from Section 4-110(a), dealing with electronic presentment.~~

~~***~~

Section 3-105. Issue of Instrument.

(a) “Issue” means:

- (1) the first delivery of an instrument by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person; or
- (2) if agreed by the payee, first transmission by the drawer to the payee of an

1 image of an item and ~~of~~ information derived from the item [in a manner] that enables the
2 depository bank to collect the item by transferring or presenting ~~under federal law~~ an electronic
3 check ~~under federal law~~.

4 (b) An unissued instrument, or an unissued incomplete instrument that is completed, is
5 binding on the maker or drawer, but nonissuance is a defense. An instrument that is conditionally
6 issued or is issued for a special purpose is binding on the maker or drawer, but failure of the
7 condition or special purpose to be fulfilled is a defense.

8 (c) “Issuer” applies to issued and unissued instruments and means a maker or drawer of
9 an instrument.

10 Official Comment

11
12 1. Under former Section 3–102(1)(a) “issue” was defined as the first delivery to a “holder
13 or a remitter” but the term “remitter” was neither defined nor otherwise used. In revised Article
14 3, Section 3–105(a) defines “issue” more broadly to include the first delivery to anyone by the
15 drawer or maker for the purpose of giving rights to anyone on the instrument. “Delivery” with
16 respect to instruments is defined in ~~Section 1–201(14)~~ Section 1-201(b)(15) as meaning
17 “voluntary transfer of possession.”

18
19 Subsection (a) permits an instrument to be issued by an electronic transmission of an
20 image of and information derived from the instrument by maker and drawer, rather than by
21 delivery. Thus, for example, a drawer might, with the permission of the payee, write and sign a
22 check, take a photograph of the check, send the photograph to the drawee for processing
23 electronically, and destroy the original check. If the electronic image and the information derived
24 from it can be processed as an “electronic check” under Regulation CC, see 12 C.F.R.
25 § 229.2(ggg), the check is “issued” and hence can be enforced pursuant to this Article.

26 * * *

27 Reporter’s Note

28
29
30
31 The ~~phrase “reference in subsection (a)(2) to~~ transmission of an image of an item ~~or~~ and
32 information ~~describing derived from~~ the item is derived from Section 4–110(a), dealing with
33 electronic presentment.

34 * * *

35 Section 3-309. Enforcement of Lost, Destroyed, or Stolen Instrument.

1 * * *

2 **Official Comment**

3 * * *

4 4. The destruction of a check in connection with a truncation process in which
5 information is extracted from the check and an image of the check is made, and then such
6 information and image are transmitted for payment does not, by itself, prevent application of this
7 section. See Section 3-604 comment 1.

8
9 **Example:** The payee of a check creates an image of the check, destroys the check, and
10 transmits the image and information derived from the check for payment. Due to an error
11 in transmission, the depository bank never receives the transmission. The payee may be
12 able to enforce the check if the payee can prove the terms of the check and otherwise
13 satisfy the requirements of this section. The result would be different if there were no
14 error in the transmission and the payor discharged its obligation on the check.

15 * * *

16
17
18 **Section 3-604. Discharge ~~By~~ by Cancellation ~~Or~~ or Renunciation.**

19 (a) A person entitled to enforce an instrument, with or without consideration, may
20 discharge the obligation of a party to pay the instrument (i) by an intentional voluntary act, such
21 as surrender of the instrument to the party, destruction, mutilation, or cancellation of the
22 instrument, cancellation or striking out of the party's signature, or the addition of words to the
23 instrument indicating discharge, or (ii) by agreeing not to sue or otherwise renouncing rights
24 against the party by a signed record. The obligation of a party to pay ~~the instrument~~ a check is
25 not discharged solely by the destruction of ~~a the~~ check in connection with a process in which,
26 initially, information is extracted from the check and an image of the check is made and,
27 subsequently, the information and image are transmitted for payment.

28 (b) Cancellation or striking out of an indorsement pursuant to subsection (a) does not
29 affect the status and rights of a party derived from the indorsement.

30 (c) In this section, "signed," with respect to a record that is not a writing, includes the

attachment to or logical association with the record of an electronic symbol, sound, or process with the present intent to adopt or accept the record.

Official Comment

Section 3–604 replaces former Section 3–605.

1. The destruction of a check in connection with a truncation process in which information is extracted from the check and an image of the check is made, and then such information and image are transmitted for payment is not within the scope of this section and does not by itself discharge the obligation of a party to pay the instrument. ~~Such~~ The destruction of the check also does not affect whether the check has been issued. See Section 3-105(a) and comment 1.

~~/Renumber remaining comments./~~

~~***~~

ARTICLE 4

BANK DEPOSITS AND COLLECTIONS

~~***~~

Section 4-207. Transfer Warranties.

Official Comment

1. Except for subsection (b), this section conforms to Section 3–416 and extends its coverage to items. The substance of this section is discussed in the Comment to Section 3–416. Subsection (b) provides that customers or collecting banks that transfer items, whether by indorsement or not, undertake to pay the item if the item is dishonored. This obligation cannot be disclaimed by a “without recourse” indorsement or otherwise. With respect to checks, Regulation CC Section 229.34 states the warranties made by paying and returning banks.

2. For an explanation of subsection (a)(6), see comment 8 to Section 3-416.

3. The warranties provided for in this Section, and in Sections 4-208 and 4-209 are supplemented by warranties created under federal law. For example, ~~pursuant to~~ under Section 4-209(b), a person who undertakes to retain an item in connection with an agreement for electronic presentment makes a warranty that retention and presentment comply with the agreement. Under federal law, ~~such~~ a person might also make a warranty that [no][a] person will [not] be asked to make payment based on a check already paid. See 12 C.F.R. § 229.34(a).

1 subject to a requirement that the beneficiary perform some act such as delivery of documents.

2
3 **For example, Example:** a New York bank may have issued a letter of credit in favor of
4 X, a California seller of goods to be shipped to the New York bank's customer in New
5 York. The terms of the letter of credit provide for payment to X if documents are
6 presented to prove shipment of the goods. Instead of providing for presentment of the
7 documents to the New York bank, the letter of credit states that they may be presented to
8 a California bank that acts as an agent for payment. The New York bank sends an
9 instruction to the California bank to pay X upon presentation of the required documents.
10 The instruction is not covered by Article 4A because payment to the beneficiary is
11 conditional upon receipt of shipping documents. The function of banks in a funds transfer
12 under Article 4A is comparable to the role of banks in the collection and payment of
13 checks in that it is essentially mechanical in nature. The low price and high speed that
14 characterize funds transfers reflect this fact. Conditions to payment by the California
15 bank other than time of payment impose responsibilities on that bank that go beyond
16 those in Article 4A funds transfers. Although the payment by the New York bank to X
17 under the letter of credit is not covered by Article 4A, if X is paid by the California bank,
18 payment of the obligation of the New York bank to reimburse the California bank could
19 be made by an Article 4A funds transfer. In such a case there is a distinction between the
20 payment by the New York bank to X under the letter of credit and the payment by the
21 New York bank to the California bank. For example, if the New York bank pays its
22 reimbursement obligation to the California bank by a Fedwire naming the California bank
23 as beneficiary (see Comment 1 to Section 4A-107), payment is made to the California
24 bank rather than to X. That payment is governed by Article 4A and it could be made
25 either before or after payment by the California bank to X. The payment by the New
26 York bank to X under the letter of credit is not governed by Article 4A and it occurs
27 when the California bank, as agent of the New York bank, pays X. No payment order was
28 involved in that transaction. In this example, if the New York bank had erroneously sent
29 an instruction to the California bank unconditionally instructing payment to X, the
30 instruction would have been an Article 4A payment order. If the payment order was
31 accepted (Section 4A-209(b)) by the California bank, a payment by the New York bank
32 to X would have resulted (Section 4A-406(a)). But Article 4A would not prevent
33 recovery of funds from X on the basis that X was not entitled to retain the funds under the
34 law of mistake and restitution, letter of credit law or other applicable law.

35
36 An instruction to pay might be a component of a computer program or a transaction
37 protocol intended to execute automatically under specified circumstances. The fact that the
38 program or protocol itself is subject to a condition does not necessarily mean that an instruction
39 to pay issued pursuant to that program or protocol "state[s] a condition to payment of the
40 beneficiary" within the meaning of Section 4A-103(a)(1)(i). Whether the instruction does state
41 such a condition depends on what the instruction says when it is received by the receiving bank.
42 An instruction that neither grants discretion nor imposes a limitation on payment by the receiving
43 bank does not state a condition to payment. What distinguishes the prior example is that the New
44 York bank's instruction to the California bank did state a condition when the California bank
45 received it.

1 Similarly, an instruction that is subject to a condition when received by Bank A, and
2 which therefore does not constitute a payment order, does not become a payment order when the
3 condition is satisfied. However, if, after the condition is satisfied, Bank A sends the instruction to
4 Bank B without the stated condition, that second instruction could be a payment order if the
5 instruction otherwise complies with Section 4A-103(a).

6
7 * * *

8 **Section 4A-201. Security Procedure.** “Security procedure” means a procedure
9 established by agreement of a customer and a receiving bank for the purpose of (i) verifying that
10 a payment order or communication amending or cancelling a payment order is that of the
11 customer, or (ii) detecting error in the transmission or the content of the payment order or
12 communication. A security procedure may impose an obligation on the receiving bank or the
13 customer and may require the use of algorithms or other codes, identifying words, ~~or~~ numbers,
14 symbols, sounds or biometrics, encryption, callback procedures, or similar security devices.
15 Comparison of a signature on a payment order or communication with an authorized specimen
16 signature of the customer or requiring that a payment order be sent from a known email address,
17 IP address or phone number is not by itself a security procedure.

18 Official Comment

19
20 A large percentage of payment orders and communications amending or cancelling
21 payment orders are transmitted electronically and it is standard practice to use security
22 procedures that are designed to assure the authenticity of the message through steps designed to
23 assure the identity of the sender, the integrity of the message, or both. Security procedures can
24 also be used to detect error in the content of messages or to detect payment orders that are
25 transmitted by mistake as in the case of multiple transmission of the same payment order.
26 Security procedures might also apply to communications that are transmitted by telephone or in
27 ~~writing~~ a record. Section 4A-201 defines these security procedures. The second sentence of the
28 definition provides several examples of a security procedure, but this list is not exhaustive. The
29 inclusion of the phrase “or similar security devices” means that, as new technologies emerge,
30 what can be a security procedure will change. The definition of security procedure limits the
31 term to a procedure “established by agreement of a customer and a receiving bank.” The term
32 does not apply to procedures that the receiving bank may follow unilaterally in processing
33 payment orders. The question of whether loss that may result from the transmission of a spurious
34 or erroneous payment order will be borne by the receiving bank or the sender or purported sender
35 is affected by whether a security procedure was or was not in effect and whether there was or

1 was not compliance with the procedure. Security procedures are referred to in Sections 4A-202
2 and 4A-203, which deal with authorized and verified payment orders, and Section 4A-205,
3 which deals with erroneous payment orders.

4
5 Requiring that a payment order be sent from a known email, IP address or phone number
6 is not by itself a “security procedure” within the meaning of this section because it is possible to
7 make a payment order with a different origin appear to have been sent from such an address or
8 phone number. However, requiring that a payment order have such an apparent origin in
9 combination with other security protocols might be a security procedure.

10 11 **Section 4A-202. Authorized ~~And~~ and Verified Payment Orders.**

12 (a) A payment order received by the receiving bank is the authorized order of the person
13 identified as sender if that person authorized the order or is otherwise bound by it under the law
14 of agency.

15 (b) If a bank and its customer have agreed that the authenticity of payment orders issued
16 to the bank in the name of the customer as sender will be verified pursuant to a security
17 procedure, a payment order received by the receiving bank is effective as the order of the
18 customer, whether or not authorized, if (i) the security procedure is a commercially reasonable
19 method of providing security against unauthorized payment orders, and (ii) the bank proves that
20 it accepted the payment order in good faith and in compliance with the bank’s obligations under
21 the security procedure and any ~~written~~ agreement or instruction of the customer, evidenced by a
22 record, restricting acceptance of payment orders issued in the name of the customer. The bank is
23 not required to follow an instruction that violates ~~a written~~ an agreement evidenced by a record
24 with the customer or notice of which is not received at a time and in a manner affording the bank
25 a reasonable opportunity to act on it before the payment order is accepted.

26 (c) Commercial reasonableness of a security procedure is a question of law to be
27 determined by considering the wishes of the customer expressed to the bank, the circumstances
28 of the customer known to the bank, including the size, type, and frequency of payment orders

1 normally issued by the customer to the bank, alternative security procedures offered to the
2 customer, and security procedures in general use by customers and receiving banks similarly
3 situated. A security procedure is deemed to be commercially reasonable if (i) the security
4 procedure was chosen by the customer after the bank offered, and the customer refused, a
5 security procedure that was commercially reasonable for that customer, and (ii) the customer
6 expressly agreed in ~~writing~~ a record to be bound by any payment order, whether or not
7 authorized, issued in its name and accepted by the bank in compliance with the bank's
8 obligations under the security procedure chosen by the customer.

9 * * *

10 **Official Comment**

11 This section is discussed in the Comment following Section 4A-203.

12 **Section 4A-203. Unenforceability of Certain Verified Payment Orders.**

13 (a) If an accepted payment order is not, under Section 4A-202(a), an authorized order of a
14 customer identified as sender, but is effective as an order of the customer pursuant to Section
15 4A-202(b), the following rules apply:

16 (1) By express ~~written~~ agreement evidenced by a record, the receiving bank may
17 limit the extent to which it is entitled to enforce or retain payment of the payment order.

18 (2) The receiving bank is not entitled to enforce or retain payment of the payment
19 order if the customer proves that the order was not caused, directly or indirectly, by a person
20 (i) entrusted at any time with duties to act for the customer with respect to payment orders or the
21 security procedure, or (ii) who obtained access to transmitting facilities of the customer or who
22 obtained, from a source controlled by the customer and without authority of the receiving bank,
23 information facilitating breach of the security procedure, regardless of how the information was

1 obtained or whether the customer was at fault. Information includes any access device, computer
2 software, or the like.

3 (b) This section applies to amendments of payment orders to the same extent it applies to
4 payment orders.

5 Official Comment

6 * * *

7 3. Subsection (b) of Section 4A-202 is based on the assumption that losses due to
8 fraudulent payment orders can best be avoided by the use of commercially reasonable security
9 procedures, and that the use of such procedures should be encouraged. The subsection is
10 designed to protect both the customer and the receiving bank. A receiving bank needs to be able
11 to rely on objective criteria to determine whether it can safely act on a payment order.
12 Employees of the bank can be trained to “test” a payment order according to the various steps
13 specified in the security procedure. The bank is responsible for the acts of these employees.
14 Subsection (b)(ii) requires the bank to prove that it accepted the payment order in good faith and
15 “in compliance with the bank’s obligations under the security procedure.” If the fraud was not
16 detected because the bank’s employee did not perform the acts required by the security
17 procedure, the bank has not complied. Subsection (b)(ii) also requires the bank to prove that it
18 complied with any agreement or instruction that restricts acceptance of payment orders issued in
19 the name of the customer. If an agreement establishing a security procedure places obligations on
20 both the sender and the receiving bank, the receiving bank need prove only that it complied with
21 the obligations placed on the receiving bank. A customer may want to protect itself by imposing
22 limitations on acceptance of payment orders by the bank. For example, the customer may
23 prohibit the bank from accepting a payment order that is not payable from an authorized account,
24 that exceeds the credit balance in specified accounts of the customer, or that exceeds some other
25 amount. Another limitation may relate to the beneficiary. The customer may provide the bank
26 with a list of authorized beneficiaries and prohibit acceptance of any payment order to a
27 beneficiary not appearing on the list. Such limitations may be incorporated into the security
28 procedure itself or they may be covered by a separate agreement or instruction. In either case, the
29 bank must comply with the limitations if the conditions stated in subsection (b) are met.
30 Normally limitations on acceptance would be incorporated into an agreement between the
31 customer and the receiving bank, but in some cases the instruction might be unilaterally given by
32 the customer. If standing instructions or an agreement state limitations on the ability of the
33 receiving bank to act, provision must be made for later modification of the limitations. Normally
34 this would be done by an agreement that specifies particular procedures to be followed. Thus,
35 subsection (b) states that the receiving bank is not required to follow an instruction that violates a
36 written an agreement evidenced by a record. The receiving bank is not bound by an instruction
37 unless it has adequate notice of it. Subsections (25), (26)~~7~~ and (27) of Section 1-201 apply.
38

39 Subsection (b)(i) assures that the interests of the customer will be protected by providing
40 an incentive to a bank to make available to the customer a security procedure that is

1 commercially reasonable. If a commercially reasonable security procedure is not made available
2 to the customer, subsection (b) does not apply. The result is that subsection (a) applies and the
3 bank acts at its peril in accepting a payment order that may be unauthorized. Prudent banking
4 practice may require that security procedures be utilized in virtually all cases except for those in
5 which personal contact between the customer and the bank eliminates the possibility of an
6 unauthorized order. The burden of making available commercially reasonable security
7 procedures is imposed on receiving banks because they generally determine what security
8 procedures can be used and are in the best position to evaluate the efficacy of procedures offered
9 to customers to combat fraud. The burden on the customer is to supervise its employees to assure
10 compliance with the security procedure and to safeguard confidential security information and
11 access to transmitting facilities so that the security procedure cannot be breached.

12
13 4. The principal issue that is likely to arise in litigation involving subsection (b) is
14 whether the security procedure in effect when a fraudulent payment order was accepted was
15 commercially reasonable. In considering this issue, a court will need to consider the totality of
16 the security procedure, including each party's obligations under such the procedure. The concept
17 of what is commercially reasonable in a given case is flexible. Verification entails labor and
18 equipment costs that can vary greatly depending upon the degree of security that is sought. A
19 customer that transmits very large numbers of payment orders in very large amounts may desire
20 and may reasonably expect to be provided with state-of-the-art procedures that provide
21 maximum security. But the expense involved may make use of a state-of-the-art procedure
22 infeasible for a customer that normally transmits payment orders infrequently or in relatively low
23 amounts. Another variable is the type of receiving bank. It is reasonable to require large money
24 center banks to make available state-of-the-art security procedures. On the other hand, the same
25 requirement may not be reasonable for a small country bank. A receiving bank might have
26 several security procedures that are designed to meet the varying needs of different customers.
27 The type of payment order is another variable. For example, in a wholesale wire transfer, each
28 payment order is normally transmitted electronically and individually. A testing procedure will
29 be individually applied to each payment order. In funds transfers to be made by means of an
30 automated clearing house many payment orders are incorporated into an electronic device such
31 as a magnetic tape that is physically delivered. Testing of the individual payment orders is not
32 feasible. Thus, a different kind of security procedure must be adopted to take into account the
33 different mode of transmission.

34
35 The issue of whether a particular security procedure is commercially reasonable is a
36 question of law. Whether the receiving bank complied with the procedure is a question of fact. It
37 is appropriate to make the finding concerning commercial reasonability a matter of law because
38 security procedures are likely to be standardized in the banking industry and a question of law
39 standard leads to more predictability concerning the level of security that a bank must offer to its
40 customers. The purpose of subsection (b) is to encourage banks to institute reasonable safeguards
41 against fraud but not to make them insurers against fraud. A security procedure is not
42 commercially unreasonable simply because another procedure might have been better or because
43 the judge deciding the question would have opted for a more stringent procedure. For example,
44 the use of a computer program to detect fraud is not commercially unreasonable merely because
45 it does not detect all fraud or because another system or approach might be more successful at
46 detecting fraud. The standard is not whether the security procedure is the best available. Rather it

1 is whether the procedure is reasonable for the particular customer and the particular bank, which
2 is a lower standard. What is reasonable for a particular customer requires the court to consider
3 the circumstances of the customer known to the bank, including the size, type, and frequency of
4 payment orders normally issued by the customer to the bank. Article 4A does not create an
5 affirmative obligation on the receiving bank to obtain information about its customer. However,
6 whatever knowledge the bank does have about the customer is relevant in determining the
7 commercial reasonableness of the security procedure. On the other hand, a A security procedure
8 that fails to meet prevailing standards of good banking practice applicable to the particular bank
9 and customer should not be held to be commercially reasonable. Subsection (c) states factors to
10 be considered by the judge in making the determination of commercial reasonableness. The
11 reasonableness of a security procedure is to be determined at the time that a payment order is
12 processed, not ~~that~~ at the time the customer and the bank agree to the security procedure.
13 Accordingly, a security procedure that was reasonable when agreed to might become
14 unreasonable as technologies emerge, prevailing practices change, or the bank acquires
15 knowledge about the customer. Sometimes an informed customer refuses a security procedure
16 that is commercially reasonable and suitable for that customer and insists on using a higher-risk
17 procedure because it is more convenient or cheaper. In that case, under the last sentence of
18 subsection (c), the customer has voluntarily assumed the risk of failure of the procedure and
19 cannot shift the loss to the bank. But this result follows only if the customer expressly agrees in
20 writing a record to assume that risk. It is implicit in the last sentence of subsection (c) that a bank
21 that accedes to the wishes of its customer in this regard is not acting in bad faith by so doing so
22 long as the customer is made aware of the risk. In all cases, however, a receiving bank cannot get
23 the benefit of subsection (b) unless it has made available to the customer a security procedure
24 that is commercially reasonable and suitable for use by that customer. In most cases, the mutual
25 interest of bank and customer to protect against fraud should lead to agreement to a security
26 procedure which is commercially reasonable.

27
28 5. Subsection (b) generally allows a receiving bank to treat a payment order as authorized
29 by the customer if the bank accepts the payment order in good faith and in compliance with the
30 bank's obligations under a commercially reasonable, agreed-upon security procedure. For this
31 purpose, "good faith" requires the exercise of reasonable commercial standards of fair dealing,
32 see § 4A-105(a)(6), not the absence of negligence. Consequently, the bank has no duty, beyond
33 that to which the bank has agreed, to investigate suspicious activity or to advise its customer of
34 such activity. However, a bank that obtains knowledge that a customer's operations have been
35 infiltrated or knowledge that the customer is the victim of identity fraud might not be acting in
36 good faith if the bank, without receiving some assurance from the customer that the issue has
37 been remediated, thereafter accepts a payment order.

38
39 5-6. The effect of Section 4A-202(b) is to place the risk of loss on the customer if an
40 unauthorized payment order is accepted by the receiving bank after verification by the bank in
41 compliance with a commercially reasonable security procedure. An exception to this result is
42 provided by Section 4A-203(a)(2). The customer may avoid the loss resulting from such a
43 payment order if the customer can prove that the fraud was not committed by a person described
44 in that subsection. Breach of a commercially reasonable security procedure requires that the
45 person committing the fraud have knowledge of how the procedure works and knowledge of
46 codes, identifying devices, and the like. That person may also need access to transmitting

1 facilities through an access device or other software in order to breach the security procedure.
2 This confidential information must be obtained either from a source controlled by the customer
3 or from a source controlled by the receiving bank. If the customer can prove that the person
4 committing the fraud did not obtain the confidential information from an agent or former agent
5 of the customer or from a source controlled by the customer, the loss is shifted to the bank.
6 “Prove” is defined in Section 4A-105(a)(7). Because of bank regulation requirements, in this
7 kind of case there will always be a criminal investigation as well as an internal investigation of
8 the bank to determine the probable explanation for the breach of security. Because a funds
9 transfer fraud usually will involve a very large amount of money, both the criminal investigation
10 and the internal investigation are likely to be thorough. In some cases, there may be an
11 investigation by bank examiners as well. Frequently, these investigations will develop evidence
12 of who is at fault and the cause of the loss. The customer will have access to evidence developed
13 in these investigations and that evidence can be used by the customer in meeting its burden of
14 proof.

15
16 ~~6.7.~~ The effect of Section 4A-202(b) may also be changed by an agreement meeting the
17 requirements of Section 4A-203(a)(1). Some customers may be unwilling to take all or part of
18 the risk of loss with respect to unauthorized payment orders even if all of the requirements of
19 Section 4A-202(b) are met. By virtue of Section 4A-203(a)(1), a receiving bank may assume all
20 of the risk of loss with respect to unauthorized payment orders or the customer and bank may
21 agree that losses from unauthorized payment orders are to be divided as provided in the
22 agreement.

23
24 ~~7.8.~~ In a large majority of cases the sender of a payment order is a bank. In many cases in
25 which there is a bank sender, both the sender and the receiving bank will be members of a funds
26 transfer system over which the payment order is transmitted. Since Section 4A-202(f) does not
27 prohibit a funds transfer system rule from varying rights and obligations under Section 4A-202, a
28 rule of the funds transfer system can determine how loss due to an unauthorized payment order
29 from a participating bank to another participating bank is to be allocated. A funds transfer system
30 rule, however, cannot change the rights of a customer that is not a participating bank. § 4A-
31 501(b). Section 4A-202(f) also prevents variation by agreement except to the extent stated.

32
33 * * *

34
35 **Section 4A-206. Transmission ~~Of~~ of Payment Order Through Funds-Transfer**
36 **~~Or~~ or Other Communication System.**

37 * * *

38 **Official Comment**

39 1. A payment order may be issued to a receiving bank directly by delivery of a ~~writing or~~
40 ~~electronic device record~~ record or by an oral ~~or electronic~~ communication. If an agent of the sender is
41 employed to transmit orders on behalf of the sender, the sender is bound by the order transmitted
42 by the agent on the basis of agency law. Section 4A-206 is an application of that principle to
43 cases in which a funds transfer or communication system acts as an intermediary in transmitting
44 the sender’s order to the receiving bank. The intermediary is deemed to be an agent of the sender

1 for the purpose of transmitting payment orders and related messages for the sender. Section
2 4A-206 deals with error by the intermediary.

3
4 * * *

5
6 **Section 4A-207. Misdescription ~~Of~~ of Beneficiary.**

7 * * *

8 (c) If (i) a payment order described in subsection (b) is accepted, (ii) the originator's
9 payment order described the beneficiary inconsistently by name and number, and (iii) the
10 beneficiary's bank pays the person identified by number as permitted by subsection (b)(1), the
11 following rules apply:

12 (1) If the originator is a bank, the originator is obliged to pay its order.

13 (2) If the originator is not a bank and proves that the person identified by number
14 was not entitled to receive payment from the originator, the originator is not obliged to pay its
15 order unless the originator's bank proves that the originator, before acceptance of the originator's
16 order, had notice that payment of a payment order issued by the originator might be made by the
17 beneficiary's bank on the basis of an identifying or bank account number even if it identifies a
18 person different from the named beneficiary. Proof of notice may be made by any admissible
19 evidence. The originator's bank satisfies the burden of proof if it proves that the originator,
20 before the payment order was accepted, signed a ~~writing~~ record stating the information to which
21 the notice relates.

22 * * *

23 (e) In this section, "signed^{""}, with respect to a record that is not a writing, includes the
24 attachment to or logical association with the record of an electronic symbol, sound, or process
25 with the present intent to adopt or accept the record.

26 * * *

1 Section 4A-208. Misdescription ~~Of~~ of Intermediary Bank ~~Or~~ or Beneficiary's
2 Bank.

3 * * *

4 ~~(b)~~ * * *

5 (b) This subsection applies to a payment order identifying an intermediary bank or the
6 beneficiary's bank both by name and an identifying number if the name and number identify
7 different persons.

8 (1) If the sender is a bank, the receiving bank may rely on the number as the
9 proper identification of the intermediary or beneficiary's bank if the receiving bank, when it
10 executes the sender's order, does not know that the name and number identify different persons.
11 The receiving bank need not determine whether the name and number refer to the same person or
12 whether the number refers to a bank. The sender is obliged to compensate the receiving bank for
13 any loss and expenses incurred by the receiving bank as a result of its reliance on the number in
14 executing or attempting to execute the order.

15 (2) If the sender is not a bank and the receiving bank proves that the sender,
16 before the payment order was accepted, had notice that the receiving bank might rely on the
17 number as the proper identification of the intermediary or beneficiary's bank even if it identifies
18 a person different from the bank identified by name, the rights and obligations of the sender and
19 the receiving bank are governed by subsection (b)(1), as though the sender were a bank. Proof of
20 notice may be made by any admissible evidence. The receiving bank satisfies the burden of proof
21 if it proves that the sender, before the payment order was accepted, signed a ~~writing~~ record
22 stating the information to which the notice relates.

23 (c) In this section, "signed," with respect to a record that is not a writing, includes the

attachment to or logical association with the record of an electronic symbol, sound, or process
with the present intent to adopt or accept the record.

* * *

Section 4A-210. Rejection ~~Of~~ of Payment Order.

(a) A payment order is rejected by the receiving bank by a notice of rejection transmitted to the sender orally, ~~electronically~~, or in ~~writing~~ a record. A notice of rejection need not use any particular words and is sufficient if it indicates that the receiving bank is rejecting the order or will not execute or pay the order. Rejection is effective when the notice is given if transmission is by a means that is reasonable in the circumstances. If notice of rejection is given by a means that is not reasonable, rejection is effective when the notice is received. If an agreement of the sender and receiving bank establishes the means to be used to reject a payment order, (i) any means complying with the agreement is reasonable and (ii) any means not complying is not reasonable unless no significant delay in receipt of the notice resulted from the use of the noncomplying means.

* * *

Section 4A-211. Cancellation ~~And~~ and Amendment ~~Of~~ of Payment Order.

(a) A communication of the sender of a payment order cancelling or amending the order may be transmitted to the receiving bank orally, ~~electronically~~, or in ~~writing~~ a record. If a security procedure is in effect between the sender and the receiving bank, the communication is not effective to cancel or amend the order unless the communication is verified pursuant to the security procedure or the bank agrees to the cancellation or amendment.

* * *

Official Comment

* * *

2. Subsection (a) allows a cancellation or amendment of a payment order to be communicated to the receiving bank “orally, ~~electronically~~, or in writing a record.” The quoted phrase is consistent with the language of Section 4A-103(a) applicable to payment orders. Cancellations and amendments are normally subject to verification pursuant to security procedures to the same extent as payment orders. Subsection (a) recognizes this fact by providing that in cases in which there is a security procedure in effect between the sender and the receiving bank the bank is not bound by a communication cancelling or amending an order unless verification has been made. This is necessary to protect the bank because under subsection (b) a cancellation or amendment can be effective by unilateral action of the sender. Without verification the bank cannot be sure whether the communication was or was not effective to cancel or amend a previously verified payment order.

* * *

ARTICLE 5

LETTERS OF CREDIT

Section 5-102. Definitions.

(a) In this article:

* * *

(14A) “Signed” with respect to a record that is not a writing, ~~means to attach~~
~~includes the attachment to or logically associate~~ logical association with the record an electronic
sound, symbol, or process with present intent to adopt or accept the record.

* * *

Reporter's Note

1. “Signed.” ~~The proposed definition—~~The definition of “signed” contained in Section 5-102(a)(14A) is copied from Section 3-604(c). It would accommodate the use of electronic signatures under Sections 5-104(i), 5-108(i)(5), 5-113(a), (b), (c) and (d), and 5-116(a) without invalidating the use of traditional, non-electronic signatures on paper documents in letter-of-credit transactions. ~~The Drafting Committee may wish to consider including biometric technology in the definition of “signed.” Biometric technology is now included in draft § 4A-211, dealing with security procedures. However, a~~ A biometric measurement or calculation ~~should~~ would be an “electronic . . . process,” ~~so~~ and that technology ~~may~~ would be covered by the proposed new definition.

1 2. The Drafting Committee plans to consider more generally the definition and use of
2 “signed,” which also is defined in Section 1-201(b)(37), throughout the Uniform Commercial
3 Code.

4
5 * * *

6 **Section 5-116. Choice ~~Of~~ of Law ~~And~~ and Forum.**

7 (a) The liability of an issuer, nominated person, or adviser for action or omission is
8 governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or
9 otherwise authenticated by the affected parties in the manner provided in Section 5-104 or by a
10 provision in the ~~person's~~ person's letter of credit, confirmation, or other undertaking. The
11 jurisdiction whose law is chosen need not bear any relation to the transaction.

12 (b) Unless subsection (a) applies, the liability of an issuer, nominated person, or adviser
13 for action or omission is governed by the law of the jurisdiction in which the person is located.
14 The person is considered to be located at the address indicated in the ~~person's~~ person's
15 undertaking. If more than one address is indicated, the person is considered to be located at the
16 address from which the ~~person's~~ person's undertaking was issued.

17 (c) For the purpose of jurisdiction, choice of law, and recognition of interbranch letters of
18 credit, but not enforcement of a judgment, all branches of a bank are considered separate
19 juridical entities and a bank is considered to be located at the place where its relevant branch is
20 considered to be located under ~~this~~-subsection (d).

21 (d) A branch ~~of a bank~~ is considered to be located at the address indicated in ~~its~~ the
22 ~~branch's~~ undertaking ~~and, if~~. If more than one address is indicated, the branch is considered to be
23 located at the address from which ~~its~~ the undertaking was issued.

24 ~~(e)~~(e) Except as otherwise provided in this subsection, the liability of an issuer,
25 nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform

1 Customs and Practice for Documentary Credits, to which the letter of credit, confirmation, or
2 other undertaking is expressly made subject. If (i) this article would govern the liability of an
3 issuer, nominated person, or adviser under subsection (a) or (b), (ii) the relevant undertaking
4 incorporates rules of custom or practice, and (iii) there is conflict between this article and those
5 rules as applied to that undertaking, those rules govern except to the extent of any conflict with
6 the nonvariable provisions specified in Section 5-103(c).

7 ~~(d)~~(f) If there is conflict between this article and Article 3, 4, 4A, or 9, this article
8 governs.

9 ~~(e)~~(g) The forum for settling disputes arising out of an undertaking within this article may
10 be chosen in the manner and with the binding effect that governing law may be chosen in
11 accordance with subsection (a).

12 **Reporter's Note**

13
14 ~~1~~—*Clarification of ambiguity as to separateness of bank branches.* The last sentence of
15 existing subsection (b) is placed in a new subsection (c) and a new subsection (d) is added. These
16 revisions are necessary to eliminate a potential ambiguity arising from the first sentence of
17 subsection (b). The first sentence has been construed incorrectly as meaning that the last
18 sentence, which recognizes the separateness of bank branches for the specified purposes, is
19 inapplicable when a governing law has been chosen pursuant to subsection (a). These
20 amendments would reject that construction and override cases such as *Zeeco, Inc. v. JPMorgan*
21 *Chase Bank*, Case No. 17 -CV-384-JED-FHM, 2018 WL 1414119 (N.D. Okla. Mar. 21, 2018),
22 *amending opinion dated March 20, 2018, both opinions vacated*, 2019 WL 3543081, 2019 U.S.
23 Dist. LEXIS 133756 (Feb. 8, 2019).

24 * * *

26 **ARTICLE 7**

27 **DOCUMENTS OF TITLE**

28 **Section 7-106. Control of Electronic Document of Title.**

29 (a) **[General rule.]** A person has control of an electronic document of title if a system
30 employed for evidencing the transfer of interests in the electronic document reliably establishes

1 that person as the person to which the electronic document was issued or transferred.

2 (b) **[Single authoritative copy.]** A system satisfies subsection (a), and a person is
3 ~~deemed to have~~ has control of an electronic document of title, if the document is created, stored,
4 and ~~assigned~~ transferred in such a manner that:

5 (1) a single authoritative copy of the document exists which is unique,
6 identifiable, and, except as otherwise provided in paragraphs (4), (5), and (6), unalterable;

7 (2) the authoritative copy identifies the person asserting control as:

8 (A) the person to which the document was issued; or

9 (B) if the authoritative copy indicates that the document has been
10 transferred, the person to which the document was most recently transferred;

11 (3) the authoritative copy is communicated to and maintained by the person
12 asserting control or its designated custodian;

13 (4) copies or amendments that add or change an identified ~~assignee~~ transferee of
14 the authoritative copy can be made only with the consent of the person asserting control;

15 (5) each copy of the authoritative copy and any copy of a copy is readily
16 identifiable as a copy that is not the authoritative copy; and

17 (6) any amendment of the authoritative copy is readily identifiable as authorized
18 or unauthorized.

19 (c) **[One or more authoritative electronic copies.]** A system ~~also~~ satisfies subsection (a)
20 and a person has control of an electronic document of title if an electronic copy of the document
21 ~~of title~~, a record attached to or logically associated with the electronic copy, or ~~the~~ a system in
22 which the electronic copy is recorded, if any:

23 (1) enables the person to readily identify each electronic copy ~~of the document of~~

1 ~~title~~ as an authoritative copy or nonauthoritative copy ~~of the document of title~~;

2 (2) enables the person ~~to~~ readily ~~to~~ identify itself ~~in any way, including by name,~~
3 ~~identifying number, cryptographic key, office, or account number,~~ as the person to which each
4 authoritative electronic copy ~~of the document of title~~ was issued or transferred; and

5 (3) ~~subject to subsection (e),~~ gives the person ~~the~~ exclusive power, ~~subject to~~
6 ~~subsection(e), to:~~

7 (A) prevent others from ~~[adding to or changing]~~ ~~[[altering]]~~ the person to
8 which ~~of each~~ authoritative electronic copy ~~of the document of title was~~ ~~has been~~ issued or
9 transferred; and

10 (B) transfer control of the authoritative copy ~~of the document of title.~~

11 (d) **[Obtaining control through another person.]** A person ~~also~~ has control of an
12 electronic document of title if another person, ~~other than the transferor of an interest in the~~
13 ~~document:~~

14 (1) has control of the document and acknowledges that it has control on behalf of
15 the person, or

16 (2) obtains control of the document after having acknowledged that it will ~~acquire~~
17 ~~obtain~~ control of the document on behalf of the person.

18 (e) **[Meaning of exclusive.]** A power ~~specified in is exclusive under~~ subsection (c)(3) ~~is~~
19 ~~exclusive,).~~ even if:

20 (1) the ~~authoritative~~ electronic copy or ~~the~~ a system in which the electronic copy
21 is recorded, ~~if any,~~ limits the use ~~to which of the~~ ~~electronic~~ document ~~of title may be put~~ or has
22 ~~protocols a protocol~~ that ~~are is~~ programmed to ~~result in a~~ transfer ~~of~~ control; or

23 (2) the person has agreed to share the power with another person.

~~(f) [Identification of person.] For the purposes of subsection (c)(2), a person may be identified in any way, including by name, identifying number, cryptographic key, office, or account number.~~

Reporter's Note

1. *Background of revisions.* Draft § 7-106 on control of electronic documents of title preserves the existing subsection (a) general rule and the existing subsection (b) “safe harbor.” The minor stylistic revisions are not substantive. The other proposed revisions add an additional “safe harbor” in subsection (c), along the lines of the proposed revisions to draft § 9-105 on control of chattel paper evidenced by electronic records, and subsection (d) on control through another person.

2. *Control of documents of title evidenced by an electronic record.* Draft § 7-106(c), supplemented by subsections (e) and (f), generally follows draft § 9-105 on control of an authoritative electronic ~~copies~~ copy of a record evidencing chattel paper. Subsection (c) differs from subsection (b), which is based on a “single authoritative copy” of an electronic document of title. *See generally* draft § 9-105 and Reporter's Note.

3. *Control through another person.* Subsection (d) provides for a person to obtain control through the control of another person. It follows the corresponding provisions for control of deposit accounts (draft § 9-104), authoritative electronic copies of records evidencing chattel paper (draft § 9-105), control of electronic money (draft § 9-105A), and control of controllable electronic records (draft § 12-105). For a brief discussion, see draft § 12-105, Reporter's Note 7.

ARTICLE 8

INVESTMENT SECURITIES

Reporter's Prefatory Note to Article 8 Amendments

Proposed amendments to the official comments to Section 8-102 primarily serve to make clear that a controllable electronic record may be a financial asset credited to a securities account under Article 8. *See also* draft § 12-102, Reporter's Note 1. The proposed amendment to Section 8-106(d) on control through another person conforms that provision to proposed amendments to Section 7-106 (control of electronic documents of title) and Section 9-105 (control of authoritative electronic copies of records evidencing chattel paper) and to draft §§ 9-105A (control of electronic money) and 12-105 (control of controllable electronic records). The proposed amendment to Section 8-303 conforms the text on the rights of a protected purchaser to the corresponding provision for a qualifying purchaser under Article 12. The proposed revision of Section 8-501 addresses the specified financial assets as to which both a securities intermediary and its customer have control. These financial assets would be treated as being held directly by the customer and would not be included in a security entitlement.

1 **Section 8-102. Definitions and Index of Definitions.**

2
3 * * *

4 (b) Other definitions applying to this Article and the sections in which they appear are:

5
6 “Appropriate person”. Section 8-107.

7 “Control”. Section 8-106.

8 [“Chattel paper”. Section 9-102.]

9 “Controllable account”. Section 9-102.

10 “Controllable electronic record”. Section 12-102.

11 “Controllable payment intangible”. Section 9-102.

12 “Delivery”. Section 8-301.

13 “Electronic money”. Section 9-102.

14 “Investment company security”. Section 8-103.

15 “Issuer”. Section 8-201.

16 “Overissue”. Section 8-210.

17 “Protected purchaser”. Section 8-303.

18 “Securities account”. Section 8-501.

19
20 **Official Comment**

21 * * *

22 9. “Financial asset.” The definition of “financial asset,” in conjunction with the definition
23 of “securities account” in Section 8-501, sets the scope of the indirect holding system rules of
24 Part 5 of Revised Article 8. The Part 5 rules apply not only to securities held through
25 intermediaries, but also to other financial assets held through intermediaries. The term financial
26 asset is defined to include not only securities but also a broader category of obligations, shares,
27 participations, and interests.

28
29 Having separate definitions of security and financial asset makes it possible to separate
30 the question of the proper scope of the traditional Article 8 rules from the question of the proper
31 scope of the new indirect holding system- rules. Some forms of financial assets should be
32 covered by the indirect holding system rules of Part 5, but not by the rules of Parts 2, 3, and 4.
33 The term financial asset is used to cover such property. Because the term security entitlement is
34 defined in terms of financial assets rather than securities, the rules concerning security
35 entitlements set out in Part 5 of Article 8 and in Revised Article 9 apply to the broader class of
36 financial assets.

37
38 The fact that something does or could fall within the definition of financial asset does not,
39 without more, trigger Article 8 coverage. The indirect holding system rules of Revised Article 8
40 apply only if the financial asset is in fact held in a securities account, so that the interest of the
41 person who holds the financial asset through the securities account is a security entitlement.
42 Thus, questions of the scope of the indirect holding system rules cannot be framed as “Is such-
43 and-such a ‘financial asset’ under Article 8?” Rather, one must analyze whether the relationship

1 between an institution and a person on whose behalf the institution holds an asset falls within the
2 scope of the term securities account as defined in Section 8-501. That question turns in large
3 measure on whether it makes sense to apply the Part 5 rules to the relationship.

4
5 It is not necessary for all of the Part 5 rules to be relevant to a particular financial asset
6 for the relevant property to qualify as a “financial asset” credited to a securities account. Many of
7 the duties set forth in Part 5 will often be relevant to a digital asset treated as a financial asset
8 credited to a securities account, including the duty to exercise rights as directed by the
9 entitlement holder, comply with the entitlement holder’s entitlement orders, and change the
10 position to another form of holding. If the parties agree to treat a digital asset as a financial asset
11 under Article 8 and the digital asset is in fact held in a securities account for an entitlement
12 holder, the rules applicable to “controllable electronic records” under Article 12 would not apply
13 to the entitlement holder’s security entitlement related to the financial asset. If the financial asset
14 itself is a controllable electronic record, however, then the rules in Article 12 would apply to the
15 securities intermediary’s rights with respect to the controllable electronic record.

16
17 The term financial asset is used to refer both to the underlying asset and the particular
18 means by which ownership of that asset is evidenced. Thus, with respect to a certificated
19 security, the term financial asset may, as context requires, refer either to the interest or obligation
20 of the issuer or to the security certificate representing that interest or obligation. Similarly, if a
21 person holds a security or other financial asset through a securities account, the term financial
22 asset may, as context requires, refer either to the underlying asset or to the ~~person's~~ person’s
23 security entitlement.

24
25 * * *

26 14. “Securities intermediary.” A “securities intermediary” is a person that in the ordinary
27 course of its business maintains securities accounts for others and is acting in that capacity. The
28 most common examples of securities intermediaries would be clearing corporations holding
29 securities for their participants, banks acting as securities custodians, and brokers holding
30 securities on behalf of their customers. However, a person need not be such an entity in order to
31 be a securities intermediary. Because a “securities account” is an account to which a financial
32 asset is or may be credited ~~in accordance with~~ under Section 8-501(a) and the definition of
33 “financial asset” is not limited to securities, a person may be a “securities intermediary” even if
34 that person does not credit “securities” (as defined in Article 8) to the account. Rather, the
35 securities accounts that a securities intermediary maintains may consist exclusively of financial
36 assets described in ~~clauses (ii) and (iii) of~~ Section 8-102(a)(9~~-~~)(ii) and (iii). Clearing
37 corporations are listed separately as a category of securities intermediary in subparagraph (i)
38 even though in most circumstances they would fall within the general definition in subparagraph
39 (ii). The reason is to simplify the analysis of arrangements such as the NSCC-DTC system in
40 which NSCC performs the comparison, clearance, and netting function, while DTC acts as the
41 depository. Because NSCC is a registered clearing agency under the federal securities laws, it is
42 a clearing corporation and hence a securities intermediary under Article 8, regardless of whether
43 it is at any particular time or in any particular aspect of its operations holding securities on behalf
44 of its participants.

1 The terms securities intermediary and broker have different meanings. Broker means a
2 person engaged in the business of buying and selling securities, as agent for others or as
3 principal. Securities intermediary means a person maintaining securities accounts for others. A
4 stockbroker, in the colloquial sense, may or may not be acting as a securities intermediary.
5

6 The definition of securities intermediary includes the requirement that the person in
7 question is “acting in the capacity” of maintaining securities accounts for others. This is to take
8 account of the fact that a particular entity, such as a bank, may act in many different capacities in
9 securities transactions. A bank may act as a transfer agent for issuers, as a securities custodian
10 for institutional investors and private investors, as a dealer in government securities, as a lender
11 taking securities as collateral, and as a provider of general payment and collection services that
12 might be used in connection with securities transactions. A bank that maintains securities
13 accounts for its customers would be a securities intermediary with respect to those accounts; but
14 if it takes a pledge of securities from a borrower to secure a loan, it is not thereby acting as a
15 securities intermediary with respect to the pledged securities, since it holds them for its own
16 account rather than for a customer. In other circumstances, those two functions might be
17 combined. For example, if the bank is a government securities dealer it may maintain securities
18 accounts for customers and also provide the customers with margin credit to purchase or carry
19 the securities, in much the same way that brokers provide margin loans to their customers.
20

21 The definition of securities intermediary includes the requirement that the person in
22 question “in the ordinary course of its business maintain securities accounts for others”. This
23 “ordinary course” requirement does not have a fixed quantitative requirement and is determined
24 by the facts of each case. Thus, a person need not necessarily satisfy a specified threshold of
25 activity or necessarily have a minimum number of customers.

26 27 **Reporter’s Note**

28
29 *Relationship between Articles 8 and 12.* These draft amendments to the Official
30 Comments to Article 8 are intended to make clear that a controllable electronic record may be a
31 financial asset credited to a securities account under Article 8 and to identify several significant
32 aspects of the relationship between Articles 8 and 12. *See also* draft § 12-102, Reporter’s Note 1
33 (second paragraph).
34

35 * * *

36 **Section 8-106. Control.**

37 (d) A purchaser has “control” of a security entitlement if:

38 * * *

39 (3) another person, other than the transferor of an interest in the security
40 entitlement; ~~has control of the security entitlement on behalf of the purchaser or, having~~

1 previously acquired control of the security entitlement, acknowledges that it has control on
2 behalf of the purchaser.

3 (A) has control of the security entitlement and acknowledges that it has
4 control on behalf of the ~~person~~ purchaser, or

5 (B) obtains control of the security entitlement after having acknowledged
6 that it will ~~acquire~~ obtain control of the ~~document~~ security entitlement on behalf of the ~~person~~
7 purchaser.

8 **Reporter's Note**

9 ~~1.~~ The proposed amendment to subsection (d)(3) would conform that provision for
10 control through another person to the corresponding provisions for control of other assets. *See*
11 Reporter's Prefatory Note to Article 8 Amendments and draft § 12-105, Reporter's Note 7.

12
13 * * *

14 **Section 8-303. Protected Purchaser.**

15 (a) "Protected purchaser" means a purchaser of a certificated or uncertificated security, or
16 of an interest therein, who:

17 (1) gives value;

18 (2) does not have notice of any adverse claim to the security; and

19 (3) obtains control of the certificated or uncertificated security.

20 (b) ~~In addition to acquiring the rights of a purchaser, a~~ A protected purchaser acquires its
21 interest in the security free of any adverse claim.

22 **Reporter's Note**

23 The proposed change conforms subsection (b) to draft § 12-104(d) on the rights of a
24 qualifying purchaser of a controllable electronic record, controllable account, or controllable
25 payment intangible. A protected purchaser acquires the rights of a purchaser under Section 8-
26 302. Consequently, the deletion of the reference in the current text to the rights of a purchaser
27 does not diminish the rights of a protected purchaser under this section.

1 * * *

2
3 **Section 8-501. Securities Account; Acquisition of Security Entitlement from**
4 **Securities Intermediary.**

5 * * *

6 (d) If a securities intermediary holds a financial asset for another person, and the other A
7 person is treated as holding the a financial asset directly rather than as having a security
8 entitlement with respect to the financial asset if:

9 (1) the financial asset is registered in the name of, payable to the order of, or
10 specially indorsed to the ~~other~~ person, and has not been indorsed to the securities intermediary or
11 in blank, or

12 ~~(2) if the financial asset is a controllable account, controllable electronic record,~~
13 ~~controllable payment intangible, [electronic document of title,] [or] electronic money[, or an~~
14 ~~electronic copy of a record evidencing chattel paper] and the securities intermediary and the~~
15 ~~other person each has control of the financial asset~~ the other person is treated as holding the
16 financial asset directly rather than as having a security entitlement with respect to the financial
17 asset. ; or

18 (2) the financial asset is a controllable account, controllable electronic record,
19 controllable payment intangible, [electronic document of title,] [or] electronic money[, or an
20 electronic copy of a record evidencing chattel paper] and both the securities intermediary and the
21 person each have control of the financial asset under Section 7-106, 9-105, 9-105A, 9-107A, or
22 12-105.

23 * * *

24 **Reporter's Note**

1 1. *Financial assets held for a person other than an entitlement holder.* The proposed
2 amendment of subsection (d) would address assets subject to control that might be held by a
3 securities intermediary for a person other than an entitlement holder. Subsection (d) generally
4 applies to “customer name securities” (see 15 U.S. Code § 7811(3)) that are held directly by a
5 securities intermediary’s customer. However, ~~that~~ subsection (d) uses terminology applicable to
6 conventional securities (e.g., “indorsed”). The proposed amendment would treat situations of
7 shared control between a securities intermediary and its customer as analogous to such customer
8 name securities.

9
10 2. As indicated by the terms placed in square brackets in subsection (d)(2), the Drafting
11 Committee should consider which assets that are subject to control under the Uniform
12 Commercial Code should be covered by the new provision.

13 14 **ARTICLE 9**

15 **SECURED TRANSACTIONS**

16 **Reporter’s Prefatory Note to Article 9 Amendments**

17 1. *General.* This draft proposes extensive amendments to Article 9. Many of the
18 amendments are necessary to conform Article 9 to new Article 12, which, along with its
19 Reporter’s Notes, should be read along with the Article 9 amendments and Reporter’s Notes.
20 Other material amendments relate to chattel paper and money.

21
22 2. *Article 12-related conforming amendments.* Article 12-related conforming
23 amendments to Article 9 include the addition of two new types of collateral: controllable
24 accounts (a subset of accounts) and controllable payment intangibles (a subset of payment
25 intangibles, which is a subset of general intangibles). Perfection of a security interest in a
26 controllable electronic record, controllable account, or controllable payment intangible may be
27 by control or by filing a financing statement. Control of a controllable electronic record is
28 determined under draft § 12-105. Control of a controllable account or controllable payment
29 intangible is achieved by obtaining control of the controllable electronic record that evidences
30 the account or payment intangible. Draft § 9-107A. The rights of a secured party that takes free
31 of competing property interests as a qualifying purchaser of a controllable account, controllable
32 electronic record, or controllable payment intangible are respected under Article 9. Draft § 9-
33 331.

34
35 The law of the controllable record’s jurisdiction under draft 12-107 governs perfection
36 by control and priority of a security interest in a controllable account, controllable electronic
37 record, or controllable payment intangible. The law of the jurisdiction in which a debtor is
38 located governs perfection by filing for such collateral. Draft § 9-306A.

39
40 The draft also contains several other Article 12-related conforming amendments to
41 Article 9.

42
43 3. *Chattel paper-related amendments.* These amendments primarily address two issues

1 that have arisen with respect to transactions in chattel paper.

2
3 First, the definition of “chattel paper” creates uncertainty in “bundled” transactions in
4 which monetary obligations exist not only under a lease of goods but also with respect to
5 software and services relating to the leased goods. Frequently, the value of the non-goods aspect
6 of a transaction is substantially greater than the value of the lessee’s rights under the lease of
7 goods. Those who finance chattel paper and other rights to payment have become uncertain as to
8 whether these transactions give rise to chattel paper. The draft resolves this issue by treating only
9 those transactions whose predominant purpose was to give the obligor (lessee) the right to
10 possession and use of the goods as giving rise to “chattel paper.”
11

12 Second, the statutory distinction between “tangible chattel paper” and “electronic chattel
13 paper” causes practical problems. As to tangible chattel paper (i.e., evidenced by writings),
14 problems arose in the case of multiple originals of writings and situations in which separate
15 writings covered different components of chattel paper. Official comments issued in connection
16 with the 1999 amendments to Article 9 addressed these issues. As to electronic chattel paper, the
17 safe harbor for control is based on a “single authoritative copy” of the chattel paper. Moreover,
18 in some situations tangible chattel paper is converted to electronic form and electronic chattel
19 paper is converted to tangible form. Additional uncertainty exists when one or more records
20 referred to in the current definition comprise one or more tangible authoritative copies of the
21 records that evidence the right to payment and rights in related property and one or more
22 electronic authoritative copies of those records also exist.
23

24 The draft provides a single rule, under which a security interest in chattel paper can be
25 perfected by taking possession of the tangible authoritative copies, if any, and obtaining control
26 of the electronic authoritative copies, if any. This single rule would address cases where some
27 records evidencing chattel paper are electronic and some are tangible or where a record in one
28 medium is replaced by a record in another.
29

30 The draft also defines chattel paper more accurately, as the right to payment of a
31 monetary obligation that is secured by a security interest in specific goods or owed under a lease
32 of specific goods, if the right to payment and interest in the goods are evidenced by a record.
33

34 4. Money-related amendments 35

36 Section 1-201(b)(24) defines “money” as including “a medium of exchange currently
37 authorized or adopted by a domestic or foreign government” There is no way of knowing
38 how money in an intangible form might develop, but there are indications that some countries
39 might authorize or adopt intangible tokens as a medium of exchange and others might authorize
40 or adopt deposit accounts with a central bank as money.¹ For many purposes, there is no need
41 for the UCC to distinguish among types of money. For Article 9 purposes, however, distinctions
42 must be drawn. Only tangible money is susceptible of perfection by possession. And the steps
43 needed for perfection by control with respect to intangible tokens, such as controllable electronic
44 records, will not work for deposit accounts with a central bank, and vice versa. For this reason,

¹ These accounts sometimes are referred to as central bank digital currency or CBDC.

1 the draft provides a new definition of “money” for purposes of Article 9 that expressly excludes
2 deposit accounts. Thus, “electronic money,” defined in draft § 9-102 as “money~~that exists~~ in an
3 electronic form,” would not include deposit accounts.

4
5 The existing Article 9 provisions governing “deposit accounts” would remain suitable for
6 accounts with a central bank, even if a government has adopted these accounts as money. The
7 draft makes no changes with respect to Article 9’s treatment of these accounts, aside from
8 distinguishing them from “money” and therefore from “electronic money.” Under the draft, a
9 security interest in electronic money as original collateral can be perfected only by control. The
10 requirements for obtaining control of electronic money are the same as those for obtaining
11 control of a controllable electronic record under draft Article 12.

12
13 The draft also makes changes to the take-free rules for transferees of money, including
14 the addition of a new rule applicable to electronic money, and transferees of funds from deposit
15 accounts.

16 **Section 9-102. Definitions and Index of Definitions.**

17
18 (a) [Article 9 definitions.] In this article:

19 * * *

20 (2) “Account”, except as used in “account for”, “on account of”, and paragraph
21 (29), means a right to payment of a monetary obligation, whether or not earned by performance,
22 (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of,
23 (ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued,
24 (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be
25 provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of
26 the use of a credit or charge card or information contained on or for use with the card, or (viii) as
27 winnings in a lottery or other game of chance operated or sponsored by a State, governmental
28 unit of a State, or person licensed or authorized to operate the game by a State or governmental
29 unit of a State. The term includes controllable accounts and health-care-insurance receivables.
30 The term does not include (i) ~~rights to payment evidenced by chattel paper or an instrument,~~
31 chattel paper, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v)

letter-of-credit rights or letters of credit, ~~or~~ (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the ~~card~~ card, or (vii) rights to payment evidenced by an instrument.

* * *

(6A) “Assignee” means a person ~~(i)~~:

(A) in whose favor a security interest that secures an obligation is created or provided for under a security agreement, whether or not an obligation to be secured is outstanding ~~or (ii) to which accounts, chattel paper, payment intangibles, or promissory notes have been sold; or~~

(B) to which an account, chattel paper, payment intangible, or promissory note has been sold.

(6B) “Assignor” means a person that ~~(i)~~:

(A) under a security agreement creates or provides for a security interest that secures an obligation; or ~~(ii)~~

(B) sells ~~accounts~~an account, chattel paper, payment ~~intangibles~~ intangible, or promissory ~~notes~~note.

* * *

(11) “Chattel paper” ~~means: a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this paragraph, “monetary obligation” means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to~~

software used in the goods. means:

(A) a right to payment of a monetary obligation secured [under a security agreement] by specific goods, if the right to payment and security agreement are evidenced by a record; or

(B) a right to payment of a monetary obligation owed by a lessee under a lease agreement with respect to specific goods and a monetary obligation, ~~if any,~~ owed by the lessee in connection with the transaction giving rise to the lease, if:

(i) the right to payment and lease agreement are evidenced by a record; and

(ii) the predominant purpose of the transaction giving rise to the lease was to give the lessee the right to possession and use of the goods.

~~The term does not include (i) charters or other contracts involving the use or hire of a vessel or (ii) records that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card. If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper.~~

The term does not include (i) a right to payment arising out of a charter or other contract involving the use or hire of a vessel or (ii) a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

~~**Legislative Note:** Replicate the formatting of the tabulated material in subsection (a)(11) exactly to ensure that the meaning of the material is preserved.~~

* * *

(27A) “Controllable account” means an account evidenced by a controllable electronic record that provides that the account debtor undertakes to pay the person that has

~~control~~ under Section 12-105 has control of the controllable electronic record.

(27B) “Controllable payment intangible” means a payment intangible evidenced by a controllable electronic record that provides that the account debtor undertakes to pay the person that ~~has control~~ under Section 12-105 has control of the controllable electronic record.

* * *

(29) “Deposit account” means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.

* * *

(31A) “Electronic money” means money ~~that exists~~ in an electronic form.

* * *

(47) “Instrument” means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, ~~or~~ (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card, or (iv) writings that evidence chattel paper.

* * *

(54A) “Money” has the meaning provided in Article Section 1, ~~except that the term 201(24), but~~ does not include a deposit account.

* * *

(61) “Payment intangible” means a general intangible under which the account

debtor's principal obligation is a monetary obligation. The term includes a controllable payment
intangibles intangible.

* * *

(64) "Proceeds", except as used in Section 9-609(b), means the following
property:

(A) whatever is acquired upon the sale, lease, license, exchange, or other
disposition of collateral;

(B) whatever is collected on, or distributed on account of, collateral;

(C) rights arising out of collateral;

(D) to the extent of the value of collateral, claims arising out of the loss,
nonconformity, or interference with the use of, defects or infringement of rights in, or damage to,
the collateral; or

(E) to the extent of the value of collateral and to the extent payable to the
debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects
or infringement of rights in, or damage to, the collateral.

* * *

(79A) "Tangible money" means money ~~that exists~~ in a tangible form.

(b) **[Definitions in other articles.]** The following definitions in other articles apply to
this article:

* * *

"Controllable electronic record" Section 12-102.

* * *

"Qualifying purchaser" Section 12-~~104~~ 102.

1 * * *

2 ***Legislative Note:** Replicate the formatting of the tabulated material in subsection (a)(11) exactly*
3 ***to ensure that the meaning of the material is preserved.***

4
5 **Official Comment**

6 * * *

7 **5. Receivables-related Definitions.**

8 * * *

9 b. **“Chattel Paper”**; **“Electronic Chattel Paper”**; **“Tangible Chattel Paper.”** “Chattel
10 paper” consists of a monetary obligation together with a security interest in or a lease of specific
11 goods if the obligation and security interest or lease are evidenced by “a record or records.”
12 ~~“Chattel paper” consists of a monetary obligation that is either secured by specific goods or~~
13 ~~arises in connection with a lease of specific goods. .”~~ The definition has been expanded from
14 that found in former Article 9 to include records that evidence a monetary obligation and a
15 security interest in specific goods and software used in the goods, a security interest in specific
16 goods and license of software used in the goods, or a lease of specific goods and license of
17 software used in the goods. The expanded definition covers transactions in which the debtor’s or
18 lessee’s monetary obligation includes amounts owed with respect to software used in the goods.
19 The monetary obligation with respect to the software need not be owed under a license from the
20 secured party or lessor, and the secured party or lessor need not be a party to the license
21 transaction itself. Among the types of monetary obligations that are included in “chattel paper”
22 are amounts that have been advanced by the secured party or lessor to enable the debtor or lessee
23 to acquire or obtain financing for a license of the software used in the goods. The definition also
24 makes clear that rights to payment arising out of credit card transactions are not chattel paper.
25 ~~The definition~~ **“Chattel paper” consists of a monetary obligation that is either secured by specific**
26 **goods or arises in connection with a lease of specific goods. The term** also includes a monetary
27 obligation and a security interest in specific goods and software used in the goods, a security
28 interest in specific goods and license of software used in the goods, or a lease of specific goods
29 and license of software used in the goods. ~~The definition term~~ covers transactions in which the
30 debtor’s or lessee’s monetary obligation includes amounts owed with respect to software used in
31 the goods. The monetary obligation with respect to the software need not be owed under a
32 license from the secured party or lessor, and the secured party or lessor need not be a party to the
33 license transaction itself. The monetary obligation itself need not relate to the goods. For
34 example, a loan secured by specific goods and evidenced by one or more records creates chattel
35 paper regardless of the purpose of the loan.

36
37 What distinguishes chattel paper from other rights to payment is the fact that creditor has
38 an interest in specific goods to enforce the right to payment. The fact that the creditor also has an
39 interest in other property does not prevent the right to payment from being chattel paper.

40
41 **Example 8.** To secure a loan, Borrower grants Lender a security interest in a specified

1 item of equipment and a deposit account. The loan and the security interest are evidenced
2 by one or more records. The right to payment is chattel paper.

3 One

4 On the other hand, to be chattel paper, a right to payment must be accompanied by a security
5 interest in *specific* goods or a lease of *specific* goods. A right to payment secured by a security
6 interest in rotating collateral is not chattel paper.

7
8 **Example 9.** To secure a loan, Borrower grants Lender a security interest in all of
9 Borrower's existing and after-acquired inventory. The loan and the security interest are
10 evidenced by one or more records. The right to payment is not chattel paper.

11
12 A right to payment arising from a lease of specific goods gives rise to chattel paper only
13 if the predominant purpose of the transaction is to provide the lessee the right to possession and
14 use of the goods. Therefore, under paragraph (11)(B)(ii), when a lease of specific goods is
15 combined with an obligation to provide or right to receive other property or services, the
16 resulting right to payment will be chattel paper only if the goods aspect of the transaction
17 predominates.

18
19 **Example 10.** In one or more authenticated records, Customer and Car Dealer enter into a
20 transaction pursuant to which, in exchange for a payment of \$2,000 per month:
21 (i) Customer is entitled to possession of a specific vehicle for 36 months; (ii) Car Dealer
22 will provide round-the-clock monitoring of the vehicle's location and condition, and alert
23 authorities to provide road-side assistance in the event of a malfunction or accident; and
24 (iii) Car Dealer will, from time to time, remotely update the vehicle's automobile's
25 operating system. The value of the right to possess and use the vehicle is significantly
26 greater than the value of the monitoring service and updates. Because the goods aspect of
27 the transaction predominates, Customer's monetary obligation, including the portion
28 attributable to Car Dealer's obligation to provide monitoring and updates, constitutes
29 chattel paper.

30
31 **Example 11.** In one or more authenticated records, Customer and Cableco enter into a
32 transaction pursuant to which, in exchange for a payment of \$200 per month, Cableco
33 will provide Customer with specified television programming and a device needed to
34 access the programming (a "lease" of the device). If the components of the transaction
35 were priced separately, the price for the programming would be nine times the price for
36 possession and use of the device. Because the goods aspect of this transaction does not
37 predominate, Customer's monetary obligation does not constitute chattel paper.

38
39 Charters of vessels are expressly excluded from the definition of chattel paper; they are
40 accounts. The term "charter" as used in this section includes bareboat charters, time charters,
41 successive voyage charters, contracts of affreightment, contracts of carriage, and all other
42 arrangements for the use of vessels.

43
44 ~~Under former Section 9-105, only if the evidence of an obligation consisted of "a writing~~
45 ~~or writings" could an obligation qualify as chattel paper. In this Article, traditional, written~~
46 ~~chattel paper is included in the definition of "tangible chattel paper." "Electronic chattel paper"~~

1 is chattel paper that is stored in an electronic medium instead of in tangible form. The concept of
2 an electronic medium should be construed liberally to include electrical, digital, magnetic,
3 optical, electromagnetic, or any other current or similar emerging technologies.

4
5 The latest revision to the definition of “chattel paper” changed the language from “a
6 record or records that evidence a monetary obligation” to “a right to payment of a monetary
7 obligation . . . evidenced by a record.” This semantic change was for clarification purposes only;
8 it ~~implies no~~ **does not imply** a change in meaning. Chattel paper is and has always been a right to
9 payment of a monetary obligation. Because the revised definition is based on the obligation,
10 rather than the record, the definition no longer includes the following statement, which was
11 previously part of the definition: “If a transaction is evidenced by records that include an
12 instrument or series of instruments, the group of records taken together constitutes chattel
13 paper.” The omission of that statement also ~~implies no~~ **does not imply** a change in meaning,
14 except that records (writings) evidencing chattel paper are excluded from the definition of
15 “instrument” under draft § 9-102(a)(47). Although the definition refers to “a record,” chattel
16 paper can be evidenced by one or more records. ~~Under because, under~~ Section 1-106, unless the
17 statutory context otherwise requires, words in the singular number include the plural.

18 19 **Reporter’s Note**

20
21 1. “*Account.*” The draft redefines “chattel paper” to mean a right to payment rather than
22 a record evidencing a right to payment. The amendments to the definition of “account” reflect
23 the redefinition. The definition also includes a new exception for the use of the term in the
24 definition of “deposit account.”

25
26 2. “*Assignor*”; “*assignee*”. Instead of referring to a “debtor,” “secured party,” and
27 “security interest,” all of which terms are defined in the UCC, several provisions of Article 9,
28 including Part 4, refer to an “assignor,” “assignee,” and “assignment,” or sometimes an
29 “assigned contract,” none of which terms are defined in the UCC. Some courts read the
30 undefined terms in an unduly narrow way. In 2020, the Permanent Editorial Board for the UCC
31 issued a Commentary clarifying the meanings of these terms and amended the official comments
32 accordingly. *PEB Commentary No. 21, Use of the Term “Assignment” in Article 9 of the*
33 *Uniform Commercial Code* (Mar. 11, 2020). New subsections (6A) and ~~6(B)~~ (6B) incorporate the
34 essence of the Commentary into the statutory text.

35
36 3. “*Chattel paper.*” Under the revised definition, “chattel paper” is a right to payment
37 rather than a record evidencing a right to payment. Records evidencing chattel paper remain
38 relevant to perfection of a security interest in chattel paper. *See* draft § 9-314A.

39
40 The right to payment that constitutes “chattel paper” under subsection (a)(11)(B) may
41 include the right to payment of a variety of “bundled” monetary obligations owed by a lessee of
42 specific goods. These obligations may include obligations arising in connection with the
43 transaction giving rise to the lease, such as obligations for software or services. However, to
44 constitute “chattel paper,” these obligations must include the right to payment of a monetary
45 obligation owed by the lessee under the lease agreement.

1 A right to payment is not “chattel paper” under ~~section~~ subsection (a)(11)(B) unless the
2 predominant purpose of the transaction giving rise to the lease was to give the lessee the right to
3 possession and use of the goods. The draft official comment explains the predominant-purpose
4 test and gives examples of its application.

5
6 4. “*Controllable account*”; “*controllable payment intangible*.” The draft affords special
7 treatment to security interests in controllable accounts and controllable payment intangibles, *i.e.*,
8 those accounts and payment intangibles that are evidenced by a controllable electronic record
9 that provides that the account debtor (obligor) undertakes to pay the person having control of the
10 controllable electronic record. (Of course, a person would be an account debtor only if it were
11 actually obligated on the underlying account or payment intangible.) An undertaking to pay the
12 “person that has control” means an undertaking to pay the person that has control at the time
13 payment is made. An undertaking to pay Smith, who happens to have control of the relevant
14 controllable electronic record at the time the undertaking was made, is not an undertaking to pay
15 the person that has control.

16
17 This special treatment includes the following:

- 18
19 • Perfection of a security interest in a controllable account or controllable payment
20 intangible can be achieved by filing a financing statement or obtaining control of the
21 controllable electronic record that evidences the controllable account or controllable
22 payment intangible. Draft §§ 9-312(a); 9-314(a); 9-107A(b).
- 23
24 • A security interest in a controllable electronic record, controllable account, or
25 controllable payment intangible that is perfected by control has priority over a
26 conflicting security interest that is perfected by another method. Draft § 9-326A.
- 27
28 • The benefit of the take-free and no-action rules for qualifying purchasers (including
29 secured parties) of controllable electronic records also ~~extend~~ extends to qualifying
30 purchasers of controllable accounts and controllable payment intangibles, whether or
31 not the qualifying purchaser also purchases the related controllable electronic record.
32 See draft § 12-104(a)-) and Reporter’s Notes 6 and 7.
- 33

34 5. “*Deposit account*.” This definition is not changed and is provided here for
35 convenience of reference.

36
37 6. “*Electronic money*” and “*tangible money*.” As the Reporter’s Prefatory Note to
38 Article 9 Amendments observes, some countries may authorize or adopt intangible tokens as a
39 medium of exchange that would be “money” as defined (and as proposed to be defined) in both
40 Article 1 and Article 9. Such intangible tokens would be “electronic money” as defined in draft §
41 9-102(a)(31A). Under the draft, a security interest in electronic money as original collateral can
42 be perfected only by control. Draft §§ 9-105A; 9-312(b)(4). The requirements for obtaining
43 control of electronic money are essentially the same as those for obtaining control of a
44 controllable electronic record under draft Article 12. The definition of “tangible money” uses the
45 word “tangible” with its normal meaning (as something that does have physical or corporeal
46 existence, such as goods).

1 7. *“Instrument.”* The change to the definition of “instrument” makes it clear that the
2 definition excludes an instrument that is a record included in the definition of “chattel paper.”
3 Note that while in many places in the UCC the term “writing” has been and is proposed to be
4 replaced by the technology neutral term, “record,” instruments (under both Articles 3 and 9)
5 must be “written” and in “writing.”
6

7 8. *Money and deposit accounts under Article 9.* As observed in the Reporter’s Prefatory
8 Note to Article 9 Amendments, some countries may authorize or adopt deposit accounts with a
9 central bank as a form of “money,” as defined in Section 1-201(b)(24) (and as that definition is
10 proposed to be revised in the draft). However, the existing Article 9 provisions governing
11 “deposit accounts” would remain suitable for such accounts with a central bank, even if a
12 government has adopted these accounts as money. The draft makes no changes with respect to
13 Article 9’s treatment of deposit accounts. However, *for purposes of Article 9* and in the interest
14 of clarity, the definition of “money” in draft § 9-102(a)(31A) excludes deposit accounts. Under
15 this definition, deposit accounts would not be money for Article 9 purposes even if they were to
16 become money under the Article 1 definition.
17

18 The principal function of the Article 9 definition of “money” is to ensure that even if
19 some deposit accounts were to become “money” as defined in Article 1, the provisions relating
20 to perfection and priority for security interests in deposit accounts, and not those for money, will
21 apply. It will be necessary to ensure that this definitional strategy does not cause any difficulties
22 for other provisions of Article 9, such as references to the cognate term “monetary.” The current
23 thinking is that this will not be problematic.
24

25 9. *Proceeds.* 26

27 a. *No change to definition of proceeds.* No change to the definition of “proceeds” is
28 proposed and the definition is provided here for convenience of reference.
29

30 b. *“Fork” involving controllable electronic record.* Sometimes there occurs a change in
31 the software (code) of a system (sometimes referred to as a “protocol” or “platform”) in which a
32 controllable electronic record is recorded. When such a change occurs in a blockchain platform,
33 the blockchain may remain intact, no new blockchain may result, and the change sometimes is
34 colloquially referred to as a “soft fork.” If such a change results in a new, separate blockchain
35 that exists alongside the original blockchain and a new controllable electronic record is created,
36 the change is sometimes referred to as a “hard fork.” But the terms “fork,” “soft fork,” and “hard
37 fork” are ambiguous and not used consistently. Even in a hard fork situation the pre-fork
38 controllable electronic record typically would remain intact (although its value might be
39 affected). However, a person in control of the original record may not automatically obtain
40 control of a new record. Additional steps may be required for the person in control to claim and
41 obtain control of the new record.
42

43 c. *New controllable electronic record as proceeds.* Depending on the nature and structure
44 of the fork, a new controllable electronic record arising under a hard fork may be property
45 “distributed on account of” the original record or “rights arising out of” the original record,
46 thereby constituting proceeds of the original record under subparagraph (B) or (C), or both, of

1 the definition of “proceeds.” If the new record is “proceeds,” then the rules on attachment,
2 perfection, priority under Sections 9-203(f), 9-315, and 9-322 would apply. If a security interest
3 in the original record is perfected by control, the creation of the new record in connection with a
4 hard fork typically results in the secured party obtaining control (or having the opportunity to
5 obtain control) of the new record. If that is not the case and perfection of the security interest in
6 the original record is only by control, however, then perfection would continue in the new record
7 only until the 21st day after the security interest attaches to the new record, unless one of the
8 exceptions under subsection (d) applies. Section 9-315(c), (d). For this reason, a secured party
9 may wish to perfect its security interest by filing so that the perfection would continue thereafter
10 in any proceeds under Section 9-315(d)(1). A secured party that does so may, to ensure the
11 priority of its perfected security interest, also wish to consider obtaining a release or
12 subordination from any earlier filed secured party whose financing statement covers the same
13 type of property. Even if that is achieved, a security interest in the record that is later perfected
14 by control would have priority over a security interest perfected by filing. Draft § 9-326A.

15
16 d. “Airdrops” of controllable electronic records. New controllable electronic records also
17 may be provided to persons in control of existing records by way of an “airdrop” that does not
18 involve a fork in an existing blockchain. Depending on the circumstances, these new records
19 may or may not be proceeds of the existing, original record.

20
21 e. *New controllable electronic record as financial asset credited to securities account.* If
22 the original record were a financial asset credited to a securities account, the new record might
23 become proceeds of a security entitlement for the reasons described in Note 89.c. Because the
24 securities intermediary (and not the entitlement holder) in such a situation presumably would
25 have control of the original record, the question sometimes arises as to whether the intermediary
26 has any duty to obtain or maintain control of the new record for the benefit of its entitlement
27 holder (and indirectly for the benefit of the holder of a security interest in the security
28 entitlement). The Drafting Committee has not yet considered that issue.

29
30 * * *

31 **Section 9-104. Control of Deposit Account.**

32 **(a) [Requirements for control.] A secured party has control of a deposit account if:**

33 (1) the secured party is the bank with which the deposit account is maintained;

34 (2) the debtor, secured party, and bank have agreed in an authenticated record that

35 the bank will comply with instructions originated by the secured party directing disposition of
36 the funds in the deposit account without further consent by the debtor; ~~or~~

37 (3) the secured party becomes the bank’s customer with respect to the deposit
38 account; ~~or~~

1 (4) another person, other than the debtor:

2 (A) has control of the deposit account and acknowledges that it has control
3 on behalf of the secured party; or

4 (B) obtains control of the deposit account after having acknowledged that
5 it will obtain control of the deposit account on behalf of the secured party.

6 (b) [Debtor's right to direct disposition.] A secured party that has satisfied subsection
7 (a) has control, even if the debtor retains the right to direct the disposition of funds from the
8 deposit account.

9 **Reporter's Note**

10 *Control on behalf of another person.* Draft subsection (a)(4) provides for a secured party
11 to obtain control of a deposit account by virtue of the acknowledgment by another person, other
12 than the debtor, in control of the deposit account. It follows the corresponding provisions for
13 control of electronic documents of title (draft § 7-106), control of an electronic copy of a record
14 evidencing chattel paper (draft § 9-105-), control of electronic money (draft § 9-105A), and
15 control of controllable electronic records (draft § 12-105). For a brief discussion, see draft § 12-
16 105, Reporter's Note 7.

17
18 **Section 9-105. Control of Electronic Chattel Paper.**

19 ~~(a) [General rule: control of electronic chattel paper.] A secured party has control of~~
20 ~~electronic chattel paper if a system employed for evidencing the transfer of interests in the~~
21 ~~chattel paper reliably establishes the secured party as the person to which the chattel paper was~~
22 ~~assigned.~~

23 ~~(b) [Specific facts giving control.] A system satisfies subsection (a) if the record or~~
24 ~~records comprising the chattel paper are created, stored, and assigned in such a manner that:~~

25 ~~(1) a single authoritative copy of the record or records exists which is unique,~~
26 ~~identifiable, and, except as otherwise provided in paragraphs (4), (5), and (6), unalterable;~~

27 ~~(2) the authoritative copy identifies the secured party as the assignee of the record~~

or records;

(3) the authoritative copy is communicated to and maintained by the secured party or its designated custodian;

(4) copies or amendments that add or change an identified assignee of the authoritative copy can be made only with the consent of the secured party;

(5) each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(6) any amendment of the authoritative copy is readily identifiable as authorized or unauthorized.

Section 9-105. Control of Electronic Copy of Record Evidencing Chattel Paper.

[(a) [General rule: control of electronic copy of record evidencing chattel paper.] A secured party purchaser has control of each authoritative electronic copy of a record evidencing chattel paper if a system employed for evidencing the [transfer][assignment] of interests in the chattel paper reliably establishes the secured party purchaser as the person to which the chattel paper was [transferred][assigned].]

(b) [Specific facts giving control.] A secured party also A purchaser has control of an electronic copy of a record evidencing chattel paper if:

(1) the electronic copy, a record attached to or logically associated with the electronic copy, or the a system in which the electronic copy is recorded, if any:

(A) enables the secured party to purchaser readily to identify each electronic copy of the record as an authoritative copy or nonauthoritative copy of the record;

(B) enables the secured party to purchaser readily to identify itself in any way, including by name, identifying number, cryptographic key, office, or account number, as

1 the assignee of each authoritative electronic copy ~~of the record~~; and

2 (C) ~~gives the purchaser exclusive power~~, subject to subsections (c) and

3 (d), ~~gives the secured party the exclusive power to~~:

4 (i) prevent others from ~~[adding to or changing] [altering]~~ an
5 identified assignee of each authoritative electronic copy ~~of the record~~; and

6 (ii) transfer control of the authoritative ~~electronic copy of the~~
7 ~~record~~; or

8 (2) another person, ~~other than the debtor~~:

9 (A) has control of the electronic copy and acknowledges that it has control
10 on behalf of the ~~secured party, purchaser~~; or

11 (B) obtains control of the electronic copy after having acknowledged that
12 it will ~~acquireobtain~~ control of the electronic copy on behalf of the ~~secured party purchaser~~.

13 **(c) [Exception for single authoritative electronic copy of record evidencing chattel**
14 **paper.] ~~If This subsection applies if a single, unique, and identifiable~~ authoritative electronic**
15 **copy of a record evidencing chattel paper ~~which is unique and identifiable~~ exists, then the. The**
16 **requirements of subsection (b)(1)(C) are satisfied if the ~~[addition to or change] [alteration]~~ of an**
17 **identified assignee of the authoritative electronic copy ~~[can] [may]~~ be made only with the**
18 **consent of the secured party.**

19 **(d) [Meaning of exclusive.] A power ~~specified in is exclusive under~~ subsection (b)(1)(C)**
20 **~~is exclusive,~~), even if:**

21 (1) the electronic copy or ~~the a~~ system in which the electronic copy is recorded, ~~if~~
22 ~~any,~~ limits the use ~~to which of~~ the electronic record ~~may be put~~ or has ~~protocols that area~~
23 ~~protocol~~ programmed to ~~result in a~~ transfer ~~of~~ control; or

(2) the secured party has agreed to share the power with another person.

~~(e) [Identification of secured party.] For the purposes of subsection (b)(1)(B), a secured party may be identified in any way, including by name, identifying number, cryptographic key, office, or account number.~~

Reporter's Note

1. *The function of control.* Under the draft, as under current law, a secured party can perfect a security interest in chattel paper by filing. *See* Section 9-312(a). Alternatively, a secured party can perfect a security interest in chattel paper by taking possession of all ~~tangible~~ authoritative tangible copies of the record evidencing the chattel paper and obtaining control of all ~~electronic~~ authoritative electronic copies. *See* draft § 9-314A.

2. *Conditions for obtaining control.* As explained in the preceding Note, control relates to perfection of a security interest in chattel paper. One method of perfecting a security interest in chattel paper is to take possession of all tangible authoritative copies of the record evidencing the chattel paper and obtain control of all electronic records. Perfection generally serves the function of enabling the public to determine that the asset in question (here, chattel paper) may be encumbered with a security interest.

The amended definition of “control” is meant to reflect the functions that possession serves with respect to writings in a more accurate and technologically flexible way than does the current definition.

To show that it has possession of all tangible authoritative copies of a record evidencing chattel paper, a secured party can produce the copies in its possession and provide evidence that these are authoritative copies. The secured party need not prove that no other tangible authoritative copies exist. *See* draft § 12-105, Reporter’s Note 8. (The Reporter’s Note to draft § 9-314A explains the meaning of “authoritative copy.”) The secured party’s possession of the tangible authoritative copies gives the secured party the power to prevent others from taking possession of the copies and to transfer possession of the copies.

Under the draft, to obtain control of an electronic copy of a record evidencing chattel paper a secured party must be able to identify each electronic copy as authoritative or nonauthoritative and identify itself as the assignee of each authoritative copy. In addition, the secured party must have the exclusive power to prevent others from adding or changing an identified assignee and to transfer control of the authoritative copies.

The utility of distributed ledger technology (including blockchain technology) depends on there being multiple authoritative copies of a record. The safe harbor under existing Section 9-105(b) contemplates a “single authoritative copy” and so is unavailable when the relevant record is maintained on a blockchain or other distributed ledger. The draft allows a secured party to obtain control when there are multiple authoritative copies.

1 3. *Use of singular.* The draft refers to “record” and “copy.” In any given case, there may
2 be more than one relevant record and more than one copy. Under Section 1-106, unless the
3 statutory context otherwise requires, words in the singular number include the plural.

4
5 4. *Control on behalf of another person.* Draft subsection (b)(2) provides for a secured
6 party to obtain control of an electronic copy by virtue of the ~~acknowledgement~~ acknowledgment
7 by another person in control of the electronic copy. It follows the corresponding provisions for
8 control of electronic documents of title (draft § 7-106), control of electronic money (draft § 9-
9 105A), and control of controllable electronic records (draft § 12-105). For a brief discussion, see
10 draft § 12-105, Reporter’s Note 7.

11
12 5. *Accommodation of systems for control under existing Section 9-105.* Subsections (a)
13 and (c) are intended to ensure that systems for control of electronic chattel paper under existing
14 Section 9-105 will also provide for control under the draft subsection (b)-). Subsection (a)
15 appears in square brackets to indicate that it may not be necessary. It appears that existing
16 systems rely on the “safe harbor” of existing subsection (b) and not on the general rule under
17 subsection (a). With one potential exception, control of electronic chattel paper under an existing
18 system that complies with existing subsection (b) would also satisfy the requirements for control
19 under the draft subsection (b). Subsection (c) provides for this exception.

20
21 6. *Application of section to “purchaser.”* References to a “secured party” in this section
22 have been changed to refer to a “purchaser.” This conforms the terminology to Section 9-330,
23 which conditions non-temporal priority on a “purchaser” obtaining control under this section.
24 This is not a substantive change. See Section 330(a), (b), (c), and (f).

25
26 * * *

27 **Section 9-105A. Control of Electronic Money.**

28 (a) **[General rule: control of electronic money.]** A person has control of electronic
29 money if ~~the following conditions are met:~~

30 (1) the electronic money or ~~the~~ a system in which the electronic money is
31 recorded, ~~if any,~~ gives the person:

32 (A) the power to avail itself of substantially all the benefit from the
33 electronic money; and

34 (B) ~~exclusive power,~~ subject to subsection (b), ~~the exclusive power~~ to:

35 (i) prevent others from availing themselves of substantially all the
36 benefit from the electronic money; and

1 (ii) transfer control of the electronic money to another person or
2 cause another person to obtain control of ~~other~~ electronic money ~~that is traceable to as a result of~~
3 ~~the transfer of~~ the electronic money; and

4 (2) the electronic money, a record attached to or logically associated with the
5 electronic money, or ~~the a~~ system in which the electronic money is recorded, ~~if any,~~ enables the
6 person ~~to readily to~~ identify itself ~~as having the powers under subsection (a)(1). The person may~~
7 ~~be identified~~ in any way, including by name, identifying number, cryptographic key, office, or
8 account number, ~~as having the powers under paragraph (1).~~

9 (b) **[Control through another person.]** A person ~~also~~ has control of electronic money if
10 another person, ~~other than the transferor of an interest in the electronic money:~~

11 (1) has control of the electronic money and acknowledges that it has control on
12 behalf of the person, or

13 (2) obtains control of the electronic money after having acknowledged that it will
14 ~~acquire~~obtain control of the electronic money on behalf of the person.

15 (c) **[Meaning of exclusive.]** A power ~~specified in~~ ~~is exclusive under~~ subsection (a) ~~is~~
16 ~~exclusive;~~(1)(B), even if:

17 (1) the electronic money or ~~the a~~ system in which the electronic money is
18 recorded, ~~if any,~~ limits the use ~~to which of~~ the electronic money ~~may be put~~ or has ~~protocols that~~
19 ~~area protocol~~ programmed to ~~result in a~~ transfer of control; or

20 (2) the person has agreed to share the power with another person.

21 Reporter's Note

22
23 1. “Control.” A security interest in electronic money as original collateral may be
24 perfected only by control as provided in this section. See draft § 9-312(b)(4). The requirements
25 for obtaining control track those in draft § 12-105. See Reporter's Note to draft § 12-105.
26

Section 9-107A. Control of Controllable Electronic Record, Controllable Account, or Controllable Payment Intangible.

~~(a)~~ (a) **[Control under Section 12-105.]** A secured party has control of a controllable electronic record as provided in Section 12-105.

~~(b)~~ (b) **[Control of controllable account and controllable payment intangible.]** A secured party has control of a controllable account or controllable payment intangible if the secured party has control of the controllable electronic record that evidences the controllable account or controllable payment intangible.

Reporter's Note

1. *Control of controllable electronic records.* This draft provides for perfection by filing and perfection by control as alternative methods of perfection with respect to a controllable electronic record. See draft §§ 9-312; and 9-314. Under draft § 9-107A(a), a secured party has control of a controllable electronic record as provided in draft § 12-105. Under draft § 9-326A, a security interest in a controllable electronic record that is perfected by control has priority over a security interest perfected by another method.

2. ~~*Consequences of control*~~ ***Control*** of controllable account or controllable payment intangible. This draft provides for perfection by filing and perfection by control as alternative methods of perfection with respect to a controllable account or controllable payment intangible. See draft §§ 9-312, 9-314. Under draft § 9-107A(a), a secured party would obtain control of a controllable account or controllable payment intangible by obtaining control of the related controllable electronic record. Under draft § 9-326A, a security interest in a controllable account or controllable payment intangible that is perfected by control would have priority over a security interest perfected by another method.

By definition, a controllable account would be an Article 9 “account,” and a controllable payment intangible would be an Article 9 “payment intangible.” Draft § 9-102. The fact that an account or payment intangible is a controllable account or controllable payment intangible does not affect a secured party’s alternative method of perfection, *i.e.*, filing. Moreover, that fact does not affect the applicability of other provisions of Article 9, including the provisions governing an account debtor’s agreement not to assert defenses (Section 9-403) and the statutory overrides of legal and contractual restrictions on the assignability of accounts and payment intangibles (Sections 9-406 and 9-408).

* * *

Section 9-203. Attachment and Enforceability of Security Interest; Proceeds;

1 **Supporting Obligations; Formal Requisites.**

2 * * *

3 (b) **[Enforceability.]** Except as otherwise provided in subsections (c) through (i), a
4 security interest is enforceable against the debtor and third parties with respect to the collateral
5 only if:

6 (1) value has been given;

7 (2) the debtor has rights in the collateral or the power to transfer rights in the
8 collateral to a secured party; and

9 (3) one of the following conditions is met:

10 * * *

11 (C) the collateral is a certificated security in registered form and the
12 security certificate has been delivered to the secured party under Section 8-301 pursuant to the
13 debtor's security agreement; ~~or~~

14 (D) the collateral is controllable accounts, controllable electronic records,
15 controllable payment intangibles, deposit accounts, ~~electronic chattel paper, electronic~~
16 documents, electronic money, investment property, or letter-of-credit rights, ~~or electronic~~
17 documents, and the secured party has control under Section 7-106, 9-104, 9-105A, 9-106, ~~or~~ 9-
18 107, or 9-107A pursuant to the debtor's security agreement; or

19 (E) the collateral is chattel paper and the secured party has possession and
20 control under Section 9-314A pursuant to the debtor's security agreement.

21 **Reporter's Note**

22 ~~1-.~~ *Substitute for authenticated security agreement.* Under existing subparagraphs
23 (b)(3)(B) and (b)(3)(D), possession of tangible collateral and control of intangible collateral may
24 substitute for an authenticated security agreement that provides a description of the collateral.
25 With respect to chattel paper, some of the authoritative records that evidence the right to

1 payment may be tangible and some electronic. Accordingly, new subparagraph (b)(3)(E) would
2 provide that possession of the tangible authoritative records, if any, and control of the electronic
3 records, if any, may substitute for an authenticated security agreement.

4
5 ***

6
7 **Section 9-204. After-Acquired Property; Future Advances.**

8 **(a) [After-acquired collateral.]** Except as otherwise provided in subsection (b), a
9 security agreement may create or provide for a security interest in after-acquired collateral.

10 **(b) [When after-acquired property clause not effective.]** A security interest does not
11 attach under a term constituting an after-acquired property clause to:

12 (1) consumer goods, other than an accession when given as additional security,
13 unless the debtor acquires rights in them within 10 days after the secured party gives value; or

14 (2) a commercial tort claim.

15 **(c) [Limitation on subsection (b).]** Subsection (b) does not prevent a security interest
16 from attaching:

17 (1) to consumer goods under Section 9-315(a) or Section 9-336(c);

18 (2) to a commercial tort claim under Section 9-315(a); or

19 (3) under an after-acquired property clause to property that is proceeds of
20 consumer goods or a commercial tort claim.

21 ~~**(e)(d) [Future advances and other value.]**~~ A security agreement may provide that
22 collateral secures, or that accounts, chattel paper, payment intangibles, or promissory notes are
23 sold in connection with, future advances or other value, whether or not the advances or value are
24 given pursuant to commitment.

25 **Reporter's Note**

26 The proposed revision would clarify the appropriate result when a debtor acquires
27 consumer goods or a commercial tort claim as proceeds of collateral and when a consumer

1 acquires an interest in commingled goods. This clarification would override the erroneous
2 holdings of several cases addressing commercial tort claims that are proceeds.

3
4 * * *

5 **Section 9-207. Rights and Duties of Secured Party Having Possession or Control**
6 **of Collateral.**

7 * * *

8 (c) **[Duties and rights when secured party in possession or control.]** Except as
9 otherwise provided in subsection (d), a secured party having possession of collateral or control of
10 collateral under Section 7-106, 9-104, 9-105, 9-105A, 9-106, ~~or~~ 9-107, or 9-107A:

11 (1) may hold as additional security any proceeds, except money or funds, received
12 from the collateral;

13 (2) shall apply money or funds received from the collateral to reduce the secured
14 obligation, unless remitted to the debtor; and

15 (3) may create a security interest in the collateral.

16 * * *

17 **Reporter's Note**

18 ~~4.~~ *New methods of control.* Cross-references have been added to reflect the new methods
19 of “control” for electronic money (draft § 9-105A) and for controllable electronic records,
20 controllable accounts, and controllable payment intangibles (draft § 9-107A).

21
22 **Section 9-208. Additional Duties of Secured Party Having Control of Collateral.**

23 (a) **[Applicability of section.]** This section applies to cases in which there is no
24 outstanding secured obligation and the secured party is not committed to make advances, incur
25 obligations, or otherwise give value.

26 (b) **[Duties of secured party after receiving demand from debtor.]** Within 10 days
27 after receiving an authenticated demand by the debtor:

1 * * *

2 (3) a secured party, other than a buyer, having control of electronic chattel paper
3 under Section 9-105 shall:

4 (A) communicate the authoritative copy of the electronic chattel paper to
5 the debtor or its designated custodian;

6 (B) if the debtor designates a custodian that is the designated custodian
7 with which the authoritative copy of the electronic chattel paper is maintained for the secured
8 party, communicate to the custodian an authenticated record releasing the designated custodian
9 from any further obligation to comply with instructions originated by the secured party and
10 instructing the custodian to comply with instructions originated by the debtor; and

11 (C) take appropriate action to enable the debtor or its designated custodian
12 to make copies of or revisions to the authoritative copy which add or change an identified
13 assignee of the authoritative copy without the consent of the secured party; and

14 (3) a secured party, other than a buyer, having control under Section 9-105 of an
15 electronic copy of a record evidencing chattel paper ~~under Section 9-105~~ shall transfer control of
16 the electronic copy to the debtor or ~~to~~ a person designated by the debtor;

17 * * *

18 (6) a secured party having control of an electronic document shall:

19 (A) give control of the electronic document to the debtor or its designated
20 custodian;

21 (B) if the debtor designates a custodian that is the designated custodian
22 with which the authoritative copy of the electronic document is maintained for the secured party,
23 communicate to the custodian an authenticated record releasing the designated custodian from

1 any further obligation to comply with instructions originated by the secured party and instructing
2 the custodian to comply with instructions originated by the debtor; and

3 ~~(C) take appropriate action to enable the debtor or its designated custodian~~
4 ~~to make copies of or revisions to the authoritative copy which add or change an identified~~
5 ~~assignee of the authoritative copy without the consent of the secured party;~~

6 (6) a secured party having control under Section 7-106 of an authoritative copy of
7 an electronic document of title under Section 7-106 shall transfer control of the authoritative
8 copy to the debtor or to a person designated by the debtor;

9 (7) a secured party having control of electronic money under Section 9-105A of
10 electronic money shall transfer control of the electronic money to the debtor or to a person
11 designated by the debtor; and.

12 (8) a secured party having control under Section 12-105 of a controllable
13 electronic record under 12-105 shall transfer control of the controllable electronic record to the
14 debtor or to a person designated by the debtor.

15 Reporter's Note

16 ~~1.~~ *New methods of control.* Provisions have been modified or added to take account of the
17 new methods of "control" for chattel paper, electronic documents, electronic money, and
18 controllable electronic records.

19 * * *

21 Section 9-301. Law Governing Perfection and Priority of Security Interests.

22 Except as otherwise provided in Sections 9-303 through 9-~~306~~ 9-306A, the following rules
23 determine the law governing perfection, the effect of perfection or nonperfection, and the priority
24 of a security interest in collateral:

25 (1) Except as otherwise provided in this section, while a debtor is located in a

jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.

(2) ~~While~~ Except as otherwise provided in paragraph (5), while collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a possessory security interest in that collateral.

(3) Except as otherwise provided in paragraph (4), while negotiable tangible documents, goods, instruments, or tangible money, ~~or tangible chattel paper~~ is located in a jurisdiction, the local law of that jurisdiction governs:

(A) perfection of a security interest in the goods by filing a fixture filing;

(B) perfection of a security interest in timber to be cut; and

(C) the effect of perfection or nonperfection and the priority of a nonpossessory security interest in the collateral.

~~(4)~~ * * *

~~f(5)~~ While a ~~tangible~~ authoritative ~~tangible~~ copy of a record evidencing chattel paper is located in a jurisdiction, the local law of that jurisdiction governs:

(A) perfection of a security interest in the chattel paper by possession and control under Section 9-314A; and

(B) the effect of perfection or nonperfection and the priority of a security interest in the chattel paper~~1~~.

Reporter's Note

1. *Choice of governing law.* Under the amended definition of chattel paper, a right to payment and rights in related property may be evidenced by one or more ~~tangible~~-authoritative tangible copies and one or more ~~electronic~~-authoritative electronic copies.

Draft paragraph (5) would address these cases by tying the choice-of-law rules to the authoritative tangible copy. Consequently, the local law of the jurisdiction where the

authoritative tangible copy is physically located would govern perfection of a security interest in the chattel paper by possession and control under Section 9-314A.

The location of the debtor would govern perfection by filing. *See* paragraph (1). However, under paragraph (5), if there is ~~a tangible an~~ authoritative tangible copy, the location of that copy would govern the effect of perfection or nonperfection and the priority of a security interest in the chattel paper.

This approach is modeled on paragraph (3), which is designed to reduce the confusion that might arise when the choice-of-law rules of a given jurisdiction result in each of two conflicting security interests in the same collateral being governed by a different priority rule. *The Drafting Committee plans to reconsider the approach.*

2. Multiple ~~tangible~~ authoritative ~~records~~ tangible copies. Like existing law, paragraph (5) assumes that all the ~~tangible~~ authoritative ~~records~~ tangible copies are located in the same jurisdiction.

* * *

Section 9-306A. Law Governing Perfection and Priority of Security Interests in Controllable Accounts, Controllable Electronic Records, and Controllable Payment Intangibles.

(a) **[Governing law: general rules.]** Except as provided in subsection (b), the local law of the controllable electronic record's jurisdiction as specified in Section 12-107(c) [and (d)] governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a controllable account, controllable electronic record, or controllable payment intangible ~~is governed by the local law of the controllable electronic record's jurisdiction as specified in Section 12-107(c) and (d).~~

(b) **[Governing law: perfection by filing.]** The local law of the jurisdiction in which the debtor is located governs:

(1) perfection of a security interest in a controllable electronic record by filing;

and

(2) automatic perfection of a security interest in a controllable payment intangible

1 created by a sale of the controllable payment intangible.

2 [(c) **[Location of debtor.]** In an action in which the location of the debtor is in issue for
3 purposes of subsection (b), if the ~~tribunal determines that there evidence~~ is not sufficient
4 ~~evidence~~ to establish the ~~actual~~ location of the debtor, the debtor is located in the District of
5 ~~Colombia~~Columbia.]

6 **Reporter's Note**

7
8 1. *Perfection by control and priority.* Subsection (a) deals with perfection of a security
9 interest in a controllable account, controllable electronic record, or controllable payment
10 intangible other than by filing—i.e., perfection by control under draft § 12-105—and priority.
11 For these purposes the governing law is that of the controllable electronic record's jurisdiction
12 under draft § 12-107(c) ~~[and (d)-)].~~

13
14 2. *Perfection by filing.* Under subsection (b) the local law of jurisdiction of the debtor's
15 location governs perfection of a security interest in a controllable electronic record by filing (but
16 not priority, as to which subsection (a) would apply). The same jurisdiction's law applies to
17 perfection by filing for controllable accounts and controllable payment intangibles pursuant to
18 the general rule in Section 9-301(1).

19
20 3. *Location of debtor in District of ~~Colombia~~-Columbia.* As with the approach in draft §
21 12-107(c) and (d), subsection (c) would locate the debtor in the District of ~~Colombia~~ Columbia
22 when a tribunal lacks sufficient evidence to determine the actual location of a debtor. Subsection
23 (c) appears in square brackets to indicate that the Drafting Committee has yet to determine
24 whether it should be included. One view is that, for purposes of perfection by filing ~~it~~, there is
25 ~~sufficient no need~~ to ~~for~~ address the situation in which the debtor's location ~~to be is~~
26 undetermined and ~~that, consequently,~~ subsection (c) is unnecessary. In such a case, a secured
27 party could not perfect its security interest by filing and control would be the only available
28 perfection method. Another view is that there is no downside to providing for perfection by filing
29 in the District of ~~Colombia when~~ Columbia and subsection (c) ~~would apply. should be included.~~
30 The rationale for permitting such a filing is similar to that supporting the location of a debtor in
31 the District of ~~Colombia~~ Columbia under Section 9-307(c). If subsection (c) is adopted, then
32 subsection (b) should be modified to include controllable accounts and controllable payment
33 intangibles.

34 **Section 9-307. Location of Debtor.**

35 * * *

36
37 (b) **[Debtor's location: general rules.]** Except as otherwise provided in this section[
38 and Section 9-306A(c)], the following rules determine a debtor's location:

(1) A debtor who is an individual is located at the individual's principal residence.

(2) A debtor that is an organization and has only one place of business is located at its place of business.

(3) A debtor that is an organization and has more than one place of business is located at its chief executive office.

* * *

Reporter's Note

~~1-~~Exception for draft § 9-306A(c). If ~~subsection (c)~~ to-draft § 9-306A(c) is adopted, then the exception that appears in square brackets in subsection (b) of this section should be adopted as well.

* * *

Section 9-310. When Filing Required to Perfect Security Interest or Agricultural Lien; Security Interests and Agricultural Liens to Which Filing Provisions Do Not Apply.

* * *

(b) **[Exceptions: filing not necessary.]** The filing of a financing statement is not necessary to perfect a security interest:

* * *

(8) in controllable accounts, controllable electronic records, controllable payment intangibles, deposit accounts, ~~electronic chattel paper~~, electronic documents, ~~electronic money~~, investment property, or letter-of-credit rights which is perfected by control under Section 9-314;

(9) in proceeds which is perfected under Section 9-315; or

(10) that is perfected under Section ~~9-316~~; 9-316; or

(11) in chattel paper which is perfected by possession and control under Section

1 9-314A.

2 **Reporter's Note**

3 ~~4-Exceptions to perfection by filing.~~ Exceptions to perfection by filing have been added
4 for controllable accounts, controllable electronic records, and controllable payment intangibles
5 (perfection by control) and for chattel paper (perfection by possession and control).
6

7 * * *

8 **Section 9-312. Perfection of Security Interests in Chattel Paper, Controllable**
9 **Accounts, Controllable Electronic Records, Controllable Payment Intangibles, Deposit**
10 **Accounts, Negotiable Documents, Goods Covered by Documents, Instruments,**
11 **Investment Property, Letter-of-Credit Rights, and Money; Perfection by Permissive**
12 **Filing; Temporary Perfection Without Filing or Transfer of Possession.**

13 (a) **[Perfection by filing permitted.]** A security interest in chattel paper, controllable
14 accounts, controllable electronic records, controllable payment intangibles, ~~chattel paper,~~
15 ~~negotiable documents,~~ instruments, ~~or investment property, or negotiable ~~tangible~~ documents~~
16 may be perfected by filing.

17 (b) **[Control or possession of certain collateral.]** Except as otherwise provided in
18 Section 9-315(c) and (d) for proceeds:

19 (1) a security interest in a deposit account may be perfected only by control under
20 Section 9-314;

21 (2) except as otherwise provided in Section 9-308(d), a security interest in a letter-
22 of-credit right may be perfected only by control under Section 9-314; ~~and~~

23 (3) a security interest in tangible money may be perfected only by the secured
24 party's taking possession under Section 9-313; and

25 (4) a security interest in electronic money may be perfected only by control under

~~section~~Section 9-105A314.

Reporter's Note

~~1. Perfection for controllable accounts, controllable electronic records, controllable payment intangibles, tangible money, and electronic money. Perfection for controllable accounts, controllable electronic records, and controllable payment intangibles may be by filing, for tangible money may be only by possession, and for electronic money may be only by control. Perfection by possession of tangible chattel paper has been deleted from this section. Instead, perfection by possession and control would be governed by new Section 9-314A.~~

Section 9-313. When Possession by or Delivery to Secured Party Perfects

Security Interest Without Filing.

(a) [Perfection by possession or delivery.] Except as otherwise provided in subsection (b), a secured party may perfect a security interest in ~~tangible negotiable documents~~, goods, instruments, negotiable tangible documents, or tangible money, or tangible chattel paper by taking possession of the collateral. A secured party may perfect a security interest in certificated securities by taking delivery of the certificated securities under Section 8-301.

* * *

Reporter's Note

~~1. Perfection by possession. Perfection by possession of tangible chattel paper has been deleted from this section. Instead, perfection by possession and control would be governed by new Section 9-314A.~~

Section 9-314. Perfection by Control.

(a) [Perfection by control.] A security interest in ~~investment property, deposit accounts, letter-of-credit rights, controllable accounts, controllable electronic records, controllable payment intangibles, electronic chattel paper, or electronic documents~~ deposit accounts, electronic documents, electronic money, investment property, or letter-of-credit rights, may be perfected by control of the collateral under Section 7-106, 9-104, ~~9-105~~, 9-105A, 9-106, ~~or 9-107~~, or 9-107A.

(b) [Specified collateral: time of perfection by control; continuation of perfection.]

A security interest in controllable accounts, controllable electronic records, controllable payment intangibles, deposit accounts, ~~electronic chattel paper, letter-of-credit rights, or electronic documents, electronic money, or letter-of-credit rights~~ is perfected by control under Section 7-106, 9-104, ~~9-105~~, 9-105A, ~~or 9-107, or 9-107A~~ when the secured party obtains control and remains perfected by control only while the secured party retains control.

Reporter's Note

~~4.–~~*Perfection by control.* Perfection by control of controllable accounts, controllable electronic records, ~~and~~ controllable payment intangibles, and electronic money has been added to this section. Perfection by control of electronic chattel paper has been deleted from this section. Instead, ~~new Section~~ draft § 9-314A would govern perfection for chattel paper by possession and control.

Section 9-314A. Perfection by Possession and Control of Chattel Paper.

(a) [Perfection by possession and control.] A secured party may perfect a security interest in chattel paper by taking possession of the ~~tangible~~-authoritative ~~tangible~~ copy, ~~if any,~~ of the record evidencing the chattel paper and obtaining control of the ~~electronic~~-authoritative ~~electronic~~ copy, ~~if any,~~ of the electronic record evidencing the chattel paper.

(b) [Time of perfection; continuation of perfection.] A security interest is perfected under subsection (a) when the secured party takes possession and obtains control and remains perfected under subsection (a) only while the secured party retains possession and control.

(c) [Application of Section 9-313 to Perfection by Possession of Chattel Paper.]

~~Subsections Section 9-313(c) and (f) through (i) of Section 9-313 apply~~ applies to perfection by possession of ~~tangible~~ an authoritative ~~copies~~ tangible copy of ~~records~~ a record evidencing chattel paper.

Reporter's Note

1. “*Authoritative copy.*” This draft section provides that to perfect a security interest in

1 chattel paper other than by filing, a secured party must obtain control of all ~~electronic~~
2 authoritative electronic copies and take possession of all ~~tangible~~-authoritative tangible copies.

3
4 Existing Section 9-105(b) distinguishes between authoritative and nonauthoritative copies
5 of electronic chattel paper. Like current law, the draft refers to copies that are “authoritative.”
6 And, like current law, the draft does not define the term. However, the draft would apply this
7 concept also to tangible records that evidence chattel paper.

8
9 As explained above, perfection of a security interest in chattel paper by taking possession
10 of the collateral was understood to mean taking possession of the wet-ink “original.” Experience
11 has shown that the concept of an original breaks down when one allows for the possibility of the
12 same monetary obligation being evidenced in different media over time, such as where electronic
13 records evidencing the chattel paper are “papered out” (replaced with tangible records
14 evidencing the same chattel paper) or tangible records are “converted” to electronic records.

15
16 To accommodate current practices and future technology, the draft would allow the
17 parties considerable flexibility in determining the method used to establish whether a particular
18 copy is authoritative, as long as third parties are able to reasonably identify the authoritative
19 copies that must be possessed or controlled to achieve perfection. For example, the parties could
20 develop a system or protocol where each copy is watermarked as authoritative or
21 nonauthoritative or where the terms of the records themselves describe how to determine which
22 copies are authoritative and which are not.

23
24 *2. Time of perfection.* Subsection (b) is modeled on Sections 9-313(d) and 9-314(b).

25
26 *3. Applicability of Section 9-313.* New subsection (c) makes specified subsections of
27 Section 9-313 applicable to possession of tangible authoritative copies of records evidencing
28 chattel paper.

29
30 * * *

31 **Section 9-316. Continued Perfection of Security Interest Following Change in**
32 **Governing Law.**

33 (a) **[General rule: effect on perfection of change in governing law.]** A security
34 interest perfected pursuant to the law of the jurisdiction designated in Section 9-301(1), ~~or~~ 9-
35 305(c), or 9-306A(b) remains perfected until the earliest of:

- 36 (1) the time perfection would have ceased under the law of that jurisdiction;
37 (2) the expiration of four months after a change of the debtor’s location to another
38 jurisdiction; or

1 (3) the expiration of one year after a transfer of collateral to a person that thereby
2 becomes a debtor and is located in another jurisdiction.

3 * * *

4 (f) [**Change in jurisdiction of controllable electronic record, bank, issuer, nominated**
5 **person, securities intermediary, or commodity intermediary.**] A security interest in
6 controllable accounts, controllable electronic records, controllable payment intangibles, deposit
7 accounts, letter-of-credit rights, or investment property which is perfected under the law of the
8 controllable electronic record's jurisdiction, the bank's jurisdiction, the issuer's jurisdiction, a
9 nominated person's jurisdiction, the securities intermediary's jurisdiction, or the commodity
10 intermediary's jurisdiction, as applicable, remains perfected until the earlier of:

11 (1) the time the security interest would have become unperfected under the law of
12 that jurisdiction; or

13 (2) the expiration of four months after a change of the applicable jurisdiction to
14 another jurisdiction.

15 (g) [**Subsection (f) security interest perfected or unperfected under law of new**
16 **jurisdiction.**] If a security interest described in subsection (f) becomes perfected under the law
17 of the other jurisdiction before the earlier of the time or the end of the period described in that
18 subsection, it remains perfected thereafter. If the security interest does not become perfected
19 under the law of the other jurisdiction before the earlier of that time or the end of that period, it
20 becomes unperfected and is deemed never to have been perfected as against a purchaser of the
21 collateral for value.

22 * * *

23 **Reporter's Note**
24

1 ~~1.~~ *Change in controllable electronic record's jurisdiction.* A change in the controllable
2 electronic record's jurisdiction has been added to this section to conform to the treatment for
3 other collateral subject to similar rules on governing law. *See* draft §§ 9-306A; and 12-107.
4

5 **Section 9-317. Interests That Take Priority Over or Take Free of Security**

6 **Interest or Agricultural Lien.**

7 * * *

8 (b) **[Buyers that receive delivery.]** Except as otherwise provided in subsection (e), a
9 buyer, other than a secured party, of ~~tangible chattel paper~~, tangible documents, goods,
10 instruments, negotiable tangible documents, or a security certificate takes free of a security
11 interest or agricultural lien if the buyer gives value and receives delivery of the collateral without
12 knowledge of the security interest or agricultural lien and before it is perfected.

13 * * *

14 (d) **[Licensees and buyers of certain collateral.]** A licensee of a general intangible or a
15 buyer, other than a secured party, of accounts, ~~electronic chattel paper~~, general intangibles, or
16 investment property other than a certificated security takes free of a security interest if the
17 licensee or buyer gives value without knowledge of the security interest and before it is
18 perfected.

19 * * *

20 (f) **[Buyers of chattel paper.]** A buyer, other than a secured party, of chattel paper
21 takes free of a security interest if, without knowledge of the security interest and before it is
22 perfected, the buyer gives value and receives delivery of the ~~tangible~~ authoritative tangible copy,
23 if any, of the record evidencing the chattel paper and obtains control of the ~~electronic~~
24 authoritative electronic copy, if any, of the record evidencing the chattel paper.

25 **Reporter's Note**
26

1 ~~1.~~*New rule for buyers of chattel paper.* The new take-free rule for buyers of chattel paper
2 reflects the corresponding changes in the definition of chattel paper and methods of perfection.
3 See draft §§ 9-102(a)(11) (defining “chattel paper”); 9-314A (perfection by possession and
4 control). Because this subsection applies only to chattel paper, the Drafting Committee should
5 consider whether the reference to “other than a secured party,” which appears in square brackets,
6 should be deleted.

7
8 * * *

9 **Section 9-326A. Priority of Security Interests in Controllable Account,**
10 **Controllable Electronic Record, and Controllable Payment Intangible.** A security
11 interest in a controllable account, controllable electronic record, or controllable payment
12 intangible held by a secured party having control of the ~~controllable~~ account, ~~controllable~~
13 electronic record, or ~~controllable~~ payment intangible has priority over a conflicting security
14 interest held by a secured party that does not have control.

15 **Reporter’s Note**

16
17 ~~1.~~*Control priority.* This section adopts an approach to priority in controllable accounts,
18 controllable electronic records, and controllable payment intangibles) that is similar to the
19 approach of Sections 9-327 (deposit accounts) and 9-328 (investment property): A security
20 interest perfected by control has priority over conflicting security interests that are not perfected
21 by control.

22
23 * * *

24 **Section 9-330. Priority of Purchaser of Chattel Paper or Instrument.**

25 (a) **[Purchaser’s priority: security interest claimed merely as proceeds.]** A purchaser
26 of chattel paper has priority over a security interest in the chattel paper which is claimed merely
27 as proceeds of inventory subject to a security interest if:

28 (1) in good faith and in the ordinary course of the purchaser’s business, the
29 purchaser gives new value and takes possession of the ~~tangible~~ authoritative tangible copy, if
30 any, of the record evidencing the chattel paper ~~or~~ and obtains control under Section 9-105 of the
31 electronic authoritative electronic copy, if any, of the record evidencing the chattel paper under

document of title has been duly negotiated, ~~or~~ a protected purchaser of a security, or a qualifying purchaser (as defined in Section 12-104) of a controllable account, controllable electronic record, or controllable payment intangible. These holders or purchasers take priority over an earlier security interest, even if perfected, to the extent provided in Articles 3, 7, ~~and~~ 8, and 12.

(b) **[Protection under ~~Article 8~~ Articles 8 and 12.]** This article does not limit the rights of or impose liability on a person to the extent that the person is protected against the assertion of a claim under Article 8 or 12.

(c) **[Filing not notice.]** Filing under this article does not constitute notice of a claim or defense to the holders, ~~or~~ purchasers, or persons described in subsections (a) and (b).

Reporter's Note

———~~1.~~ *Purpose of this section.* ~~This~~ The revisions of this section ~~ensures~~ ensure that Article 9 does not interfere with the protections that Article 12 affords to qualifying purchasers under the take-free and no-action rules in draft § 12-104(~~fd~~) and (~~hf~~).

Section 9-332. Transfer of Money; Transfer of Funds from Deposit Account.

(a) **[Transferee of tangible money.]** A transferee of tangible money takes the money free of a security interest ~~unless the transferee acts in the money~~ if the transferee ~~receives when receiving~~ delivery of the money ~~without acting unless the transferee acts does not act~~ in collusion with the debtor in violating the rights of the secured party.

(b) **[Transferee of electronic money.]** A transferee of electronic money takes the money free of a security interest ~~unless the transferee acts in the money~~ if the transferee ~~obtains when obtaining~~ control of the money ~~without acting does not act~~ in collusion with the debtor in violating the rights of the secured party.

~~(b)(c)~~ **[Transferee of funds from deposit account.]** A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account ~~unless the~~

1 ~~transferee acts~~ if the transferee ~~receives when receiving~~ the funds ~~without acting unless the~~
2 ~~transferee acts does not act~~ in collusion with the debtor in violating the rights of the secured
3 party.

4 **Reporter's Note**

5
6 1. *“Delivery” of tangible money; “control” of electronic money.* Conditioning the takes-
7 free rule of subsection (a) on delivery of money reflects what has always been assumed—that a
8 transfer of an interest in money that is not accompanied by a physical delivery would not impair
9 the rights of third parties. Inasmuch as “electronic money” is a new classification, no pattern of
10 past practices or understandings exists. New subsection (b) provides a rule for electronic money
11 that complements draft subsection (a) by conditioning the takes-free rule on the transferee
12 obtaining control.

13
14 2. *Transferees of funds from deposit account.* Similarly, the revisions to subsection (c)
15 (formerly subsection (b)) make a corresponding change for a transfer of funds from a deposit
16 account. To qualify for the take-free protection under subsection (c), the transferee must
17 “receive[] the funds without acting in collusion [etc.] . . .” The draft amendments to Section 9-
18 332(a) and (c) are intended to clarify what is implicit under the original text.

19
20 3. *Meaning of “transfer”.* A “transfer” of property occurs when the transferee has
21 obtained a property interest in the relevant property. *See* Section 9-102, Comment 26 (“In
22 numerous provisions, this Article refers to the “assignment” or the “transfer” of *property*
23 interests.” (emphasis added)). Other law determines when the transferee has acquired a property
24 interest. *See* Section 9-408, Comment 3 (“Other law determines whether a debtor has a property
25 interest (‘rights in the collateral’) and the nature of that interest.”). Although the terms “transfer”
26 and “transferee” are not defined in the UCC, the term “transfer” is broader in scope than
27 “purchase,” which requires taking in a “voluntary transaction creating an interest in property.”
28 Section 1-201(29). For example, “transfer” includes involuntary transfers such as the acquisition
29 of a judicial lien by a lien creditor. *See* Section 9-102(a)(52) (defining “lien creditor”).

30
31 4. *Transfer of interest in deposit account.* With respect to subsection (c), because a
32 deposit account is a debt of the bank to its customer, a transfer of the deposit account itself does
33 not transfer the funds credited to the deposit account. *See* Section 9-332, Comment 2 (5th
34 paragraph) (distinguishing “*transfers of funds from a deposit account*” from “*transfers of the*
35 *deposit account* itself or an interest therein.” (Emphasis in original.) Even when a “transfer” of a
36 deposit account has occurred under other law, the transferee does not take free of a security
37 interest under subsection (c) until the actual receipt of funds from the deposit account has
38 occurred. The proper construction of current subsection (b) and draft subsection (c) rejects cases
39 that treat garnishment of a deposit account as an immediate transfer of an interest in funds
40 credited to the deposit account.

41
42 The last event that provides a recovery for a creditor in a garnishment action virtually
43 always would be a transfer of funds from a deposit account. However, this does not mean that a

1 perfected security interest will always be cut off by a garnishing creditor. By intervening in the
2 garnishment proceeding to assert its senior security interest before funds are disbursed, the
3 secured party might assert and retain its priority. However, the relevant procedural law may not
4 provide the secured party with adequate advance notice. In some cases, a control agreement that
5 perfects a security interest in the deposit account may require the garnished bank to provide
6 prompt notice to the secured party. But not all control agreements will so provide. Moreover, the
7 secured party's priority is not absolute. *See, e.g.*, Section 9-401, Comment 6 (explaining that the
8 equitable doctrine of marshaling may be appropriate in the case of a lien creditor's interest in
9 collateral when a senior secured party is oversecured).

10
11 * * *

12 **Section 9-406. Discharge of Account Debtor; Notification of Assignment;**
13 **Identification and Proof of Assignment; Restrictions on Assignment of Accounts,**
14 **Chattel Paper, Payment Intangibles, and Promissory Notes Ineffective.**

15 (a) **[Discharge of account debtor; effect of notification.]** Subject to subsections (b)
16 through (i) and (l), an account debtor on an account, chattel paper, or a payment intangible may
17 discharge its obligation by paying the assignor until, but not after, the account debtor receives a
18 notification, authenticated by the assignor or the assignee, that the amount due or to become due
19 has been assigned and that payment is to be made to the assignee. After receipt of the
20 notification, the account debtor may discharge its obligation by paying the assignee and may not
21 discharge the obligation by paying the assignor.

22 (b) **[When notification ineffective.]** Subject to ~~subsection~~ subsections (h) and (l),
23 notification is ineffective under subsection (a):

24 (1) if it does not reasonably identify the rights assigned;

25 (2) to the extent that an agreement between an account debtor and a seller of a
26 payment intangible limits the account debtor's duty to pay a person other than the seller and the
27 limitation is effective under law other than this article; or

28 (3) at the option of an account debtor, if the notification notifies the account

debtor to make less than the full amount of any installment or other periodic payment to the assignee, even if:

(A) only a portion of the account, chattel paper, or payment intangible has been assigned to that assignee;

(B) a portion has been assigned to another assignee; or

(C) the account debtor knows that the assignment to that assignee is limited.

(c) **[Proof of assignment.]** Subject to ~~subsection~~ subsections (h) and (l), if requested by the account debtor, an assignee shall seasonably furnish reasonable proof that the assignment has been made. Unless the assignee complies, the account debtor may discharge its obligation by paying the assignor, even if the account debtor has received a notification under subsection (a).

* * *

(g) **[Subsection (b)(3) not waivable.]** Subject to subsection (h), an account debtor may not waive or vary its option under subsection (b)(3).

* * *

(h) [Rule for individual under other law.] This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(i) [Inapplicability to health-care-insurance receivable.] This section does not apply to an assignment of a health-care-insurance receivable.

(j) [Section prevails over specified inconsistent law.] This section prevails over any inconsistent provisions of the following statutes, rules, and regulations:

[List here any statutes, rules, and regulations containing provisions
inconsistent with this section.]

(k) [Inapplicability to interests in certain entities.] Subsections (d), (f),
and (j) do not apply to a security interest in an ownership interest in a general
partnership, limited partnership, or limited liability company.

(l) [Inapplicability of certain subsections.] Subsections (a) through (c) and (g) do not
apply to a controllable account or controllable payment intangible.

*Legislative Note: States that amend statutes, rules, and regulations to remove provisions
inconsistent with this section need not enact subsection (j)*

Reporter's Note

~~1.~~ *Controllable accounts and controllable payment intangibles.* For controllable accounts
and controllable payment intangibles, subsections (a) through (c) and (g) will be replaced by
analogous provisions in draft § 12-106.

* * *

Section 9-601. Rights After Default; Judicial Enforcement; Consignor or Buyer of Accounts, Chattel Paper, Payment Intangibles, or Promissory Notes.

* * *

(b) **[Rights and duties of secured party in possession or control.]** A secured party in
possession of collateral or control of collateral under Section 7-106, 9-104, 9-105, 9-105A, 9-
106, ~~or~~ 9-107, or 9-107A has the rights and duties provided in Section 9-207.

* * *

Section 9-605. Unknown Debtor or Secondary Obligor.

(a) A ~~Subject to~~ Except as provided in subsection (b), a secured party does not owe a duty
based on its status as secured party:

(1) to a person that is a debtor or obligor, unless the secured party knows:

(A) that the person is a debtor or obligor;

(B) the identity of the person; and

(C) how to communicate with the person; or

(2) to a secured party or lienholder that has filed a financing statement against a person, unless the secured party knows:

(A) that the person is a debtor; and

(B) the identity of the person.

~~(b) Subsection (a) does not apply [When secured party owes duty to duties owed debtor notwithstanding subsection (a).] A secured party owes a duty based on its status as a secured party to a person that is a debtor by a secured party that if, at the time the secured party obtains control of a controllable account, controllable electronic record, or controllable payment intangible, the secured party has [notice] [knowledge] that the nature of the collateral or the a system in which the collateral is recorded, if any, would prevent the secured party from acquiring the knowledge specified in that subsection: (a)(1)(A), (B), or (C).~~

* * *

**Section 9-628. Nonliability and Limitation on Liability of Secured Party;
Liability of Secondary Obligor.**

(a) [Limitation of liability of secured party for noncompliance with article.] Unless a secured party knows that a person is a debtor or obligor, knows the identity of the person, and knows how to communicate with the person:

(1) the secured party is not liable to the person, or to a secured party or lienholder that has filed a financing statement against the person, for failure to comply with this article; and

(2) the secured party's failure to comply with this article does not affect the liability of the person for a deficiency.

(b) **[Limitation of liability based on status as secured party.]** A Subject to subsection (c), a secured party is not liable because of its status as secured party:

(1) to a person that is a debtor or obligor, unless the secured party knows:

(A) that the person is a debtor or obligor;

(B) the identity of the person; and

(C) how to communicate with the person; or

(2) to a secured party or lienholder that has filed a financing statement against a person, unless the secured party knows:

(A) that the person is a debtor; and

(B) the identity of the person.

~~(c) Subsection (b) does not apply~~

~~* * *~~

~~(f) [When secured party owes duty to duties owed debtor notwithstanding subsection (b).] A secured party owes a duty based on its status as a secured party to a person that is a debtor by a secured party that if, at the time the secured party obtains control of a controllable account, controllable electronic record, or controllable payment intangible, the secured party has [notice] [knowledge] that the nature of the collateral or the system in which the collateral is recorded, if any, would prevent the secured party from acquiring the knowledge specified in that subsection: (b)(1)(A), (B), or (C).~~

Reporter's Note to Draft §§ 9-605 and 9-628

~~4-~~ *Liability to unknown persons.* Practices are developing under which lenders extend secured credit without knowing, or having the ability to discover, the identity of their borrowers.

Existing Sections 9-605 and 9-628 would excuse these secured parties from having duties to their debtors, including, *e.g.*, the duty to notify the debtor before disposing of the collateral and the duty to account to the debtor for any surplus arising from a disposition. In many cases these debtors may be aware that their identities are unknown to their secured parties. By failing to make their identities and contact information known ~~they, these debtors~~ are knowingly preventing their secured parties from complying with their duties under Article 9. However, such debtor complicity notwithstanding, if secured parties were relieved of their duties in these circumstances, arguably it would conflict with the policy of Section 9-602, which prohibits a waiver or variance of many rights of debtors and duties of secured parties.

Comment 2 to Section 9-628 observes, “[w]ithout this group of provisions [in Sections 9-605 and 9-628], a secured party could incur liability to unknown persons and under circumstances that would not allow the secured party to protect itself.” That comment also notes that “[t]he broadened definition of the term ‘debtor’ underscores the need for these provisions.” For example, a debtor may dispose of collateral subject to a security interest ~~and, resulting in the transferee becoming a debtor, but~~ the secured party may have no knowledge of the disposition or ~~that~~ the transferee ~~that~~ has ~~thereby~~ become a debtor. In that situation the secured party will have no means of giving notice to or accounting to the transferee debtor. Sections 9-605 and 9-628 contemplate such situations by relieving the secured party of its duties to the debtor.

The draft amendments to Sections 9-605 and 9-628 reflect the policy that a secured party should not be free to avoid statutory duties or absolve itself from liability to a debtor ~~by entering into a transaction when the secured party can protect itself, i.e.,~~ when the secured party has ~~[notice-~~or~~]~~ [knowledge] that the nature of the collateral or any system in which the collateral is recorded would prevent the secured party from acquiring the knowledge necessary to fulfill its statutory duties. ~~As discussed in the following paragraph, this [notice][knowledge] enables the secured party to protect itself from being in breach of these duties.~~ *The Drafting Committee will consider further whether the standard should be “notice” or “knowledge.”* (A person has notice of a fact if, *inter alia*, from all the facts and circumstances known to the person at the time in question, has reason to know that it exists. Section 1-202(a)(3). A person has knowledge of a fact if it has “actual knowledge.” Section 1-202(b).). The exceptions from the exculpatory protections otherwise afforded to secured parties are ~~conditioned on~~ determined by the secured party’s ~~[notice-~~or~~]~~ [knowledge] at the time the secured party obtains control of a controllable account, controllable electronic record, or controllable payment intangible.

Obtaining control serves as a rough proxy for the context in which a secured party may have notice or knowledge that it will be unable to comply with its duties, usually because the transferor is anonymous. The carve-out from the exculpatory protection is limited to duties owed to a debtor—the transferor of a controllable account, controllable electronic record, or controllable payment intangible over which the secured party obtains control. The secured party in such situations could protect itself by choosing not to enter into a transaction in which it would be unable to comply with its statutory duties or by conditioning its participation on disclosure of the debtor’s identity and contact information. Ideally, systems providing for the transfer of controllable electronic records would provide mechanisms that would permit compliance with such duties (such as methods of communication and payments that would preserve a debtor’s anonymity, where that is desired).

1 Secured parties that enter into transactions with ~~[notice-of-]~~[knowledge] that they will
2 not be able to comply with their Article 9 duties do so at their own peril. Note, however, that the
3 limitation on a secured party's relief from duties and liability relates only to secured transactions
4 involving controllable accounts, controllable electronic records, or controllable payment
5 intangibles. Designing systems for these assets that would afford secured parties with the
6 opportunities to comply with their Article 9 duties, as suggested above, could eliminate the risks
7 to secured parties and also provide for the protection of debtors' rights.

8
9 * * *

10 ARTICLE 12

11 CONTROLLABLE ELECTRONIC RECORDS

12 Reporter's Prefatory Note to Article 12

13 1. *Introduction to controllable electronic records.* New UCC Article 12, which deals with
14 controllable electronic records, and the conforming amendments to Articles 1 and 9 are a major
15 part of the effort to adapt the UCC to emerging technologies as they might affect electronic
16 commerce.

17
18 Article 12 creates a legal regime that is meant to apply more broadly than to electronic
19 (intangible) assets that are created using existing technologies such as distributed ledger
20 technology (DLT), including blockchain technology, which powers transactions in bitcoin and
21 other digital ~~asset-~~assets. It also aspires to apply to electronic assets that may be created using
22 technologies that have yet to be developed, or even imagined.

23
24 The adoption of ~~distributed ledger technology (DLT)~~ has underscored two important
25 trends in electronic commerce. First, people have begun to assign economic value to some
26 electronic records that bear no relationship to extrinsic rights and interests. For example, without
27 any law or binding agreement, people around the world have agreed to treat virtual currencies
28 such as bitcoin (or, more precisely "transaction outputs" generated by the Bitcoin protocol) as a
29 medium of exchange and store of value. Second, people are using the creation or transfer of
30 electronic records to transfer rights to receive payment, rights to receive performance of other
31 obligations (*e.g.*, services or delivery of goods), and other interests in personal and real property.

32
33 These trends will inevitably result in disputes among claimants to electronic records and
34 their related rights and other benefits. Uncertainty as to the criteria for resolving these claims
35 creates commercial risk. The magnitude of these risks will grow as these trends continue.

36
37 As explained in more detail below, draft Article 12 is designed to reduce these risks by
38 providing the legal rules governing the transfer—both outright and for security—of interests in
39 some, but not all, electronic records (*controllable electronic records*). These rules specify the
40 rights in a controllable electronic record that a purchaser would acquire. Many systems for
41 transferring controllable electronic records are pseudonymous, so that the transferee of a
42 controllable electronic record is unable to verify the identity of the transferor or the source of the

1 transferor's title. Accordingly, the Article 12 rules would make controllable electronic records
2 negotiable, in the sense that a good faith purchaser for value would take a controllable electronic
3 record free of third-party claims of a property interest in the controllable electronic record.

4
5 Experience with DLT and other records-management systems has established some
6 general functions required for electronic records to serve as an effective and reliable means of
7 transferring economic value.

- 8
9 • The electronic record must have some "use" that one person can enjoy to the
10 exclusion of all others, *e.g.*, the power to "spend" a bitcoin (or, more precisely,
11 the power to include an unspent transaction output (a UTXO) in a message that
12 the Bitcoin protocol will record to its blockchain).
- 13
14 • A person must be able to transfer to another person this exclusive power to use
15 the electronic record. To remain exclusive, the transfer must divest the transferor
16 of the power to use the electronic record.
- 17
18 • A person must be able to demonstrate to others that the person has the power to
19 "use" the electronic record.

20
21 As discussed in the Reporter's Note to draft § 12-105, these functions form the basis of
22 the Article 12 concept of *control*. To receive the benefits of negotiability and take free of third-
23 party claims of a property interest in a controllable electronic record, a person must have control
24 of the controllable electronic record. In addition, control serves as a method of perfection of a
25 security interest in a controllable electronic record and as a condition for achieving a non-
26 temporal priority of a security interest. In this context, it may be useful to think of control as the
27 rough functional equivalent of possession of tangible personal property such as goods.

28
29 Article 12 governs the rights of transacting parties and the rights of persons that might be
30 affected by the transactions. With the important exception of certain rights to payment evidenced
31 by a controllable electronic record (discussed below), Article 12 does not govern assets other
32 than controllable electronic records. Like the UCC in general, Article 12 is not a regulatory
33 statute. The fact that an asset is or is not a controllable electronic record under the UCC would
34 not necessarily affect the application of laws regulating securities, commodities, or money
35 transmission.

36 37 2. What is the scope of draft Article 12? 38

39 Article 12 applies to *controllable electronic records*. Controllable electronic records are a
40 subset of what often are referred to as digital assets. Article 12 is designed to work for both
41 technologies that are known and those that may be developed in the future. Whether an asset is a
42 controllable electronic record (and therefore within the scope of Article 12) depends on whether
43 the characteristics of the asset and the protocols of any system on which the asset is recorded
44 make it suitable for the application of Article 12's substantive rules. The nature of electronic
45 commerce is constantly changing. For this reason, the technology on which an asset depends, the
46 type of asset, and the prevailing use of the asset are all irrelevant to whether the asset is a

1 controllable electronic record.

2
3 To determine whether Article 12 applies to a particular asset, *e.g.*, bitcoin, one must
4 determine whether the asset falls within the definition of *controllable electronic record*. A
5 controllable electronic record is a *record*, as the UCC defines the term. A *record* is information
6 that is retrievable in perceivable form.² A *controllable electronic record* is a record that is stored
7 in an electronic medium³ and that can be subjected to *control*, as defined in draft § 12-105. An
8 electronic record that cannot be subjected to control under draft § 12-105 is outside the scope of
9 Article 12.

10
11 The meaning of *control* in the UCC depends on the type of property involved.⁴ The
12 Reporter’s Note accompanying draft § 12-105 explains the requirements for obtaining control of
13 a controllable electronic record. For present purposes, it is sufficient to think of bitcoin as the
14 prototypical controllable electronic record.

15
16 The existing law governing that governs control for some types of electronic records
17 (including provisions on control for some types that are proposed to be modified in this draft) is
18 sufficient. These electronic records are excluded from Article 12.⁵

19
20 3. *What are the substantive provisions of Article 12?*
21

22 The principal function of Article 12 is to specify the rights of a *purchaser* of a
23 controllable electronic record. A purchaser is a person that acquires an interest in property by a
24 voluntary transaction, such as a sale.⁶ Law other than Article 12 would determine whether a
25 person acquires any rights in a controllable electronic record and so would be eligible to be a
26 purchaser.

27
28 Draft § 12-104 adopts the “shelter” principle, under which a purchaser of a controllable
29 electronic record acquires whatever rights the transferor had or had power to transfer. This rule
30 appears in Article 2 with respect to goods and Article 8 with respect to securities.⁷
31

² See UCC § 1-201(b)(31).

³ See draft § 12-102(a)(2) (defining “electronic record”).

⁴ *E.g.*, UCC § 7-106 (electronic documents of title); § 8-106 (~~containing four definitions of “control,” one for each of~~ four different types of investment property); each with a different definition of “control”; § 9-104 (deposit accounts); § 9-105 (electronic chattel paper).

⁵ See draft § 12-102(a)(1) (defining “controllable electronic record”).

⁶ “‘Purchase’ means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property.” UCC § 1-201(b)(29).

⁷ UCC § 2-403(1) provides, “A purchaser of goods acquires all title which his transferor had or had power to transfer” UCC § 8-302(a) provides, “a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer.” Other UCC provisions also reflect the shelter principle. See, *e.g.*, UCC § 3-203(b) (concerning negotiable instruments); UCC § 7-504(a) (concerning documents of title).

1 The ability to take a controllable electronic record free of third-party property claims
2 appears to be necessary for a controllable electronic record to have commercial utility. As is the
3 case with Articles 2, 3, 7, and 9, Article 12 would facilitate commerce by affording to certain
4 good-faith purchasers for value greater rights than their transferors had or had power to transfer.⁸
5 Draft Article 12 refers to these purchasers as *qualifying purchasers*. Qualifying purchasers are
6 purchasers that obtain control of a controllable electronic record for value, in good faith, and
7 without notice of any claim of a property interest in the controllable electronic record. Like a
8 holder in due course of a negotiable instrument, a qualifying purchaser of a controllable
9 electronic record takes the controllable electronic record free of property claims.

10
11 Consider the case in which *B* contracts to buy bitcoin from *S*. Assume that *S* is the owner
12 of the bitcoin.

- 13
14 • Law other than Article 12 generally would determine whether *S* is the owner of
15 the bitcoin.
- 16
17 • Law other than Article 12 would resolve issues concerning the formation of the
18 contract of sale between *B* and *S* and the obligations of the parties under the
19 contract.
- 20
21 • Law other than Article 12 would determine what steps are necessary for *B* to
22 acquire rights in the bitcoin.⁹
- 23
24 • By acquiring rights in the bitcoin by sale, *B* would become a *purchaser* of the
25 bitcoin within the meaning of UCC Article 1.
- 26
27 • Article 12 provides that if *B* becomes a purchaser, *B* will acquire whatever rights
28 *S* had or had power to transfer. As a general matter, law other than Article 12
29 would define these rights. *B* would acquire these rights regardless of whether *B*
30 obtained control of the bitcoin.

31
32 Now assume that *S* is a hacker, who acquired the bitcoin illegally from the owner, *O*.

- 33
34 • Just as a buyer of goods can obtain possession from a seller that has no rights in
35 the goods, *B* can obtain control of the bitcoin, even if *S* “stole” it from the owner.
- 36
37 • If *B* obtains control of the bitcoin for value, in good faith, and without notice of
38 any claim of a property interest, *B* would be a *qualifying purchaser*.
- 39
40 • Even if *B* would not have acquired any rights in the bitcoin under non-Article 12

⁸ Article 8 also provides for certain purchasers for value to take greater rights but does not contain a good-faith requirement. See UCC § 8-303.

⁹ Law other than Article 12 includes UCC Article 9. Thus, Article 9 would determine whether a security interest attaches to a controllable electronic record. More generally, Article 9 governs any conflict between Article 9 and Article 12. Draft § 12-102(b).

1 law, as an Article 12 qualifying purchaser, *B* would acquire the bitcoin free of all
2 claims of a property interest in the bitcoin. In the unlikely event that *O* could
3 locate *B*, *B* would defeat *O*'s claim of ownership and own the bitcoin free and
4 clear. (The same result would obtain if *B* bought a negotiable instrument from a
5 thief under circumstances where *B* became a holder in due course.)

6
7 4. How would Article 12 deal with rights or property that is linked to a controllable
8 electronic record?

9
10 a. The general rules.

11
12 Recall that a controllable electronic record is a record, *i.e.*, information. Some records
13 have what one might call "inherent value" solely because the market treats them as having value
14 Bitcoin would be an example of such a record. Bitcoin can be exchanged (sold) for cash or other
15 valuable assets. Or, the owner of bitcoin can hold the bitcoin as an investment.

16
17 The value of many (if not most) records, however, is as evidence of the rights of the
18 parties to a transaction. In these situations, it is essential to differentiate between the *record* and
19 the *rights* that are evidenced by the record.

20
21 Suppose, for example, that *S* and *B* enter into a written contract for the sale of 100 air
22 purifiers. The contract provides that at a specified time in the future, *S* is to deliver the goods and
23 *B* is to pay for them. *B* may sell (assign) to *P* the right to receive delivery of the goods from *S*. *P*
24 has acquired a valuable asset, *i.e.*, the right to receive delivery.

25
26 In contrast, if *B* sells to *P* only the paper (record) on which the contract is written, *P*
27 might or might not acquire the right to delivery of the goods, depending on whether applicable
28 law treats the sale of the paper as an assignment of the right to delivery. *P* would become the
29 owner of the paper in any event, but the paper itself may be of little value.

30
31 If the contract for the sale of air purifiers were electronic rather than written, the same
32 analysis would apply. The *right* evidenced by the electronic record (*i.e.*, *B*'s right to receive
33 delivery from *S*) would be the valuable asset, not the *record* itself.

34
35 Suppose that the contract of sale between *B* and *S* is evidenced by a controllable
36 electronic record that *B* sells to *P*. Under draft § 12-104(d), *P* would acquire all rights *in the*
37 *controllable electronic record* that the transferor (*B*) had or had power to transfer. If *P* obtains
38 control of the controllable electronic record for value, in good faith, and without notice of any
39 claim of a property right in the controllable electronic record, *P* will become a *qualifying*
40 *purchaser* and, as such, would acquire its rights *in the controllable electronic record* free of any
41 claim of a property right under draft § 12-104.

42
43 But the controllable electronic record itself may or may not be a valuable asset. In this
44 example, unlike bitcoin, the record would have value to *P* only if by virtue of acquiring rights in
45 the controllable electronic record, *P* would also acquire the right to receive delivery of the goods
46 from *S*.

1 Article 12 leaves to other law the question whether *P*'s acquisition of rights in the
2 controllable electronic record gives *P* the right to receive delivery of the goods. We would
3 typically expect that under other law *P* would not acquire the right to receive the goods merely
4 by acquiring rights in the controllable electronic record, any more than *P* would have acquired
5 the right to receive the goods if the record were in paper form and physically delivered to *P*.

6
7 Suppose, however, that other law does provide that, by acquiring the controllable
8 electronic record, *P* would acquire the right to receive delivery of the goods from *S*. Suppose also
9 that *P* becomes a qualifying purchaser of the controllable electronic record. As we have seen, as
10 a qualifying purchaser, *P* would take its rights *in the controllable electronic record* free of
11 property claims. But even though under non-Article 12 law *P* would (as posited) acquire the right
12 to receive delivery of the goods, *P* would not acquire that right free of property claims unless
13 non-Article 12 law were to provide otherwise.

14
15 *b. The exceptions: controllable accounts and controllable payment intangibles.*

16
17 As a general rule, draft Article 12 applies to records and not to rights evidenced by
18 records (or to rights that records purport to evidence). Law other than Article 12 would
19 determine what steps must be taken for a person to acquire an interest in a controllable electronic
20 record and the rights, if any, that the person acquires— in other property as a result of acquiring
21 an interest in the record. This “other” law includes UCC Article 9.

22
23 The draft provides an important exception to this general rule. The exception concerns
24 rights to payment (specifically, accounts and payment intangibles) that are evidenced by a
25 controllable electronic record that provides that the obligor (account debtor) undertakes to pay
26 the person that has control of the controllable electronic record. These rights to payment are
27 referred to as “controllable accounts” and “controllable payment intangibles.”¹⁰ ~~Under Article~~
28 ~~12, a qualifying purchaser of the controllable electronic record would also acquire its rights in~~
29 ~~the controllable account or controllable payment intangible free of any claim of a property~~
30 ~~interest.~~¹¹

31 The draft amends several sections of Article 9 to deal with other aspects of security
32 interests in controllable accounts and controllable payment intangibles. The Reporter’s Prefatory
33 Note to Article 9 Amendments and the Reporter’s Notes to those sections discuss those
34 amendments.

35 Finally, Section 12-107 provides rules on governing law. The general rule under
36 subsection (a) is that a “controllable record’s jurisdiction” governs matters covered by Article 12.
37 The controllable record’s jurisdiction is determined by an express provision in the record or in
38 the system in which the record is recorded. If not so designated, it is determined based on the
39 designation of the law governing the record or the system. Absent such designations, at the
40 bottom of this “waterfall” of alternatives, the governing law will be that of the jurisdiction of the
41 location of the transferor. Subsection (b) provides an exception for the rights and duties of
42 account debtors under draft § 12-106 if an agreement between the account debtor and an assignor
43 of the record provides for the law of another jurisdiction to govern those rights and duties.

¹⁰ See draft § 9-102(b) (defining “controllable account” and “controllable payment intangible”).

¹¹ ~~Draft § 12-104.~~

Section 12-101. ~~Short~~ Title. This article may be cited as Uniform Commercial Code—
Controllable Electronic Records.

Official Comment

Subsection headings are not a part of the official text itself and have not been approved by the sponsors.

Section 12-102. Definitions.

(a) **Article 12 definitions.** In this article:

(1) “Controllable electronic record” means a record stored in an electronic ~~record~~ medium that can be subjected to control under Section 12-105. The term does not include a deposit ~~accounts, an~~ account, electronic copy of a record evidencing chattel paper, electronic ~~documents~~ document of title, electronic money, investment property, or “a transferable record.”

(2) “Qualifying purchaser” means a purchaser of a controllable electronic record or an interest in the controllable electronic record that obtains control of the controllable electronic record for value, in good faith, and without notice of a claim of a property right in the controllable electronic record.

(3) “Transferable record” means:

(A) “Transferable records”, as defined in the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7021(a)(1) ~~or as defined in [cite to Uniform Electronic Transaction Act Section 16(a)]~~, as amended].

~~(2) “Electronic record” means a record stored in an electronic medium.~~

(B) “Transferable record” as defined in [cite to Uniform Electronic Transactions Act Section 16(a)].

(4) “Value” has the meaning provided in Section 3-303(a).

(b) **Definitions in Article 9.** The definitions in Article 9 of “account debtor,”

1 “authenticate,” “controllable account,” “controllable payment intangible,” “chattel paper,”
2 “deposit account,” “electronic money,” and “investment property,” and “proceeds” in Article
3 9” apply to this article.

4 (e) “Value” has the meaning provided in Section 3-303(a).

5 ~~Legislative Note: In subsection (a)(1)~~ Legislative Note: It is the intent of this act to incorporate
6 future amendments to the federal law cited in subsection (a)(3)(A). A state in which the
7 constitution or other law does not permit incorporation of future amendments when a federal
8 statute is incorporated into state law should omit the phrase “, as amended”. A state in which, in
9 the absence of a legislative declaration, future amendments are incorporated into state law also
10 should omit the phrase.

11
12 In subsection (a)(3)(B), the state should cite to the state’s version of the Uniform Electronic
13 Transactions Act Section 16(a) or comparable state law.

14 15 Reporter’s Note

16
17 1. “Controllable electronic record.” To be a “controllable electronic record” within the
18 scope of Article 12, an electronic record must be susceptible of control under Section 12-105.
19 Unlike “transferable records” under the Electronic Signatures in Global and National Commerce
20 Act or a “transferable record” under ~~E-SIGN or UETA~~ the Uniform Electronic Transactions Act,
21 a record can be a controllable electronic record under Article 12 in the absence of an agreement
22 to that effect.

23
24 The provisions of Article 12 do not apply to certain types of electronic records, and the
25 definition has been limited accordingly. Article 12 does not, however, limit the extent to which
26 property, including an electronic record, may be a financial asset under Article 8, including as a
27 result of an express agreement between a securities intermediary and another person to treat such
28 property held by the securities intermediary as a “financial asset” credited to a securities account
29 pursuant to Section 8-102(a)(9)(iii). See Section 8-102, amendments to official comments.

30
31 ~~2. “Electronic record.”~~ This definition uses the term “record,” defined in Section 1-201
32 to include “information . . . that is stored in an electronic or other medium and is retrievable in
33 perceivable form,” and the ULC’s standard definition of “electronic,” which this draft proposes
34 to add to Section 1-201.

35
36 ~~23~~ 2. “Qualifying purchaser.” The conditions for becoming a qualifying purchaser
37 were drawn from Article 3. More specifically, the conditions for becoming a qualifying
38 purchaser were drawn from Section 3-302(a)(2), which defines “holder in due course” of a
39 negotiable instrument. Among these conditions is that a person take the instrument “for value.”
40 As Reporter’s Note 9 to Section 12-104 explains, the concept of value in Article 3 differs from
41 the concept of value that is generally applicable in the UCC. Article 12 adopts the Article 3
42 concept.

Under Section 12-104(a), not only a purchaser of a controllable electronic record but also a purchaser of a controllable account or controllable payment intangible may be a qualifying purchaser. Moreover, a purchaser of a controllable account or a controllable payment intangible may be a qualified purchaser even if it does not also purchase the controllable electronic record that evidences the account of payment intangible. However, to obtain control of the controllable account or controllable payment intangible, a requirement for of qualifying purchaser status, the purchaser must obtain control of that controllable electronic record. Draft § 9-107A.

3. ‘Transferable record.’ This definition facilitates the exclusion of transferable records from the definition of controllable electronic records.

4. “Value.” The concept of value in Section 3-303 is narrower than the generally applicable concept in Section 1-201. Reporter’s Note ~~109~~ to draft § 12-104 explains the difference between the two concepts and that the draft adopts the Article 3 approach.

Section 12-103. Scope.

(a) ~~This article applies to controllable accounts, controllable electronic records, and controllable payment intangibles.~~

(b) **Article 9 governs in case of conflict.** If there is conflict between this article and Article 9, Article 9 governs.

(e) (b) [Applicable consumer law and other laws.] A transaction subject to this article is subject to any applicable rule of law that establishes a different rule for consumers and [insert reference to (i) any other statute or regulation that regulates the rates, charges, agreements, and practices for loans, credit sales, or other extensions of credit and (ii) any consumer-protection statute or regulation].

Reporter's Note

1. *Source of these provisions.* Subsection (b a) follows Section 3-102(b). As is the case with respect to Article 3, Article 9 would defer to Article 12 in some instances. *See* subsection (b a) and draft § 9-331. Subsection (e b) is copied from Section 9-201.

2. *Controllable accounts and controllable payment intangibles.* As to controllable accounts and controllable payment intangibles, see Reporter’s Note 4 to draft § 9-102.

Section 12-104. Rights in Controllable Accounts Account, Controllable

1 **Electronic ~~Records~~ Record, and Controllable Payment ~~Intangibles~~ Intangible.**

2 ~~(a)~~ (a) [Applicability of section to controllable account and controllable payment
3 intangible.] This section applies to the acquisition and purchase of rights in ~~controllable~~
4 ~~accounts and controllable payment intangibles in the same manner that it applies to a~~ controllable
5 ~~electronic records.~~

6 ~~(b)~~ In this section, “account or controllable payment intangible, including the rights of a
7 purchaser and a qualifying purchaser” means a purchaser of a and under subsections (c), (d), and
8 (f), in the same manner this section applies to a controllable electronic record ~~or an interest in the~~
9 ~~controllable electronic record that obtains control of the controllable electronic record for value,~~
10 ~~in good faith, and without notice of a claim of a property right in the controllable electronic~~
11 ~~record.~~

12 ~~(e)~~ (b) [Applicability of other law to acquisition of rights.] Except as provided in this
13 section, law other than this article determines whether a person acquires a right in a controllable
14 electronic record and the right, ~~if any,~~ the person acquires.

15 ~~(d)~~ (c) [Shelter principle and purchase of limited interest.] A purchaser of a
16 controllable electronic record acquires all rights in the controllable electronic record that the
17 transferor had or had power to transfer.

18 ~~(e)~~ A, except that a purchaser of a limited interest in a controllable electronic record
19 acquires rights only to the extent of the interest purchased.

20 ~~(f)~~ (d) [Rights of qualifying purchaser.] A qualifying purchaser acquires its rights in the
21 controllable electronic record free of a claim of a property right in the controllable electronic
22 record.

23 ~~(g)~~ Except as provided in subsection (f)

1 (e) [Limitation of rights of qualifying purchaser in other property.] Except as
2 provided in subsections (a) and (d) for controllable accounts and controllable payment
3 intangibles or law other than this article, a qualifying purchaser takes a right to payment, right to
4 performance, or interest in property evidenced by the controllable electronic record subject to a
5 claim of a property right in the right to payment, right to performance, or other interest in
6 property.

7 ~~(h)f)~~ [No-action protection for qualifying purchaser.] An action ~~based on the purchase~~
8 ~~by may not be asserted against~~ a qualifying purchaser based on both a purchase by the qualifying
9 purchaser of a controllable electronic record and ~~on~~ a claim of a property right in another
10 controllable electronic record, [whether framed in conversion, replevin, constructive trust,
11 equitable lien, or other theory, ~~may not be asserted against~~] [regardless of how the qualifying
12 purchaser action is framed].

13 ~~(+)~~ (g) [Filing not notice.] Filing of a financing statement under Article 9 is not notice of
14 a claim of a property right in a controllable electronic record.

Reporter's Note

17 1. *Source of these provisions.* Subsection (b) derives from Section 3-302(a)(2) (defining
18 “holder in due course”).

20 ~~Subsections (d) and (e) derive~~ Subsection (c) derives from Section 2-403(1) (concerning
21 the rights of a purchaser).

23 Subsection ~~(fd)~~ derives from Sections 3-306 (concerning the rights of a holder in due
24 course of an instrument) and 8-303 (concerning rights of a protected purchaser of a security).

26 Subsection ~~(hf)~~ derives from Section 8-502 (protecting entitlement holders) and its
27 applicability to a qualifying purchaser derives from Sections 3-302(b) (concerning notice of a
28 claim) and 3-306 (protecting holder in due course).

30 Subsection ~~(ig)~~ derives from Section 9-331(c) (filing under Article 9 does not provide
31 notice for purposes of protections of purchasers under other articles).

1 2. *Applicability of section to controllable accounts and controllable payment intangibles.*
2 ~~Pursuant to~~ Under subsection (a), the provisions of this section apply to controllable accounts
3 and controllable payment intangibles in the same manner that they apply to controllable
4 electronic records. For example, a qualifying purchaser of a controllable account that obtains
5 control of the controllable electronic record that evidences the account (and who thereby obtains
6 control of the account ~~pursuant to~~ under Section 9-107A) would take the account free of
7 conflicting rights in the account ~~pursuant to~~ under subsection (~~f~~-d). Unless otherwise specified
8 or the context otherwise requires, references to a controllable electronic record in the Reporter's
9 Notes in this Article also refer to a controllable account or controllable payment intangible.

10
11 3. *Applicability of other law.* As a general matter, this section leaves to other law the
12 resolution of questions concerning the transfer of rights in a controllable electronic record, such
13 as the acts that must be taken to effectuate a transfer of rights and the scope of the rights that a
14 transferee acquires. *See* subsection (~~e~~-b). Subsections (~~d~~c) through (~~i~~g) contain important
15 exceptions to this subsection.

16
17 **Example:** A creates a controllable electronic record. Other law would determine what
18 rights A has in the controllable electronic record. A and B agree to the sale of the
19 controllable electronic record to B. Other law would determine what steps need to be
20 taken for B to acquire rights in the controllable electronic record. Once B acquires those
21 rights, B would be a purchaser (as defined in Section 1-201), whose rights would be
22 determined ~~by~~ either by subsection (~~e~~b) or ~~by~~ subsections (~~d~~c) and (~~f~~d), depending on
23 whether B was a qualifying purchaser.

24
25 The “law other than this article” that may apply to the transfer of rights in a controllable
26 electronic record under subsection (~~e~~b) includes UCC Article 9. Section 9-203 would apply, for
27 example, to determine whether a purported secured party acquired an enforceable security
28 interest in a controllable electronic record.

29
30 4. *Purchaser and transferor under subsection (c): resulting controllable electronic*
31 *records.* Subsection (~~d~~c) sets forth the familiar “shelter” principle, under which a purchaser of a
32 controllable electronic record acquires whatever rights the transferor had or had power to
33 transfer. However, in some cases the controllable electronic record that is acquired by the
34 purchaser will not be the “same” controllable electronic record that was transferred by the
35 transferor. Such a transfer might involve the elimination of a “transferred” controllable electronic
36 record and the resulting and corresponding derivative creation and acquisition of a new
37 controllable electronic record. An example of such a resulting controllable electronic record is
38 the unspent transaction output (UTXO) generated by a transaction in bitcoin. Subsection (d)
39 should be construed broadly to encompass such transfers and resulting derivative controllable
40 electronic records acquired by a purchaser. Because subsection (~~d~~c) addresses the rights of a
41 purchaser in the “purchased” asset and not the “transferred” asset, this construction is wholly
42 consistent with the statutory text.

43
44 5. *Nonpurchaser having control.* Under draft § 12-105, a person may have control of a
45 controllable electronic record even if the person has no property interest in the controllable
46 electronic record. A person that has control of, but no interest in, a controllable electronic record

1 would not be a purchaser of the controllable electronic record and so would not be eligible to be
2 a qualifying purchaser under this section.

3
4 **Example:** Debtor granted to Secured Party a security interest in all Debtor's existing and
5 after-acquired accounts, chattel paper, and payment intangibles. Secured Party perfected
6 its security interest in a specific controllable account by obtaining control of the
7 controllable electronic record that evidences the controllable account. *See* draft § 9-107A.

8
9 Because Debtor's security agreement does not cover controllable electronic records,
10 Secured Party would have no interest in the controllable electronic record. Accordingly,
11 Secured Party would not be a purchaser of the controllable electronic record. However, as
12 a purchaser of the controllable accounts and controllable payment intangibles, Secured
13 Party could benefit from the take-free rule in subsection (f) (discussed in *Notes Note 6*
14 *and 7*). Having taken control of the specific controllable account, Secured Party may be
15 a qualifying purchaser. ~~Even if~~ Secured Party were not a qualifying purchaser of the
16 controllable account, its security interest in the account ~~as to~~ over which ~~to it~~ obtained
17 control would, however, have priority over a conflicting security interest that was
18 perfected by a method other than control. *See* draft § 9-326A.

19
20 6. ~~Conditions for, and consequences of, becoming a qualifying purchaser. The~~
21 ~~conditions for, and consequences of, becoming a qualifying purchaser pursuant to subsection (f)~~
22 ~~were drawn from Article 3. More specifically, the conditions for becoming a qualifying~~
23 ~~purchaser were drawn from Section 3-302(a)(2), which defines "holder in due course" of a~~
24 ~~negotiable instrument. Among these conditions is that a person take the instrument "for value."~~
25 ~~As Note 10 explains, the concept of value in Article 3 differs from the concept of value that is~~
26 ~~generally applicable in the UCC. Article 12 adopts the Article 3 concept.~~

27
28 ~~Pursuant to subsection (a), not only a purchaser-free rule. Subsection (d) makes~~
29 ~~controllable electronic records and, under subsection (a), controllable accounts and controllable~~
30 ~~payment intangibles, highly negotiable. Subsection (d) derives from Section 3-306, under which~~
31 ~~a holder in due course takes a negotiable instrument free of a claim of a property right in the~~
32 ~~instrument. A qualifying purchaser of a controllable electronic record but also a purchaser of a,~~
33 ~~controllable account, or controllable payment intangible may be a qualifying purchaser.~~
34 ~~Moreover, a purchaser of a controllable account or a controllable payment intangible may be a~~
35 ~~qualified purchaser even if it does not also purchase the takes free of all claims of a property~~
36 ~~right in the purchased controllable electronic record that evidences the, account of, or payment~~
37 ~~intangible. However, to obtain control of the controllable account or controllable payment~~
38 ~~intangible (a condition of qualifying purchaser status under subsection (b)), the purchaser must~~
39 ~~obtain control of that controllable electronic record. Draft § 9-107A.~~

40
41 ~~The~~ As a general matter, law other than Article 12 would determine whether any
42 particular transaction creates a property interest in a controllable electronic record. *See*
43 subsection (b). The applicable law may provide that a hacker, who is essentially a thief, acquires
44 no rights in a "stolen" controllable electronic record. Even if this is the case, subsection (d)
45 would enable a purchaser that obtains control from a hacker and that otherwise meets the
46 definition of "qualifying purchaser" (for value, in good faith, and without notice of property

1 claims) to take the controllable electronic record (or any purchased controllable account or
2 controllable payment intangible) free of property claims. A person in control of a controllable
3 electronic record therefore has the power, even if not the right, to transfer rights in the record to a
4 qualifying purchaser. Of course, if the qualifying purchaser is a secured party whose security
5 interest secures an obligation, the purchaser would take free of the conflicting property right only
6 to the extent of the obligation secured. See subsection (c) (purchaser of a limited interest); cf.
7 UCC § 3-302(e).

8
9 7. Subsection (f)—the “no-action” rule. Subsection (f) applies in the situation (explained
10 in Note 4) in which the “resulting” controllable electronic record (or controllable account or
11 controllable payment intangible) purchased by a qualifying purchaser is not the “same” record,
12 account, or payment intangible that was transferred. In such a situation, a person claiming a
13 property right in the transferred asset may assert a claim against a purchaser of the “resulting”
14 asset even though the claimant is not asserting a claim of a property right in the purchased asset.
15 If the claim is based on both the purchaser’s purchase of the acquired asset and the claimant’s
16 rights in the transferred asset, subsection (f) protects the qualified purchaser from liability to the
17 claimant based on any theory. The qualified purchaser’s protection from the assertion of such a
18 claim does not depend on any proof that the purchased asset is somehow “traceable” to the
19 transferred asset.

20
21 If instead, such a claimant were to assert a claim based on a property right in the
22 purchased asset, then the qualified purchaser would take free of that claim under subsection (d).
23 Subsection (d) applies whether or not the acquired asset is the same asset that was transferred.

24
25 8. “Tethered” assets. Certain controllable electronic records may carry with them rights
26 to other assets, e.g., goods or rights to payment. By its terms, the take-free rule in subsection (d)
27 applies to controllable electronic records (and, under subsection (a), controllable accounts and
28 controllable payment intangibles). One might argue that the inclusion of controllable accounts
29 and controllable payment intangibles in the scope of subsection (d) is unnecessary. By taking a
30 controllable electronic record free of property claims, the argument would be that a person takes
31 not only the controllable electronic record itself but also all rights that are “carried” in the
32 controllable electronic record free and clear.

33
34 Subsection (e) defeats that argument. It limits the application of the take-free rule in
35 subsection (d) to controllable electronic records and, through the application of subsection (a),
36 controllable accounts and controllable payment intangibles. Under subsection (e), except as
37 provided in subsection (a) and (d), a qualifying purchaser takes rights to payment (other than
38 controllable accounts and controllable payment intangibles), rights to performance, and interests
39 in property that are evidenced by a controllable electronic record subject to third-party property
40 claims, unless law other than Article 12 provides to the contrary. The reference in subsection (e)
41 to “law other than this article” contemplates that another article of the UCC might provide a
42 contrary rule for some types of property that might be tethered to a controllable electronic record.

43
44 9. Creating the functional equivalent of a negotiable instrument. Two defining
45 characteristics of an Article 3 negotiable instrument are that a holder in due course (i) takes free
46 of claims of a property or possessory right to the instrument (Section 3-306) and (ii) takes free of

1 most defenses and claims in recoupment (Section 3-305). Article 3 applies only to written
2 instruments. This draft provides a method for reaching a similar result with respect to
3 controllable accounts and controllable payment intangibles.

4
5 As regards the first characteristic, a qualifying purchaser could acquire the controllable
6 account or controllable payment intangible free of any claim of a property interest. As regards
7 the second characteristic, the definition of “qualifying purchaser” omits some of the conditions
8 for becoming a holder in due course. For example, to qualify as a holder in due course, a holder
9 must take “without notice that any party has a defense or claim in recoupment” Section 3-
10 302(a)(2)(vi). A controllable electronic record is information; there are no parties to a
11 controllable electronic record. ~~There~~However, there are parties to a controllable account or
12 controllable payment intangible. Accordingly, Sections 9-404 and 9-403 would determine
13 whether a purchaser of the controllable account or controllable payment intangible takes free of a
14 defense.

15
16 ~~Subsection (f) derives from Section 3-306, under which a holder in due course takes a~~
17 ~~negotiable instrument free of a claim of a property right in the instrument. A qualifying~~
18 ~~purchaser of a controllable electronic record, controllable account, or controllable payment~~
19 ~~intangible takes free of all claims of a property right in the purchased controllable electronic~~
20 ~~record, account, or payment intangible.~~

21
22 ~~7. The take-free rule. Subsection (f) makes controllable electronic records and, pursuant~~
23 ~~to subsection (a), controllable accounts and controllable payment intangibles, highly negotiable.~~
24 ~~It protects a qualifying purchaser against claims of a property interest in the purchased~~
25 ~~controllable electronic record, account, or payment intangible.~~

26
27 ~~As a general matter, law other than Article 12 would determine whether any particular~~
28 ~~transaction creates a property interest in a controllable electronic record. See subsection (c).~~
29 ~~The applicable law may provide that a hacker, who is essentially a thief, acquires no rights in a~~
30 ~~“stolen” controllable electronic record. Even if this is the case, subsections (d) and (f) would~~
31 ~~enable a purchaser that obtains control from a hacker and that otherwise meets the definition of~~
32 ~~“qualifying purchaser” (for value, in good faith, and without notice of property claims) to take~~
33 ~~the controllable electronic record (or any purchased controllable account or controllable payment~~
34 ~~intangible) free of property claims. A person in control of a controllable electronic record~~
35 ~~therefore has the power, even if not the right, to transfer rights in the record to a qualifying~~
36 ~~purchaser. Of course, if the qualifying purchaser is a secured party whose security interest~~
37 ~~secures an obligation, the purchaser would take free of the conflicting property right only to the~~
38 ~~extent of the obligation secured. See subsection (c) (purchaser of a limited interest); cf. UCC §~~
39 ~~3-302(e).~~

40
41 ~~8. Subsection (h) the “no action” rule. Subsection (h) applies in the situation~~
42 ~~(explained in Note 4) in which the “resulting” controllable electronic record (or controllable~~
43 ~~account or controllable payment intangible) purchased by a qualifying purchaser is not the~~
44 ~~“same” record, account, or payment intangible that was transferred. In such a situation, a person~~
45 ~~claiming a property right in the transferred asset may assert a claim against a purchaser of the~~
46 ~~“resulting” asset even though the claimant is not asserting a claim to the purchased asset. If the~~

1 ~~claim is based on both the purchaser's purchase of the acquired asset and the claimant's rights in~~
2 ~~the transferred asset, subsection (h) protects the qualified purchaser from liability to the claimant~~
3 ~~based on any theory. The qualified purchaser's protection from the assertion of such a claim~~
4 ~~does not depend on any proof that the purchased asset is somehow "traceable" to the transferred~~
5 ~~asset.~~

6
7 ~~If instead, such a claimant were to assert a claim based on a property right in the~~
8 ~~purchased asset, then the qualified purchaser would take free of that claim pursuant to subsection~~
9 ~~(f). Subsection (f) applies whether or not the acquired asset is the same asset that was~~
10 ~~transferred.~~

11
12 ~~9. "Tethered" assets. Certain controllable electronic records may carry with them rights~~
13 ~~to other assets, e.g., goods or rights to payment. By its terms, the take free rule in subsection (f)~~
14 ~~applies to controllable electronic records (and, pursuant to subsection (a), controllable accounts~~
15 ~~and controllable payment intangibles). One might argue that the inclusion of controllable~~
16 ~~accounts and controllable payment intangibles in the scope of subsection (f) is unnecessary. By~~
17 ~~taking a controllable electronic record free of property claims, the argument would be that a~~
18 ~~person takes not only the controllable electronic record itself but also all rights that are "carried"~~
19 ~~in the controllable electronic record free and clear.~~

20
21 ~~Subsection (g) defeats that argument. It limits the application of the take free rule in~~
22 ~~subsection (f) to controllable electronic records, controllable accounts, and controllable payment~~
23 ~~intangibles. Under subsection (g), except as provided in subsection (f), a qualifying purchaser~~
24 ~~takes rights to payment, rights to performance, and interests in property that are evidenced by a~~
25 ~~controllable electronic record subject to third party property claims, unless law other than Article~~
26 ~~12 provides to the contrary. The reference in subsection (g) to "law other than this article"~~
27 ~~contemplates that another article of the UCC might provide a contrary rule for some types of~~
28 ~~property that might be tethered to a controllable electronic record.~~

29
30 ~~10. Creating the functional equivalent of a negotiable instrument. Two defining~~
31 ~~characteristics of an Article 3 negotiable instrument are that a holder in due course (1) takes free~~
32 ~~of claims of a property or possessory right to the instrument (Section 3-306) and (2) takes free of~~
33 ~~most defenses and claims in recoupment (Section 3-305). Article 3 applies only to written~~
34 ~~instruments. This draft provides a method for reaching a similar result with respect to~~
35 ~~controllable accounts and controllable payment intangibles. As regards the first characteristic, a~~
36 ~~qualifying purchaser of could acquire the controllable account or controllable payment intangible~~
37 ~~free of any claim of a property interest. As regards the second, Section 9-403 ordinarily would~~
38 ~~give effect to the account debtor's agreement not to assert claims or defenses.~~

39
40 ~~Section 9-403 adopts the meaning of value in Section 3-303, as does Article 12. The~~
41 ~~concept of value in Section 3-303 is narrower than the concept in Section 1-204, which applies~~
42 ~~generally to UCC transactions. Under Section 1-204, a person gives value for rights if the person~~
43 ~~acquires them in return for a promise. However, under Section 3-303, if a negotiable instrument~~
44 ~~is issued or transferred for a promise of performance, the instrument is transferred for value only~~
45 ~~to the extent that the promise has been performed.~~

1 **Section 12-105. Control of Controllable Electronic Record.**

2 ~~(a)~~ (a) [General rule: control of controllable electronic record.] A person has
3 control of a controllable electronic record if:

4 (1) the ~~controllable~~-electronic record, a record attached to or logically associated
5 with the ~~controllable~~-electronic record, or ~~the~~a system in which the ~~controllable~~-electronic record
6 is recorded,~~if any~~, gives the person:

7 (A) the power to avail itself of substantially all the benefit from the
8 ~~controllable~~-electronic record; and

9 (B) exclusive power, subject to subsection (b), ~~the exclusive power~~ to:

10 (i) prevent others from availing themselves of substantially all the
11 benefit from the ~~controllable~~-electronic record; and

12 (ii) transfer control of the ~~controllable~~ electronic record to another
13 person or cause another person to obtain control of another controllable electronic record as a
14 result of the transfer of the ~~controllable~~-electronic record; and

15 (2) the ~~controllable~~-electronic record, a record attached to or logically associated
16 with the ~~controllable~~-electronic record, or ~~the~~a system in which the ~~controllable~~-electronic record
17 is recorded,~~if any~~, enables the person ~~to~~ readily to identify itself in any way ~~as having the~~
18 ~~powers specified in paragraph (1),~~₂ including by name, identifying number, cryptographic key,
19 office, or account number~~;~~ as having the powers specified in paragraph (1).

20 (b) [Control through another person.] A person ~~also~~ has control of a controllable
21 electronic record if another person, other than the transferor of an interest in the electronic
22 record:

23 (1) has control of the ~~controllable~~-electronic record and acknowledges that it has

1 control on behalf of the person, or

2 (2) obtains control of the ~~controllable~~ electronic record after having
3 acknowledged that it will ~~acquire~~obtain control of the ~~controllable~~ electronic record on behalf of
4 the person.

5 (c) [Meaning of exclusive.] A power specified in subsection (a)(1) is exclusive, even if:

6 (1) the controllable electronic record or ~~the~~a system in which the ~~controllable~~
7 electronic record is recorded, ~~if any,~~ limits the use ~~to which of~~ the ~~controllable~~ electronic record
8 ~~may be put~~ or has a protocol ~~that is~~ programmed to ~~result in~~ cause a change,
9 including a transfer or loss of control or a modification of benefits afforded by the electronic
10 record; or

11 (2) the person has agreed to share the power with another person.

12 Reporter's Note

13
14 1. *Why "control" matters.* Control serves two major functions in Article 12. An
15 electronic record is a "controllable electronic record" and is subject to the provisions of this
16 article only if it can be subjected to control under this section. *See* draft §§§ 12-102; ~~12-103.~~
17 (a)(1) (defining "controllable electronic record"). And only a person having control of a
18 controllable electronic record is eligible to become a qualifying purchaser and so take free of
19 claims of a property interest in the controllable electronic record or any controllable account or
20 controllable payment intangible evidenced by the controllable electronic record ~~– and to receive~~
21 protection from the "no-action" rule. *See* draft § 12-104.

22
23 In addition, draft amendments to Article 9 provide that obtaining control of a controllable
24 electronic record is one method by which to perfect a security interest in the controllable
25 electronic record or any controllable account or controllable payment intangible evidenced by the
26 controllable electronic record. Under these amendments, perfection of a security interest in
27 controllable accounts and controllable payment intangibles can be achieved by obtaining control
28 of the related controllable electronic record. *See* draft §§ 9-107A; 9-314. Moreover, a security
29 interest perfected by control has priority over a conflicting security interest that was perfected by
30 a method other than control. *See* draft § 9-326A.

31
32 2. *Powers and sources of powers; inability to exercise a power.* This section conditions
33 control on a person's having the three powers specified in paragraph (a)(1). A person would have
34 a power described in this paragraph if the controllable electronic record, a record attached to or
35 logically associated with the controllable electronic record, or any system in which it is recorded

1 gives the purchaser that power. This description of the source of the relevant powers should be
2 construed broadly and functionally. For example, a system in which the person in control is
3 identified is a permissible source of a power even if it is related to but not precisely the “same”
4 system in which the controllable electronic record is recorded. Moreover, a person would have a
5 power even if the characteristics of the particular purchaser disable the person from exercising
6 the power. This would be the case, for example, when the purchaser holds the private key
7 required to access the benefit of the controllable electronic record but lacks the hardware
8 required to use it.

9
10 3. “*Benefit.*” Subparagraphs (a)(1)(A) and (a)(1)(B)(i) condition control of a controllable
11 electronic record on a person’s relationship to the benefit of the controllable electronic record.

12
13 As used in the section, the “benefit” of a controllable electronic record refers to the rights
14 that are afforded by the controllable electronic record and the uses to which the controllable
15 electronic record can be put. These, in turn, depend on the characteristics of the controllable
16 electronic record in question. For example, bitcoin can be held or disposed of (sold ~~or spent~~).
17 And control of a controllable electronic record evidencing a controllable account or controllable
18 payment intangible affords the right to collect from the account debtor (obligor).

19
20 The system in which a controllable electronic record is recorded may limit the benefit
21 from the controllable electronic record that is available to those who interact with the system. In
22 determining whether a person has the power to avail itself of substantially all the benefit from a
23 controllable electronic record under subparagraph (a)(1)(A), or to prevent others from availing
24 themselves of substantially all the benefit from a controllable electronic record under
25 subparagraph (a)(1)(B)(i), only the benefit that the system makes available should be considered.

26
27 4. *Power to retrieve information.* By definition, the information constituting an electronic
28 record must be “retrievable in perceivable form.” UCC § 1-201 ~~–(b)(31 (defining “record”))~~. The
29 power to retrieve the record in perceivable form is included in the benefit of a controllable
30 electronic record. “Perceivable form” means that the contents of the record are intelligible; the
31 ability to perceive the indecipherable jumble of an encrypted record does not give a person the
32 power to retrieve the record in perceivable form.

33
34 To have control of a controllable electronic record under subparagraph (a)(1)(A), a
35 person must have at least the nonexclusive power to avail itself of this benefit. If a person also
36 has the exclusive power to decrypt the encrypted record, the person will have the exclusive
37 power to prevent others from availing themselves of substantially all the benefit from the
38 controllable electronic record and thereby satisfy the condition in subparagraph (a)(1)(B)(i).

39
40 5. *Exclusive powers.* Unlike the power in subparagraph (a)(1)(A), the powers in
41 subparagraphs (a)(1)(B)(i) and (a)(1)(B)(ii) must be held exclusively by the person claiming
42 control in order to establish control. However, subsection (c) contains two limitations on the term
43 “exclusive” as used in subsection (a) ~~–(1)~~. Under subsection (c), a power can be “exclusive”
44 even if one or both of these limitations apply.

45
46 Paragraph (c)(1) takes account of the fact that the powers of a purchaser of a controllable

1 electronic record necessarily are subject to the attributes of the controllable electronic record and
2 the protocols of any system in which the controllable electronic record is recorded. A transfer of
3 control resulting from a program that is a part of a system's protocol is inherent in the
4 controllable electronic record and does not impair the exclusivity of the power of the person in
5 control of the record.
6

7 Paragraph (c)(2) allows for a person's agreement to share a power with another person.
8 One effect of paragraph (c)(2) is that, under a multi-signature (multi-sig) agreement, any person
9 that is readily identifiable under paragraph (a)(2) and shares the relevant power would be eligible
10 to have control, even if the action of another person is a condition for the exercise of the power.
11 For example, a person in control may agree that another person's action on the relevant system
12 would be required to effect a transfer of control without impairing the requisite exclusivity.
13

14 6. *Transfer of control.* The power to transfer control of a controllable electronic record
15 under subsection (a)(1)(B)(ii) includes the power to cause another person to obtain control of
16 another derivative controllable electronic record that results from the transfer of ~~a~~ the
17 controllable electronic record. See draft § 12-104, Reporter's Note 4.
18

19 7. *Control through another person.* Neither Article 12 nor any other provision of the
20 UCC (or other law that has been brought to the attention of the Drafting Committee) would
21 restrict or render ineffective any agreement of a person in control of a controllable electronic
22 record to hold control on behalf of another person. This result is implicit from paragraph (c)(2)
23 dealing with sharing of control. It would also follow under principles of agency. But such an
24 arrangement should be effective regardless of any agency or fiduciary relationship.
25

26 This concept is expressly addressed in Section 8-106(d)(3), on control of a security
27 entitlement, which achieves perfection of a security interest under Sections 9-106(a) and 9-
28 314(a). It also applies to perfection by possession under Section 9-313(c) if a person other than
29 the debtor or the secured party is in possession of collateral. Under those provisions, however,
30 effectiveness is conditioned in some circumstances on an "acknowledgment" by the person in
31 control or possession. Under Section 9-313(c) the acknowledgment must be in an authenticated
32 record. These provisions appear to derive from practices involving bailees of tangible property,
33 such as goods, chattel paper, and certificated securities.
34

35 Subsection (b) likewise provides for control by a person through another person's control
36 on behalf of the person. ~~Although subsection~~ Subsection (b) is patterned on Section 9-313(c), ~~it~~
37 but like Section 8-103(d)(3), subsection (b) omits the requirement in Section 9-313(c) that an
38 acknowledgment be made in an authenticated record. Although best practices would suggest the
39 wisdom of relying on an authenticated record to evidence such an acknowledgment, subsection
40 (b) would permit proof by other means.
41

42 Substantially similar provisions are proposed to be included in draft §§ 7-106 (control of
43 electronic documents of title), 9-104 (control of deposit accounts), 9-105 (control of authoritative
44 electronic copies of records evidencing chattel paper), and 9-105A (control of electronic money),
45 and and in a proposed conforming modification to Section 8-106(d)(3) (control of security
46 entitlement).

1 Subsection (b) qualifies this method of obtaining control by providing that the
2 acknowledging person must be one “other than the transferor of an interest in the electronic
3 record.” Section 9-313(c) expressly provides in this context that an acknowledging person
4 having possession of goods must be a person “other than the debtor.” The official comments to
5 Section 8-106 are to the same effect in the context of control of a security entitlement. Section
6 8-106(d)(3), comment 4. The same policy that underpins the inapplicability of this method of
7 control to an acknowledgment by a debtor applies as well to a transferor that is not an Article 9
8 debtor. Control is intended to be a proxy for and a functional equivalent of the transfer of
9 physical possession of goods. In general, a person can obtain control through control by an agent,
10 as noted above. However, an acknowledgment by a debtor or transferor that acts as an agent of
11 a secured party or other transferee would be ineffective. This corresponds to the policy
12 underlying Section 9-313 that “the debtor cannot qualify as an agent for the secured party for
13 purposes of the secured party’s taking possession.” Section 9-313, comment 3. The Drafting
14 Committee may wish to consider whether the statute should provide expressly that a debtor or
15 transferor cannot act as an agent for a secured party or other transferee. The same issue arises
16 not only under 9-313 but also in connection with the proposed modifications to Sections 7-106,
17 8-106(d)(3), 9-105, and 9-105A.

18
19 The combined operation of subsections (b) and (c)(2) ensure that the continuance of
20 various existing practices would not prevent or cause the loss of control. For example, a person
21 in control may wish to grant another person the power to approve or disapprove a transfer of
22 control on the system. ~~Or~~ Alternatively, a person in control may wish to permit a system
23 administrator to transfer control to another person under specified conditions without
24 participation by the person in control. And, of course, a person in control may wish to delegate
25 the power to transfer control to an agent or fiduciary.

26
27 8. *Readily identify*. Paragraph (a)(2) provides that a person does not have control of a
28 controllable electronic record unless the controllable electronic record, a record attached to or
29 logically associated with the controllable electronic record, or any system in which the
30 controllable electronic record is recorded enables the person ~~to~~ readily to identify itself as the
31 person having the requisite powers. This paragraph does not obligate a person to identify itself as
32 having control. However, to prove that it has control, a person would need to prove that the
33 relevant records or any system in which the controllable electronic record is recorded readily
34 identifies the person as such. But proof that a person has the powers specified in section (a)(1)
35 does not require proof of exclusivity—i.e., proof of a negative (that no one else has such
36 powers). The ~~last phrase means~~ of paragraph identification mentioned in subsection (a)(2)
37 ~~derives~~ derive from Section 3-110(c). ~~It~~ Subsection (a)(2) adds “cryptographic key” as an
38 example of a way in which a person may be identified.

39
40 **Section 12-106. Discharge of Account Debtor on Controllable Account or**
41 **Controllable Payment Intangible.**

42 ~~(a) Except as provided in this section, an~~ (a) [Discharge of account debtor.] An account
43 debtor on a controllable account or controllable payment intangible may discharge its obligation

1 by paying:

2 (1) ~~by paying~~ the person having control of the controllable electronic record that
3 evidences the controllable account or controllable payment intangible; or

4 (2) ~~by paying~~ except as provided in subsection (b), a person that formerly had
5 control of the controllable electronic record.

6 (b) [Effect of notification.] Subject to subsections (d) and (h), an account debtor may not
7 discharge its obligation by paying a person that formerly had control of the controllable
8 electronic record if the account debtor receives a notification that:

9 (1) is authenticated by a person that formerly had control or the person to which
10 control was transferred;

11 (2) reasonably identifies the controllable account or controllable payment
12 intangible;

13 (3) notifies the account debtor that control of the controllable electronic record
14 that evidences the controllable account or controllable payment intangible was transferred;

15 (4) identifies the transferee, in any reasonable way, including by name,
16 identifying number, cryptographic key, office, or account number; and

17 (5) provides a commercially reasonable method by which the account debtor is to
18 pay the transferee.

19 ~~(c)~~ (c) [Discharge following effective notification.] After receipt of a notification that
20 complies with subsection (b), the account debtor may discharge its obligation only by paying in
21 accordance with the notification [and may not discharge the obligation by paying a person that
22 formerly had control—].

23 ~~(d)~~ (d) [When notification ineffective.] Subject to subsection (h), notification is

1 ineffective under subsection (b):

2 (1) unless, before the notification is sent, ~~the~~ an account debtor and the person
3 that, at that time, had control of the controllable electronic record that evidences the controllable
4 account or controllable payment intangible agree in an authenticated record to a commercially
5 reasonable method by which a person ~~can~~ may furnish reasonable proof that control has been
6 transferred;

7 (2) to the extent ~~that~~ an agreement between ~~the~~ an account debtor and ~~the~~ seller of
8 a payment intangible limits the account debtor's duty to pay a person other than the seller and the
9 limitation is effective under law other than this article; or

10 (3) at the option of ~~the~~ an account debtor, if the notification notifies the account
11 debtor to:

12 (A) divide a payment;

13 (B) make less than the full amount of ~~any~~ [a required] [an installment or
14 other periodic] payment; or

15 (C) pay any ~~portions~~part of a payment by more than one method or to
16 more than one person.

17 ~~(e)~~ (e) [Proof of transfer of control.] Subject to subsection (h), if requested by the
18 account debtor, the person giving the notification ~~shall~~ seasonably shall furnish reasonable proof,
19 using the agreed method, that control of the controllable electronic record has been transferred.

20 [Unless the person complies] [If the person does not comply] with the request, the account debtor
21 may discharge its obligation by paying a person that formerly had control, even if the account
22 debtor has received a notification under subsection (b).

23 ~~(f)~~ (f) [What constitutes reasonable proof.] A person furnishes reasonable proof that

control has been transferred if the person demonstrates, using the agreed method, that the transferee has the power to:

(1) avail itself of substantially all the benefit from the controllable electronic record;

(2) prevent others from availing themselves of substantially all the benefit from the controllable electronic record; ~~and transfer these powers to another person; and~~

(3) transfer the powers mentioned in paragraphs (1) and (2) to another person.

(g) [Rights not waivable.] Subject to subsection (h), an account debtor may not waive or vary its rights under subsections (d)(1) and (e) or its option under subsection (d)(3).

~~(h) This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.~~

Reporter's Note

1. *Source of these provisions.* These provisions derive from Section 3-602, which governs the discharge of a person obligated on a negotiable instrument, and Section 9-406, which governs the discharge of an account debtor, including a person obligated on an account or payment intangible.

2. *The basic rules.* This section applies only to an account debtor that has undertaken to pay the person that has control of the controllable electronic record that evidences the obligation to pay. *See* draft § 9-102 (defining “controllable account” and “controllable payment intangible”). Section 9-406 would continue to apply in other respects and to all other account debtors. As to the relationship between this section and Section 9-406, see Note 4.

Under subsection (a)(1), an account debtor may discharge its obligation on the controllable account or controllable payment intangible by paying the person that has control of the related controllable electronic record at the time of payment. Subsections (a)(2) and (b) would remove from an account debtor the burden of determining who has control of the related controllable electronic record at any given time—a burden that, with respect to some controllable electronic records, an account debtor may be unable to satisfy. Under paragraph (a)(2), subject to subsection (b), an account debtor may discharge its obligation by paying a person that formerly had control of the related controllable electronic record, which presumably would include the initial obligee.

1 Subsection (b) reflects the fact that a person to which control has been transferred may
2 not wish to take the risk that the account debtor will discharge its obligation by paying the
3 transferor. Subsection (b) would protect the transferee by providing that if the account debtor
4 receives ~~a~~ an effective notification that control has been transferred, the account debtor may
5 discharge its obligation by paying in accordance with the notification and may not discharge its
6 obligation by paying a person that formerly had control. The notification must be authenticated
7 by a person formerly having control or by the transferee.

8
9 To be effective under subsection (b), a notification must reasonably identify the
10 controllable account or controllable payment intangible, notify the account debtor that control of
11 the controllable electronic record that evidences the controllable account or controllable payment
12 intangible was transferred, identify the transferee in any reasonable way, and provide a
13 commercially reasonable method by which the account debtor is to make payments to the
14 transferee. A change in the identity of the person to which the account debtor must make
15 payment should not, and typically will not, impose a significant burden on the account debtor.
16 However, one can imagine a method of making payment that would be burdensome, *e.g.*, making
17 a payment through a trading platform or payment service with which the account debtor does not
18 have an account. For this reason, the designated method of making payment must be
19 “commercially reasonable.”

20
21 3. “*Reasonable proof.*” As noted above, this section derives in large part from Section 9-
22 406, which provides for notification that an account or payment intangible has been assigned.
23 Account debtors that have received notification of an assignment under Section 9-406 almost
24 always make payments in accordance with the notice. Recognizing that an account debtor may
25 be uncertain whether a notification is legitimate, Section 9-406 affords to an account debtor the
26 right to request proof that the account or payment intangible was assigned.

27
28 Subsection (e) contains a similar provision. ~~Upon~~ On the account debtor’s request, the
29 person giving the notification must seasonably furnish reasonable proof that control of the
30 controllable electronic record has been transferred. If the person does not comply with the
31 request, the account debtor may ignore the notification and discharge its obligation by a paying a
32 person formerly in control.

33
34 “Reasonable proof” requires evidence that would be understood by a typical account
35 debtor to whom it is proffered as demonstrating to a reasonably high probability that control of
36 the controllable electronic record has been transferred to the transferee. Subsection (f) provides a
37 safe harbor for providing reasonable proof. It enables a person to satisfy the account debtor’s
38 request by demonstrating that the transferee has the power to avail itself of substantially all the
39 benefit from the controllable electronic record, to prevent others from availing themselves of
40 substantially all the benefit from the controllable electronic record, and to transfer these powers
41 to another person. This demonstration would not necessarily prove that a person actually has
42 control of a controllable electronic record because it need not show that the transferee held the
43 last two powers exclusively. Nevertheless, such a demonstration would constitute “reasonable
44 proof” under subsection (f). A person that has control should have little difficulty providing this
45 proof, as a person cannot have control unless it can readily identify itself as having the requisite
46 powers. *See* draft § 12-105(a)(2).

1 Reasonable proof that is seasonably furnished by a person other than the person that gave
2 the notification would constitute compliance with the account debtor's request.

3
4 Subsection (e) requires that reasonable proof be provided "using the agreed method."
5 Subsection (f) requires that a person use "the agreed method" to demonstrate that the transferee
6 has the specified powers. "Agreed method" refers to the commercially reasonable method to
7 which the parties agreed, in an authenticated record, before the notification was sent. If parties
8 did not so agree, the notification is ineffective under subsection (d)(1).

9
10 4. *Relationship to Section 9-406.* Section 9-406 governs the discharge of the obligation of
11 an account debtor. ~~It will~~ Section 9-406 is proposed to be amended to carve out transactions
12 covered by this section. See draft § 9-406.

13 14 **Section 12-107. Governing Law.**

15 ~~(a)~~ (a) [Governing law: general rule.] Except as provided in subsection (b), the local
16 law of a controllable electronic record's jurisdiction governs ~~the matters~~ a matter covered by this
17 article.

18 ~~(b)~~ (b) [Governing law: Section 12-106.] The local law of the controllable electronic
19 record's jurisdiction for a controllable electronic record that evidences a controllable account or
20 controllable payment intangible governs ~~the matters~~ a matter covered by Section 12-106 unless an
21 effective agreement determines that the local law of another jurisdiction governs ~~such matters~~.

22 ~~(c)~~ (c) [Controllable electronic record's jurisdiction.] The following rules determine a
23 controllable electronic record's jurisdiction ~~for purposes of~~ under this section:

24 (1) If the controllable electronic record, or a record attached to or logically
25 associated with the controllable electronic record which is readily available for review, expressly
26 provides that a particular jurisdiction is the controllable electronic record's jurisdiction for
27 purposes of this article or ~~the~~ UCC [Uniform Commercial Code], that jurisdiction is the
28 controllable electronic record's jurisdiction.

29 (2) If paragraph (1) does not apply and the rules of the system in which the
30 controllable electronic record is recorded are readily available for review and expressly provide

1 that a particular jurisdiction is the controllable electronic record's jurisdiction for purposes of
2 this article or ~~the~~ [Uniform Commercial Code], that jurisdiction is the controllable electronic
3 record's jurisdiction.

4 (3) If ~~none of the preceding~~ paragraphs applies (1) and (2) do not apply and the
5 controllable electronic record, or a record attached to or logically associated with the controllable
6 electronic record which is readily available for review, expressly provides that the controllable
7 electronic record is governed by the law of a particular jurisdiction, that jurisdiction is the
8 controllable electronic record's jurisdiction.

9 (4) If ~~none of the preceding~~ paragraphs applies (1) through (3) do not apply and
10 the rules of the system in which the controllable electronic record is recorded are readily
11 available for review and expressly provide that the controllable electronic record or the system is
12 governed by the law of a particular jurisdiction, that jurisdiction is the controllable electronic
13 record's jurisdiction.

14 (5) If ~~none of the preceding~~ paragraphs applies (1) through (4) do not apply, the
15 controllable electronic record's jurisdiction is the jurisdiction in which the transferor is located.

16 (d) ~~If paragraph (5)~~ [Location of transferor if evidence not sufficient.] If subsection
17 (c)(5) applies, ~~in an action in which~~ the governing law is in issue, if in an action, and the ~~tribunal~~
18 ~~determines that there~~evidence is not sufficient ~~evidence~~ to establish the ~~actual~~ location of the
19 transferor, the transferor is located in the District of ~~Colombia~~ Columbia.

20 (e) [Applicability of Article 12.] If subsection (d) applies and Article 12 is not in effect
21 in the District of ~~Colombia has not enacted Article 12~~ Columbia without material modification,
22 ~~then~~ the governing law for ~~the matters specified in subsection (a)~~ shall be matter covered by this
23 article is the law of the District of ~~Colombia~~ Columbia as though Article 12 ~~had been adopted by~~

1 ~~were in effect in~~ the District of ~~Columbia~~ Columbia without material modification. In this
2 section, “Article 12” means Uniform Commercial Code—Controllable Electronic Records (with
3 Conforming [and Miscellaneous] Amendments to Articles 1[, 2, 2A, 3, 4, 4A, 5, 7, 8,] and 9),
4 2022 Official Text.

5 (f) [Relation of transaction to controllable electronic record’s jurisdiction not
6 necessary.] Subsections ~~(e) and (b)~~ through (d) apply even if a transaction does not bear any
7 relation to the controllable electronic record’s jurisdiction.

8 (g) [Location of transferor.] Except as provided in subsection (d), Section 9-307, other
9 than Section 9-307(c), determines the location of the transferor for purposes of
10 ~~paragraph~~ subsection (c)(5) as if the transferor were a debtor.

11 ~~(h)~~ (h) [Rights of purchasers determined at time of purchase.] The rights acquired by
12 a purchaser or a qualifying purchaser under Section 12-104 are governed by the law applicable
13 under this section at the time of ~~that person’s~~ purchase.

14 ~~(i) In this section, “Article 12” means Uniform Commercial Code, Article 12,~~
15 ~~Controllable Electronic Records (with Conforming and Miscellaneous Amendments to Articles~~
16 ~~1[, 2, 2A, 3, 4, 4A, 5, 7, 8,] and 9) 2022 Official Text. [Describe here~~

17 Legislative Note: The state should describe where and how Article 12 is ~~made~~ available to the
18 public. See, e.g., TRADES Regulations, 31 CFR 357.2, defining “Revised Article 8.” The
19 definition of “Article 12” should ~~restate~~ cite the official “title” of the Official Text. ~~of the~~
20 article.

21
22 * * *

23 Reporter’s Note

24
25 1. *Source of these provisions.* The provisions of draft § 12-107 (as well as draft § 9-
26 306A) derive from Sections 8-110 and 9-305 on law governing perfection and priority of security
27 interests in investment property and the relevance of a securities intermediary’s jurisdiction and a
28 commodity intermediary’s jurisdiction.
29

1 2. *Practical limitations on determination of governing law.* This section relating to the
2 law governing the matters covered by Article 12 must confront substantial practical limitations.
3 These limitations arise primarily from two factors. First, as described below, this section relies
4 primarily on a “waterfall” of alternatives for determining a controllable electronic record’s
5 jurisdiction. The waterfall depends on express provisions of a controllable electronic record or
6 the system in which it is recorded. Many ~~such~~ electronic records and systems that currently exist
7 do not contain ~~such~~ these provisions. As explained in the ~~following~~ Note 5, the expectation is
8 that over time electronic records and related systems will adopt ~~such~~ these provisions in reliance
9 on this section so as to create certainty as to the governing law. Second, in the absence of ~~such~~
10 these provisions, at the bottom of the waterfall the controllable electronic record’s jurisdiction is
11 the jurisdiction in which a transferor is located. This also is problematic because in some cases
12 that location cannot readily be determined by parties to a transaction or be ~~the basis of~~
13 determined by a judicial determination tribunal, primarily because the identity of the transferor
14 may be unknown. *See* Reporter’s Prefatory Note 1 to Article 12.

15
16 3. *Governing law for draft § 12-106.* Subsection (b) provides an exception to the general
17 rule of subsection (a) that “the local law of a controllable electronic record’s jurisdiction governs
18 the matters covered by this article.” The exception recognizes that an account debtor’s rights and
19 duties generally are governed by the law applicable to the underlying contract between the
20 account debtor and an assignor, and not by the law applicable to the agreement between the
21 assignor (debtor) and the assignee (secured party)—i.e., a security agreement. *See* Section 9-401,
22 Comment 3. Subsection (b) recognizes that an effective agreement between the account debtor
23 and assignor may choose a different law to cover the matters covered by draft § 12-106 (i.e., the
24 account debtor’s rights and duties addressed in that section).

25
26 4. *The basic rule: Law of controllable electronic record’s jurisdiction.* Subsection (a)
27 states the basic rule that the law of a controllable electronic record’s jurisdiction governs the
28 matters covered by Article 12. This might be viewed as a rough proxy for the traditional role of
29 the location of tangible asset (e.g., goods) in determining the applicable law (*lex rei sitae*).
30 Drawing on the analogous provisions in Sections 8-110 and 9-305 in the context of a security
31 entitlement or securities account or a commodity contract or commodity account, under this draft
32 it is the controllable electronic record itself, records attached thereto or associated therewith, or
33 the system in which the controllable electronic record is recorded that determines the governing
34 law. Subsection (c) provides a “waterfall” of rules based on provisions that identify a particular
35 jurisdiction as the controllable electronic record’s jurisdiction or alternatively that provide the
36 governing law of a controllable electronic record or the system in which the record is recorded.

37
38 5. *Bottom of the waterfall: Location of the transferor.* Subsections (c)(5) and (d) address
39 a problem that does not normally exist in the context of Sections 9-110 and 9-305. As explained
40 in Note 2, currently, many controllable electronic records, associated records, and systems in
41 which such records are recorded do not identify the “controllable electronic record’s jurisdiction”
42 or the governing law (some permissioned systems being exceptions). (One hopes that once
43 Article 12 and accompanying amendments are widely adopted, systems will adapt and the
44 waterfall will become more generally viable for identifying a controllable electronic record’s
45 jurisdiction.) Consequently, the waterfall ultimately turns to the location of the “transferor” of a
46 controllable electronic record. This approach derives from the role of the location of a debtor

1 under Sections 9-301 and 9-307. Also as explained in Note 2, in many cases involving
2 controllable electronic records the transferor is not known to or easily discoverable by a
3 purchaser. Subsection (d) resolves this dilemma by providing that the transferor's location (and,
4 therefore, the controllable electronic record's jurisdiction) is the District of ~~Colombia~~ Columbia
5 if ~~a tribunal determines that in an action~~ there is not sufficient evidence to establish a transferor's
6 actual location. Cf. Section 9-307(c).

7
8 *6. District of ~~Colombia~~ Columbia as default location of transferor.* The designation of the
9 District of ~~Colombia~~ Columbia (DC) as the location of the transferor pursuant to subsection (d)
10 assumes that DC will have adopted Article 12 and the conforming amendments to Articles 1 and
11 9 in substantially the uniform version. This is a plausible assumption based on the history of
12 adoptions in that jurisdiction. Subsection (e) addresses the unlikely situation that DC might not
13 so adopt Article 12 or might later adopt materially non-uniform amendments. Subsection (e) is
14 patterned loosely (but as closely as feasible) on the TRADES Regulations, 31 CFR § 357.11(d),
15 for U.S. Treasury securities.

16
17 The term "Article 12" is defined in draft subsection (i) as the officially promulgated
18 version of Article 12 and conforming amendments. The official comments will explain that in
19 determining whether DC has enacted Article 12 without material modification a tribunal should
20 consider the materiality of any provision in the context of the issue or issues before it. A
21 modification of a provision that would be material in another context should be disregarded if it
22 would have no bearing on the issue or issues before the tribunal.

23
24 *7. Determinative role of actual location of transferor.* When a tribunal is called upon to
25 determine the governing law concerning a matter covered by Article 12, subsection (d) instructs
26 that the location of the transferor, and consequently the controllable electronic record's
27 jurisdiction, is the District of ~~Colombia~~ Columbia when there is insufficient evidence for the
28 tribunal to determine the actual location of the transferor. Subsection (d) has no application,
29 however, when a tribunal can make a finding as to the actual location. This is so, moreover, even
30 if at the time of a transaction, such as a purchaser's acquisition of a controllable electronic
31 record, the purchaser had no practical ability to determine that location (likely because the
32 purchaser could not discover the transferor's identity). Such a purchaser's reasonable reliance on
33 the governing law being that of the District of ~~Colombia~~ Columbia necessarily is limited to a
34 future case in which no party can adduce sufficient evidence for a tribunal's determination of the
35 actual location. If in any such future case a party does adduce such evidence and a tribunal
36 determines that the actual location of the transferor is other than the District of ~~Colombia~~
37 Columbia, subsection (d) does not apply.

38
39 *8. Relevant time for determination of governing law.* Draft subsection (h) provides that
40 the rights of purchasers are governed by the applicable law as of the time of purchase. Note that
41 Sections 8-110 and 9-305 do not contain an analogous rule with respect to a securities
42 intermediary's jurisdiction. However, Section 8-110(c) does provide a similar rule for the
43 delivery of a security certificate and adverse claims. As to the timing of the determination of the
44 governing law for other issues under Article 12, such as the rights and duties of account debtors
45 under draft § 12-106, the section does not specify a time. As with most statutory provisions
46 relating to governing law, courts are free to determine the appropriate relevant time taking into

| 1 account the relevant facts and the nature of the issues involved.