

D R A F T
FOR DISCUSSION ONLY

Uniform Commercial Code and Emerging Technologies

Uniform Law Commission

May 31, 2022 Informal Session



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National Conference of Commissioners on Uniform State Laws

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May 23, 2022

Uniform Commercial Code and Emerging Technologies

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UNIFORM COMMERCIAL CODE AND EMERGING TECHNOLOGIES

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1 **UNIFORM COMMERCIAL CODE AND EMERGING TECHNOLOGIES**

2 **May 23, 2022 DRAFT**

3 **Submitted to the ULC Informal Session**
4 **May 31, 2022**
5

6 ***Note on formatting and style:***

7 *The amendments to provisions of the UCC and official comments in this draft are marked*
8 *to show changes from the current UCC official text and official comments. A few provisions of*
9 *the UCC are included for convenience of reference even though no changes are proposed.*
10

11 *Because Article 12 is a completely new UCC article and Annex A on transition rules also*
12 *is new, the provisions of Article 12 and Annex A are not underscored.*
13

14 *New sections are numbered with an “A” or “B” at the end, e.g., Sections 9-107A and 9-*
15 *306B. It is contemplated that this numbering convention will be retained for these sections that*
16 *remain in the final Act. In similar fashion, new defined terms in Section 1-201(b) and 9-102(a)*
17 *also are numbered with an “A” or “B.” This approach will avoid the need to renumber existing*
18 *provisions.*
19

20 ***Note on draft official comments and Reporter’s Notes:***
21

22 *Most of the Reporter’s Notes from earlier drafts have been revised and converted to or*
23 *incorporated into draft official comments. The principal exceptions are the Reporter’s Notes to*
24 *Article 9. However, the draft to be submitted for the final reading at the 2022 ULC Annual*
25 *Meeting will include a full set of draft and revised official comments. Reporter’s Notes will be*
26 *retained only to provide background or otherwise to aid in the discussion of the draft (e.g.,*
27 *explaining that some sections that are not being revised are included for convenience in*
28 *reviewing related revisions to the official comments).*
29

30 **Prefatory Note to May 23, 2022 Draft**
31

32 This Prefatory Note first describes the background of the project on Emerging
33 Technologies and the Uniform Commercial Code (UCC) and the work to date. It then provides a
34 brief overview of the proposed revisions to the UCC. Additional Prefatory Notes are provided
35 below for the proposed amendments relating to payments (Articles 3, 4, and 4A), investment
36 securities (Article 8), secured transactions (Article 9), and controllable electronic records (new
37 Article 12).
38

39 1. *Background*
40

41 The Uniform Commercial Code has been enacted in all 50 states, the District of
42 Columbia, Puerto Rico, and the U.S. Virgin Islands. Since its widespread enactment in the

1 1960s, the UCC has been periodically revised to address changes in commercial practices.

2
3 In 2019, the Uniform Law Commission and The American Law Institute (the Sponsors)
4 appointed a Joint Committee to consider whether changes to the UCC are advisable to
5 accommodate emerging technologies, such as artificial intelligence, distributed ledger
6 technology, and virtual currency. At the time when the Joint Committee was formed, invitations
7 were sent to large groups of potential stakeholders including trade organizations, financial
8 institutions, technology companies, government agencies, academicians, and consumer groups.
9 The Committee currently has more than 300 observers.

10
11 The Joint Committee was initially formed as a study committee. However, the Joint
12 Committee subsequently received the permission of the Sponsors to act as a drafting committee
13 for amendments to the UCC dealing with digital assets, bundled transactions (*i.e.*, transactions
14 involving the sale or lease of goods together with the provision of services, the licensing of
15 information, or both), and payments, as well as for certain discrete amendments to the UCC
16 unrelated to emerging technologies. For convenience, further references are to the Drafting
17 Committee.

18
19 The Drafting Committee has held the following meetings:

- 20 • October 4–5, 2019, in Denver, Colorado.
- 21 • January 31–February 1, 2020, in Washington, D.C.
- 22 • Remote meetings by Zoom on: May 29–30, July 23 and 31, September 2, and
23 December 1, 2020; February 1, March 9, April 27 and 29, May 3 and 10, July 6,
24 and November 5–6, 2021; and January 28–29, March 7-8, and March 28, 2022.
- 25 • Remote informal open sessions, held on June 15 and 16, 2021, for ULC
26 Commissioners and members of the Drafting Committee preliminary to the 2021
27 ULC Annual Meeting.
- 28 • ULC Annual Meeting (remote and in-person), first reading, July 13, 2021.

29
30 Currently scheduled are (i) a remote informal open session, to be held on May 31, 2022,
31 for ULC Commissioners and members of the Drafting Committee, preliminary to the 2022 ULC
32 Annual Meeting, and (ii) final reading at the 2022 ULC Annual Meeting

33
34 The Chair and Reporter along with Drafting Committee members Neil B. Cohen and
35 Steven O. Weise presented a draft to the ALI Council meeting on January 20, 2022, which was
36 approved by the Council with the usual caveats. In addition, several small working groups have
37 met remotely (and continue to meet) to discuss specific topics and to hear the views of various
38 stakeholder groups. Since the 2021 ULC Annual Meeting, the Chair, Vice Chair, Reporters, and
39 several members of the Drafting Committee have presented educational programs addressing the
40 ongoing revision process to groups including the Loan Syndication and Trading Association, the
41 ABA Business Law Section, the American College of Commercial Finance Lawyers, the
42 Association of Commercial Finance Attorneys, and the New York City Bar Association. The
43 Chair, Reporter and several members of the Drafting Committee participated in ALI Members
44 Consultative Group meetings on October 1, 2021, and April 25, 2022. Members of the Drafting
45 Committee will continue to reach out to industry groups and other stakeholders and plan to
46 continue participating in CLE presentations to educate members of the bar and others.

1 The work of the Drafting Committee has focused primarily on the following areas
2 concerning the UCC: digital assets (controllable electronic records), electronic money, chattel
3 paper, “bundled” or “hybrid” transactions (consisting of the sale or lease of goods together with
4 the sale, lease, or licensing of other property and the provision of services as an integrated
5 transaction), documents of title, payment systems, miscellaneous UCC amendments, and
6 consumer issues.

7
8 At its annual meeting on May 18, 2022, the ALI approved Tentative Draft No. 1 (April
9 2022) of the Uniform Commercial Code and Emerging Technologies, subject to the usual
10 caveats. The Committee expects to complete the draft of the amendments and obtain approval of
11 the ULC following a final reading at its July 2022 annual meeting. Members of the Drafting
12 Committee will continue to reach out to industry groups and other stakeholders and plan to
13 continue participating in CLE presentations to educate members of the bar and others.

14 15 2. *Overview of UCC Revisions*

16
17 The Drafting Committee’s charge is broad, and the resulting draft is expansive.

18 19 a. *New UCC Article 12 – Controllable electronic records, controllable accounts,* 20 *controllable payment intangibles*

21
22 The draft includes a new UCC Article 12 that would govern the transfer of property
23 rights in certain intangible digital assets (“controllable electronic records”) that have been or may
24 be created using new technologies. These assets include, for example, certain types of virtual
25 currency and nonfungible tokens (NFTs). “Control” of controllable electronic records is a central
26 organizing concept under Article 12. Controllable electronic records are defined to include only
27 those electronic records that can be subjected to control. Control is the functional equivalent of
28 “possession” of a controllable electronic record and a necessary condition for protection as a
29 good faith purchaser for value (a “qualifying purchaser”) of a controllable electronic record.
30 Article 12 confers an attribute of negotiability on controllable electronic records because a
31 qualifying purchaser takes its interest free of conflicting property claims.

32
33 Controllable electronic records also provide a mechanism for evidencing certain rights to
34 payment—controllable accounts and controllable payment intangibles. An account debtor
35 (obligor) on such a right to payment agrees to make payments to the person that has control of
36 the controllable electronic record that evidences the right to payment. Assignments and other
37 aspects of these rights to payment are governed by revisions to UCC Article 9, discussed below.
38 Because a qualifying purchaser of a controllable account or controllable payment intangible will
39 take free of competing property claims, these rights to payment also would have this attribute of
40 negotiability. Article 12 also provides some special rules with respect to the payment obligations
41 and conditions of discharge of account debtors on controllable accounts and controllable
42 payment obligations.

43
44 Article 12 includes a choice-of-law rule for the matters that it covers in connection with
45 transactions in controllable electronic records.
46

1 For a more detailed description of Article 12, see the Prefatory Note to Article 12.

2
3 b. *Secured transactions amendments – UCC Article 9*
4

5 *Article 12 conforming amendments.* The draft includes extensive amendments to UCC
6 Article 9. Several of these amendments address security interests in controllable electronic
7 records and in the rights to payment that are embedded in, or tethered to, controllable electronic
8 records—controllable accounts and controllable payment intangibles. Perfection (i.e., essentially,
9 enforceability against third-parties) of security interests in these assets may be achieved by a
10 secured party obtaining control of the asset or filing a financing statement in the appropriate
11 jurisdiction’s filing office. A security interest perfected by control has priority over a security
12 interest perfected by filing. The draft also provides special rules for the law governing perfection
13 and priority for security interests in controllable electronic records, controllable accounts, and
14 controllable payment intangibles. These rules draw on the new Article 12 choice-of-law rule.
15

16 *Chattel paper.* UCC Article 9 affords special treatment to “chattel paper” (e.g.,
17 installment sale contracts and personal property leases). The draft redefines “chattel paper” and
18 updates the Article 9 provisions applicable to this type of collateral. The new definition resolves
19 uncertainty that has arisen under the current definition and more accurately reflects the
20 distinction between the seller’s or lessor’s right to payment and the record (e.g., installment sale
21 contract or lease) evidencing that right. The new definition also resolves uncertainty that has
22 arisen when goods are leased as part of a hybrid transaction involving services or non-goods
23 property as well as goods. This draft also addresses additional issues relating to hybrid
24 transactions, mentioned in 2.d., below. The draft also provides an amended definition of
25 “control” of an authoritative electronic copy of a record evidencing chattel paper, which reflects
26 a more accurate and technologically flexible approach than the current definition.
27

28 *Money.* The draft includes a new definition of “money” in Article 1, which applies
29 throughout the UCC unless otherwise provided. It also includes amendments that define
30 “electronic money” and provide a definition of “control” of electronic money that tracks the
31 corresponding definition for control of controllable electronic records. Perfection of a security
32 interest in electronic money as original collateral must be by control, not filing. The draft
33 provides a new definition of “money” for purposes of Article 9 that excludes deposit accounts
34 (which could in the future be adopted by a government as money). The draft also updates the
35 take-free rules for transferees of money—both electronic money and tangible money—and
36 transferees of funds from deposit accounts.
37

38 *Control through another person.* Proposed revisions to the provisions on control in
39 Sections 9-104 (control of deposit accounts), 9-105 (control of authoritative electronic copies of
40 records evidencing chattel paper), and 9-105A (control of electronic money) and in a proposed
41 conforming modification to Section 8-106(d)(3) (control of security entitlement) address control
42 through the acknowledgment of a person in control. For similar revisions, see Section 7-106
43 (control of electronic document of title). For a discussion of these proposed revisions, see
44 Section 12-105, Comment 8.
45

46 For a more detailed description of the Article 9 amendments, see the Prefatory Note to

1 Article 9 Amendments.

2
3 *c. Payments amendments – UCC Articles 3 (negotiable instruments), 4 (bank*
4 *deposits and collections), and 4A (funds transfers)*
5

6 The draft proposes several amendments to Articles 3, 4 and 4A. The amendments relate
7 to negotiability, remote deposit capture, statements of account, the scope of Article 4A
8 (definition of payment order), and security procedures. The draft also deletes references to a
9 “writing” (which are changed to a “record”). Many of the proposed changes are to the official
10 comments and are intended to further clarify the black letter text.

11
12 For a more detailed description of the payments amendments, see the Prefatory Note to
13 Payments Amendments.

14
15 *d. Other emerging technologies-related amendments*
16

17 The draft contains a revised definition of “conspicuous” in Article 1 and a revised and
18 updated draft official comment on the term. It adds to Article 1 the current standard definition of
19 “electronic” used by the ULC. It also adopts a new definition of “sign” in Article 1, which
20 addresses records other than writings.

21
22 The draft revises Sections 2-102 and 2A-102 and related definitions to clarify the scope
23 of Articles 2 and 2A with respect to hybrid transactions. It also includes amendments to several
24 provisions of Articles 2 and 2A to change references to a “writing” or “written” communication
25 to refer instead to a “record.”

26
27 The draft proposes a revised Section 7-106, defining “control” for electronic documents
28 of title. The revised section retains the general rule and the safe harbor under the current
29 provision and adds an additional safe harbor along the lines of the revised section on control of
30 chattel paper. The draft also includes revisions to the official comments to several provisions of
31 Articles 7 and 9, in particular to clarify the treatment of nonnegotiable documents of title.

32
33 Finally, the draft proposes several amendments to the official comments to Article 8
34 (investment securities) to make clear that a controllable electronic record may be a “financial
35 asset” credited to a securities account.

36
37 *e. Miscellaneous amendments*
38

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

42
43 The draft proposes to revise Section 5-116 to cure an ambiguity relating to the separate
44 status of bank branches in the current provision and to override incorrectly decided case law
45 arising from that ambiguity.

1 *f. Draft Official Comments.* The draft includes revised official comments to many
2 sections. These revisions are presented not only to explain the draft statutory text but also to
3 encourage feedback on the draft comments. Of course, none of the revisions to official comments
4 will be finalized until completion of the usual processes for the preparation of official comments.
5

6 In the preparation of revised official comments consideration will be given to removing
7 references to obsolete and withdrawn uniform laws except as may be necessary or useful to
8 explain particular issues.
9

10 3. *Organization of the draft* 11

12 Revised provisions of the UCC text and comments appear in the order that they would
13 appear in the UCC—beginning with Article 1 and continuing through Article 12. Following
14 Article 12 a new Annex A provides transition rules.

1 **UNIFORM COMMERCIAL CODE AND EMERGING TECHNOLOGIES**

2 **ARTICLE 1**

3 **GENERAL PROVISIONS**

4 * * *

5 **Section 1-103. Construction of [Uniform Commercial Code] to Promote its**
6 **Purposes and Policies; Applicability of Supplemental Principles of Law.**

7 (a) [The Uniform Commercial Code] must be liberally construed and applied to promote
8 its underlying purposes and policies, which are:

9 (1) to simplify, clarify, and modernize the law governing commercial
10 transactions;

11 (2) to permit the continued expansion of commercial practices through custom,
12 usage, and agreement of the parties; and

13 (3) to make uniform the law among the various jurisdictions.

14 (b) Unless displaced by the particular provisions of [the Uniform Commercial Code], the
15 principles of law and equity, including the law merchant and the law relative to capacity to
16 contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake,
17 bankruptcy, and other validating or invalidating cause supplement its provisions.

18 **Official Comment**

19 * * *

20
21 2. **Applicability of supplemental principles of law.** Subsection (b) states the basic
22 relationship of the Uniform Commercial Code to supplemental bodies of law. The Uniform
23 Commercial Code was drafted against the backdrop of existing bodies of law, including the
24 common law and equity, and relies on those bodies of law to supplement its provisions in many
25 important ways. At the same time, the Uniform Commercial Code is the primary source of
26 commercial law rules in areas that it governs, and its rules represent choices made by its drafters
27 and the enacting legislatures about the appropriate policies to be furthered in the transactions it
28 covers. Therefore, while principles of common law and equity may *supplement* provisions of the

Uniform Commercial Code, they may not be used to *supplant* its provisions, or the purposes and policies those provisions reflect, unless a specific provision of the Uniform Commercial Code provides otherwise. In the absence of such a provision, the Uniform Commercial Code preempts principles of common law and equity that are inconsistent with either its provisions or its purposes and policies.

The language of subsection (b) is intended to reflect both the concept of supplementation and the concept of preemption. Some courts, however, had difficulty in applying the identical language of former Section 1-103 to determine when other law appropriately may be applied to supplement the Uniform Commercial Code, and when that law has been displaced by the Code. Some decisions erroneously applied other law in situations in which that application, while not inconsistent with the text of any particular provision of the Uniform Commercial Code, clearly was inconsistent with the underlying purposes and policies reflected in the relevant provisions of the Code. *See, e.g., Sheerbonnet, Ltd. v. American Express Bank, Ltd.*, 951 F. Supp. 403 (S.D.N.Y. 1995). In part, these errors arose from Comment 1 to former Section 1-103, which stated that “this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act.” The “explicitly displaced” language of that Comment did not accurately reflect the proper scope of Uniform Commercial Code preemption, which extends to displacement of other law that is inconsistent with the purposes and policies of the Uniform Commercial Code, as well as with its text.

These supplemental principles take into account developments in technology. For example, automated transactions and electronic agents are now widely recognized as being capable of acting for a person who employs such tools. See generally Uniform Electronic Transactions Act §§ 2(2), 2(6), and 14.

* * *

Reporter’s Note

No change. No change is proposed to Section 1-103, which is provided for convenience.

* * *

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 Articles 9 and 12 and Annex A (Transition Provisions). ~~See Comment 3 to Section~~ Section 9-101, Comment 3 (“subsection headings are not a part of the official text itself and have

not been approved by the sponsors.”); Section 12-101, Comment; Section A-101, Comment.

Reporter’s Note

No change. No change is proposed to Section 1-107, which is provided for convenience.

* * *

Section 1-201. General Definitions.

* * *

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

* * *

(3) “Agreement”, as distinguished from “contract”, means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in Section 1-303.

* * *

(10) “Conspicuous”, with reference to a term, means so written, displayed, or presented that, based on the totality of the circumstances, 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 set off from surrounding text of the same size by symbols or other marks that call attention to the language.~~

1 * * *

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

12 (16A) “Electronic” means relating to technology having electrical, digital,
13 magnetic, wireless, optical, electromagnetic, or similar capabilities.

14 * * *

15 (21) “Holder” means:

16 (A) the person in possession of a negotiable instrument that is payable
17 either to bearer or to an identified person that is the person in possession; or

18 (B) the person in possession of a negotiable tangible document of title if
19 the goods are deliverable either to bearer or to the order of the person in possession; or

20 (C) the person in control, other than pursuant to Section 7-106(g), of a
21 negotiable electronic document of title.

22 * * *

23 (24) “Money” means a medium of exchange that is currently authorized or

1 adopted by a domestic or foreign government. The term includes a monetary unit of account
2 established by an intergovernmental organization, or pursuant to an agreement between two or
3 more countries. The term does not include an electronic record that is a medium of exchange
4 recorded and transferable in a system that existed and operated for the medium of exchange
5 before the medium of exchange was authorized or adopted.

6 * * *

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

14 * * *

15 (33) “Representative” means a person empowered to act for another, including an
16 agent, an officer of a corporation or association, and a trustee, executor, or administrator of an
17 estate.

18 * * *

19 (37) ~~“Signed” includes using any symbol executed or adopted with present~~
20 ~~intention to adopt or accept a writing.~~ “Sign” means, with present intent to authenticate or adopt
21 a record:

22 (A) execute or adopt a tangible symbol; or

23 (B) attach to or logically associate with the record an electronic symbol,

1 sound, or process. “Signed” and “signature” have corresponding meanings.

2 * * *

3 **Legislative Note:**

4
5 A state should enact the amendment to subsection (b)(27) whether the state has enacted the
6 Uniform Protected Series Act (2017) or otherwise recognizes a protected series under its law.
7 Because the amendment applies only under the enacting state’s Uniform Commercial Code,
8 inclusion of the amendment does not require the enacting state to recognize a limit on liability of
9 a protected series organized under the law of another state or a limit on liability of the entity that
10 established the protected series. The amendment clarifies the status of a protected series as a
11 “person” under the choice-of-law and substantive law rules of the enacting state’s Uniform
12 Commercial Code.

13
14 **Official Comment**

15
16 * * *

17
18 3. “Agreement.” ~~Derived from former Section 1-201.~~ As used in the Uniform
19 Commercial Code the word is intended to include full recognition of usage of trade, course of
20 dealing, course of performance and the surrounding circumstances as effective parts thereof, and
21 of any agreement permitted under the provisions of the Uniform Commercial Code to displace a
22 stated rule of law. Whether an agreement has legal consequences is determined by applicable
23 provisions of the Uniform Commercial Code and, to the extent provided in Section 1-103, by the
24 law of contracts. Concerning developments in technology, including automated transactions and
25 electronic agents, see Section 1-103, Comment 2.

26
27 * * *

28
29 10. “Conspicuous.” ~~Derived from former Section 1-201(10).~~ This definition states the
30 general standard that to be conspicuous a term ought to be noticed by a reasonable person against
31 which the term is to operate. Whether a term is conspicuous is an issue for the court.
32 ~~Subparagraphs (A) and (B) set out several methods for making a term conspicuous. Requiring~~
33 ~~that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning~~
34 ~~function (giving guidance to the party relying on the term regarding how that result can be~~
35 ~~achieved). Although these paragraphs indicate some of the methods for making a term attention-~~
36 ~~calling, the test is whether attention can reasonably be expected to be called to it. The statutory~~
37 ~~language should not be construed to permit a result that is inconsistent with that test. Whether the~~
38 appearance and presentation of a particular term satisfy this standard is determined by reference
39 to the totality of the circumstances and requires a case-by-case analysis.

40
41 Historically, contract terms were presented in writing, making the use of standards that
42 relate to the size and appearance of type relevant to the determination of conspicuousness. Today
43 terms in a record are frequently communicated electronically. New technologies have created
44 opportunities for terms to be displayed or presented in novel ways, such as by the use of pop-up

1 windows, text balloons, dynamically expanding or dynamically magnifying text, and non-visual
2 elements such as vibrations, to name a few.

3
4 The definition has been revised by deleting the statutory examples relating to the
5 appearance of type and instead indicating in the comments a broader universe of factors that are
6 applicable to both written and electronic presentations. This approach is intended to be both
7 more protective of consumers and more useful to drafters by providing more clarity and
8 flexibility in the methods that may be used to call attention to a term.

9
10 The attributes of a reasonable person against which a term is to operate can vary
11 depending upon the nature of the transaction and the market in which the transaction occurs. For
12 example, assume that a merchant of goods wishes to enter into a transaction for the sale or lease
13 of goods which does not include an implied warranty of merchantability or fitness for particular
14 purpose. Depending on the particular transaction, the person against which the term excluding
15 implied warranties is to operate may be a large business buyer or lessee, a small business, or a
16 consumer. Similarly, the determination of whether a term is conspicuous may, depending on the
17 context, yield a different conclusion when the term is used in a standard form agreement than
18 when terms of the agreement are the subject of negotiation or discussion.

19
20 Terms presented in an online record raise issues that differ in some respects from the
21 issues associated with presenting the same terms in a writing. For example, how a term appears
22 depends to some extent on the equipment and settings of the person presented with the term.

23
24 The test of whether a term is conspicuous remains constant notwithstanding the different
25 contexts referenced above. A term is conspicuous if its appearance and presentation are such that
26 it ought to be noticed by a reasonable person against which the term is to operate. If the term is
27 in a standard form intended for use in many agreements, the determination of whether the term is
28 conspicuous may be made with reference to typical likely parties to the agreements, taking into
29 account all aspects of the transaction, the range of likely equipment and settings used by such
30 parties, and the education, sophistication, disabilities, and other attributes of such parties. If the
31 term is not in a standard form, the determination of whether it is conspicuous should be made
32 with reference to a reasonable person in the position of the actual person against which it is to
33 operate.

34
35 Factors relevant to whether a term is conspicuous include, but are not limited to, the
36 following:

37
38 (i) The use of headings and text that contrast with the surrounding text. For example, a
39 term is likely to be conspicuous if it is introduced by a heading in uppercase letters equal to or
40 greater in size than the surrounding text. Similarly, a term is likely to be conspicuous if set out in
41 language in the body of a record or display in larger type than the surrounding text, or in
42 contrasting type, font, or color to the surrounding text of the same size, or set off from
43 surrounding text of the same size by symbols or other marks that call attention to the language.
44 However, even with those characteristics, for a term to be conspicuous the overall statutory test
45 must always be met. For example, even if in bold, uppercase letters, a term might not be
46 conspicuous if placed among other terms also in bold, uppercase letters so there is no contrast

1 with the surrounding text or if the application of other factors causes the term not to be provided
2 such that a reasonable person against which it is to operate ought to have noticed it.

3
4 (ii) The placement of the term in the record. A term appearing at, or hyperlinked from,
5 text at the beginning of a record, or near the place where the person against which the term is to
6 operate must signify assent, is more likely to be conspicuous than a term in the middle of a
7 lengthy record absent the use of a method reasonably designed to draw the person's attention to
8 the term in middle of the record (for example, by providing separate reasonable notice of the
9 term before presenting the record containing the term to the person for assent or forcing the
10 person to stop on a screen highlighting the term during the presentation of the record for assent).

11
12 (iii) If terms are available only through the use of a hyperlink, in addition to the
13 placement of the hyperlink as described above, factors to be considered include whether there is
14 language drawing attention to the hyperlink and describing its function, and the size and color of
15 the text used for the hyperlink and any related language.

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

21
22 (v) The effort needed to access the term. The process and flow of the display and
23 presentation is also relevant. For example, a term accessible only by triggering multiple
24 hyperlinks is less likely to be conspicuous than a term accessible from a single hyperlink.

25
26 (vi) Whether the person against which the term is to operate must separately assent to or
27 acknowledge the term. Obtaining separate assent or acknowledgment of a term is generally
28 sufficient to make the term conspicuous.

29
30 As noted above, the evolution of technology has led to an evolution in the ways in which
31 terms in an electronic record are displayed or presented. A term displayed or presented in a novel
32 way utilizing emerging technologies is, of course, conspicuous if the effect of the display or
33 presentation is that a reasonable person against which the term is to operate ought to have
34 noticed it.

35
36 This definition deals only with requirements of that a term be conspicuous (or noted
37 conspicuously) that are stated in particular provisions of the Uniform Commercial Code. Other
38 protective doctrines designed to assure that assent is meaningful that are part of general contract
39 law may also apply. See Section 1-103(b).

40
41 * * *

42
43 16A. “Electronic.” The basic nature of most current technologies and the need for a
44 recognized, single term warrants the use of “electronic” as the defined term. The definition is
45 intended to ensure that the Uniform Commercial Code will be applied broadly as new technologies
46 develop. The term must be construed broadly in light of developing technologies in order to fulfill
47 the purpose of the Uniform Commercial Code to validate commercial transactions regardless of the

1 medium used by the parties. Current legal requirements for “writings” can be satisfied by almost any
2 tangible media, whether paper, other fibers, or even stone. The purpose and applicability of the
3 Uniform Commercial Code covers intangible media that are technologically capable of storing,
4 transmitting, and reproducing information in human perceivable form, but which lack the tangible
5 aspect of paper, papyrus, or stone.

6
7 * * *

8
9 21. “Holder.” ~~Derived from former Section 1-201.~~ The definition has been
10 reorganized for clarity and amended to provide for electronic negotiable documents of title. The
11 definition excludes persons who have control pursuant to Section 7-106(g) through the
12 acknowledgment by a person in control.

13
14 * * *

15
16 24. “Money.” ~~Substantively identical to former Section 1-201. The test is that of~~
17 ~~sanction of government, whether by authorization before issue or adoption afterward, which~~
18 ~~recognizes the circulating medium as a part of the official currency of that government. The~~
19 ~~narrow view that money is limited to legal tender is rejected.~~ The definition of “money” applies
20 to the term as used in the Uniform Commercial Code. The definition does not determine whether
21 an asset constitutes “money” for other purposes. Only something currently authorized or adopted
22 as a medium of exchange by a government can be money. As further elaborated in the second
23 sentence of the definition, adoption by a government may occur through establishment by an
24 intergovernmental organization or pursuant to an agreement between governments. Coins and
25 paper currency formerly issued by a government but now owned and traded only for their
26 numismatic or historical value, and not as a medium of exchange, are not money.

27
28 An electronic medium of exchange established pursuant to a country’s law and that is
29 recorded and transferable in a system that did not exist and did not operate for that medium of
30 exchange before the electronic medium of exchange was authorized or adopted by the country’s
31 government also constitutes money. This is so even if ownership is established or maintained
32 through a system not operated by the government. In contrast, an existing medium of exchange
33 created or distributed by one or more private parties is not money solely because the government
34 of one or more countries later authorizes or adopts the pre-existing medium of exchange.

35
36 Although the term “money” is used in several articles, the definition is particularly
37 significant under Article 9. Prior to the amendments to this section, money was generally
38 understood to include only tangible coins, bills, notes, and the like. This worked well under
39 Article 9, which provided that the only method of perfecting a security interest in money as
40 original collateral was by taking possession. See former SECTION 9-312(b)(3). The amended
41 definition of money is broader and includes both “tangible money” (things that were money
42 under the prior, more limited definition) and “electronic money” (a new type of collateral under
43 Article 9). A security interest in electronic money as original collateral may be perfected only by
44 control. Section 9-102(a)(31A) (defining “electronic money”); 9-312(b)(4) (perfection by control
45 for electronic money). The definition of “money” for purposes of Article 9 is more limited than
46 the definition in this section—the Article 9 definition excludes deposit accounts and money in
47 electronic form that cannot be subjected to control under Section 9-105A. See SECTION 9-

102(a)(54A).

Examples: The following examples illustrate the revised definition of “money.”

Example 1: Nation A enacts legislation authorizing or adopting an existing crypto currency (spitcoin), created on a private blockchain, as a medium of exchange. Because spitcoin was recorded and transferable in a system that existed and operated for that crypto currency before the electronic record was authorized or adopted by Nation A, spitcoin does not become “money” as a result of Nation A’s legislation.

Example 2: Nation B creates a new crypto currency (beebuck) and authorizes or adopts it as a medium of exchange. Beebuck is “money.” Beebuck is not recorded and transferable in a system that existed and operated for that crypto currency before the electronic record was authorized or adopted by Nation B.

Example 3: Nation C enacts legislation authorizing or adopting as a medium of exchange beebuck, the crypto currency previously adopted by Nation B in Example 2. Although beebuck *is* recorded and transferable in a system that existed and operated for beebuck before it was authorized or adopted by Nation C, beebuck was *already* money when authorized or adopted by Nation C. Consequently, beebuck is “money.” Nation C’s action had no relevance or effect on the characterization of beebuck as money.

* * *

27. “Person.” ~~The former definition of this word has been replaced with the standard definition used in acts prepared by the National Conference of Commissioners on Uniform State Laws.~~ The second sentence of the definition provides needed clarity as to the status of a protected series for purposes of the Uniform Commercial Code. Several 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.

Providing that a protected series is a “person” for purposes of the enacting state’s Uniform Commercial Code will expressly permit a protected series, whether created under the law of the enacting state or of another state, to be a “seller” or a “buyer” under Article 2, a “lessor” or a “lessee” under Article 2A, or an “organization” and a “debtor” under Article 9, and, 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.

* * *

33. “Representative.” ~~Derived from former Section 1-201. Reorganized, and form changed from “includes” to “means.”~~ Concerning developments in technology, including automated transactions and electronic agents, see Section 1-103, Comment 2.

* * *

37. ~~“Signed.” “Sign.” Derived from former Section 1-201. Former Section 1-201 referred to “intention to authenticate”; because other articles now use the term “authenticate,” the language has been changed to “intention to adopt or accept.” The latter formulation is derived from the definition of “authenticate” in Section 9-102(a)(7). This provision refers only to writings, because the term “signed,” as used in some articles, refers only to writings. The definition of “sign” is broad—it encompasses the authentication or adoption of all records, not just writings . The definition replaces the definition of “signed” in earlier texts of this article. This provision definition also makes it clear that, as the term terms “signed” is or “sign” are used in the Uniform Commercial Code, a complete signature is not necessary. The A symbol may be printed, stamped or written or electronically attached or associated with a record; it may be by initials or by thumbprint or by electronic symbol, sound, or process. It may be on any part of the document a writing or other record and in appropriate cases may be found in a billhead or letterhead. No catalog of possible situations can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the symbol, sound, or process was executed or adopted by the party with present intention to authenticate or adopt or accept the writing record. Concerning developments in technology, including automated transactions and electronic agents, see also Section 1-103, Comment 2.~~

* * *

Reporter’s Note

1. *No change.* No change is proposed to the definitions of “agreement,” “document of title,” or “representative,” which are provided for convenience.

2. *Current UCC Provisions Using “Conspicuous” or “Conspicuously.”*

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

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

Article 3. Statement that promise or order is not negotiable (3-104(d)); certain statements 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)).

* * *

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

(1) in return for a binding commitment to extend credit or for the extension of
immediately available credit, whether or not drawn upon and whether or not a charge-back is
provided for in the event of difficulties in collection;

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

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

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

Official Comment

Source: Former Section 1-201(44).

Changes from former law: Unchanged from former Section 1-201, which was derived from
Sections 25, 26, 27, 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act;
Section 53, Uniform Bills of Lading Act; Section 58, Uniform Warehouse Receipts Act; Section
22(1), Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. These provisions are
substantive rather than purely definitional. Accordingly, they have been relocated from former
Section 1-201 to this section.

1. ~~All the~~ Historically, most Uniform Acts in the commercial law field ~~(except the~~
~~Uniform Conditional Sales Act)~~ have carried definitions of “value.” ~~All those~~ Those definitions
provided that value was any consideration sufficient to support a simple contract, including the
taking of property in satisfaction of or as security for a pre-existing claim. Subsections (1), (2),
and (4) in substance continue the definitions of “value” in the earlier acts. Subsection (3) makes
explicit that “value” is also given in a third situation: where a buyer by taking delivery under a
pre-existing contract converts a contingent into a fixed obligation.

This definition is not applicable to Articles 3 and 4, but the express inclusion of
immediately available credit as value follows the separate definitions in those articles. See
Sections 4-208, 4-209, 3-303. Article 12 adopts the Article 3 definition. See Section 12-
102(a)(4). A bank or other financing agency which in good faith makes advances against
property held as collateral becomes a bona fide purchaser of that property even though provision
may be made for charge-back in case of trouble. Checking credit is “immediately available”
within the meaning of this section if the bank would be subject to an action for slander of credit
in case checks drawn against the credit were dishonored, and when a charge-back is not
discretionary with the bank, but may only be made when difficulties in collection arise in
connection with the specific transaction involved.

1 * * *

2 **Section 1-301. Territorial Applicability; Parties' Power to Choose Applicable**

3 **Law.**

4
5 (a) Except as otherwise provided in this section, when a transaction bears a reasonable
6 relation to this state and also to another state or nation the parties may agree that the law either of
7 this state or of such other state or nation shall govern their rights and duties.

8 (b) In the absence of an agreement effective under subsection (a), and except as provided
9 in subsection (c), [the Uniform Commercial Code] applies to transactions bearing an appropriate
10 relation to this state.

11 (c) If one of the following provisions of [the Uniform Commercial Code] specifies the
12 applicable law, that provision governs and a contrary agreement is effective only to the extent
13 permitted by the law so specified:

14 (1) Section 2-402;

15 (2) Sections 2A-105 and 2A-106;

16 (3) Section 4-102;

17 (4) Section 4A-507;

18 (5) Section 5-116;

19 [(6) Section 6-103;]

20 (7) Section 8-110;

21 (8) Sections 9-301 through 9-307; ~~2~~

22 (9) Section 12-107.

23 * * *

24 **ARTICLE 2**

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Section 2-102. Scope; Certain Security and Other Transactions Excluded from Article.

(2) If the sale-of-goods aspects of a hybrid transaction predominate, this article applies to the transaction.

(4) This article does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this article impair or repeal any statute regulating sales to consumers, farmers, or other specified classes of buyers.

Official Comment

Purposes of Changes and New Matter:

1
2 2. Many ordinary transactions involve both a sale of goods and the provision of
3 services, a lease of other goods, or a sale, lease, or license of property other than goods. In its
4 original formulation, Article 2 provided no guidance on whether or to what extent the article
5 applied to such a hybrid transaction, although by defining a “sale” as “the passing of title [to
6 goods] from the seller to the buyer for a price,” Section 1-206 arguably regarded such
7 transactions as sales.

8
9 Most courts dealing with the issue of whether and to what extent Article 2 applied to
10 hybrid transactions used the “predominant purpose test.” Under that test, Article 2 applies either
11 in full or not at all, depending on whether the hybrid transaction, at its inception, is
12 predominantly about the goods. Some courts looked instead to the “gravamen of the claim,”
13 applying Article 2 to issues relating to the goods and applying other law to issues relating to
14 other aspects of the transaction. Still other courts used what was sometimes referred to as the
15 “bifurcation approach,” under which Article 2 applies to the sale-of-goods aspect of a hybrid
16 transaction and other law applies to the other aspects of the transaction. The bifurcation approach
17 is similar to the gravamen of the claim, but instead of applying all of Article 2 to some, but not
18 all, types of claims relating to a hybrid transaction, it distinguishes the provisions in Article 2
19 that deal with the goods from those that deal with the transaction as a whole, and applies only the
20 former in a hybrid transaction.

21
22 Subsections (2) and (3) codify a combination of the predominant purpose test and the
23 bifurcation approach, thereby establishing a two-tiered test. If the sale-of-goods aspects of a
24 hybrid transaction predominate, then Article 2 applies. If the other aspects of the hybrid
25 transaction predominate, then the provisions of Article 2 which relate primarily to the sale of
26 goods, but not to the transaction as a whole, apply. This approach has the benefit, for example, of
27 ensuring that a buyer in a transaction in which the sale-of-goods aspects do not predominate is a
28 buyer that may have a right to recover the goods from the seller and thereby may qualify as a
29 buyer in ordinary course under Section 1-201(b)(9).

30
31 3. Relevant factors in determining whether the sale-of-goods aspects of a hybrid
32 transaction predominate include the language of the agreement and the portion of the total price
33 that is attributable to the sale of goods, although neither is determinative. An agreed-upon
34 allocation of a portion of the total price to the sale of goods is ordinarily binding on the parties.
35 Other relevant factors include the nature of the seller’s business (i.e., whether the seller is in the
36 business of selling goods of that kind) and the buyer’s purpose in entering into the transaction.
37 Because the definition of “goods” expressly includes “specially manufactured goods,” services
38 involved in manufacturing goods are normally attributable to the sale-of-goods aspects of the
39 transaction. Services in designing specially manufactured goods, however, would not normally
40 be attributable to the sale-of-goods aspects of the transaction.

41
42 4. If the sale-of-goods aspects of a hybrid transaction predominate, then this article
43 applies to the transaction. However, the application of this article to a hybrid transaction does not
44 preclude the application of principles of law and equity to supplement the provisions of this
45 article, see Section 1-103(b), nor does it preclude, in appropriate circumstances, the application
46 of other law to the non-sale-of-goods aspects of the transaction. Whether it is appropriate to

1 apply such other law will depend in part on what purposes the other law is designed to achieve
2 and whether application of the other law would be likely to interfere with the application of this
3 article.

4
5 **Example 1.** Owner hires Contractor to replace the roof on a structure. As part of
6 the transaction, Contractor promises to remove the existing shingles and install
7 new shingles, which Contractor is providing. The transaction is a hybrid
8 transaction because it involves the passing of title to the new shingles and the
9 provision of services. If the sale-of-goods aspects of the transaction predominate,
10 this article applies to the transaction.

11
12 **Example 2.** Same facts as in Example 1. Even if the sale-of-goods aspects of the
13 transaction predominate, other law might apply to the services aspects of the
14 transaction. For example, if applicable law regulates the provision of roofing
15 services, such as by requiring the roofer to be licensed, requiring specified
16 disclosures, requiring or implying a warranty with respect to the quality of
17 services, or giving the property owner a brief period of time to cancel the contract,
18 such other law might apply.

19
20 **Example 3.** In a single transaction, Seller agrees to sell a warehouse full of goods
21 to Buyer. The transaction includes the goods contained in the warehouse, the
22 warehouse itself, and the real property on which the warehouse is situated.
23 Assume the goods aspects of the transaction predominate. The application of this
24 article to the transaction does not preclude the application of real property law to
25 the real-property aspects of the transaction. Accordingly, whether the sale of the
26 real property complies with the applicable requirements of real property law is
27 determined by law other than this article. Other law will also determine whether
28 consummation of the sale of the real property is a condition to the parties'
29 obligations to buy and sell the goods.

30
31 5. If the sale-of-goods aspects of a hybrid transaction do not predominate, under
32 subsection (3), the provisions of this article relating primarily to the sale of goods apply. These
33 provisions include those relating to: warranties under Sections 2-212, 2-313, 2-314, 2-315, 2-
34 316, 2-317, 2-318; tender of delivery and risk of loss under Sections 2-503, 2-504, 2-509, 2-510;
35 acceptance, rejection, and cure under Sections 2-508, 2-601, 2-602, 2-603, 2-604, 2-605, 2-606;
36 and remedies for non-delivery of the goods or for tender of nonconforming goods under Sections
37 2-711, 2-712, 2-713, 2-714, 2-715, 2-716. In contrast, the provisions of this article dealing with
38 the transaction as a whole do not apply. These provisions include those relating to: the
39 requirement of a writing, Section 2-201; contract formation, Sections 2-204 through 2-207; and
40 whether consideration is needed to modify the agreement, Section 2-209.

41
42 **Example 4.** Owner sends a purchase order to Contractor offering to hire
43 Contractor to replace the roof on a structure. The proposed transaction involves
44 Contractor removing the existing shingles and installing new shingles, which
45 Contractor is to provide. Contractor responds with a confirmation purporting to
46 accept but containing additional and different terms. The transaction is a hybrid

1 transaction because it involves the passing of title to the new shingles and the
2 provision of services. If the sale-of-goods aspects of the transaction do not
3 predominate, this article does not apply to determine whether a contract was
4 formed. That issue is governed by other law.

5
6 **Example 5.** Under the facts of Example 1, assume that the sale-of-goods aspects
7 of the transaction do not predominate. The agreement provides that the job will be
8 completed by December 31. Due to unforeseen circumstances affecting the
9 availability of supplies and labor, the job is not completed by the agreed-upon
10 deadline. Whether Contractor's failure to perform on time is excused is
11 determined by general contract law, rather than by this article (Section 2-615).

12
13 **Example 6.** Under the facts of Example 1, assume that the sale-of-goods aspects
14 of the transaction do not predominate. A dispute between the parties arises and
15 during litigation one party seeks to admit evidence of usage of trade to
16 supplement or explain the parties' written agreement. If the proffered evidence
17 relates to the sale-of-goods aspects of the transaction, the parol evidence rule in
18 this article, Section 2-202 applies. If the proffered evidence relates to the other
19 aspects of the transaction or to the transaction as a whole, other law will govern
20 the admissibility of the evidence.

21
22 **Example 7.** Restaurateur hires Remodeler to remodel Restaurateur's kitchen. The
23 transaction requires Remodeler to supply a new oven meeting detailed
24 specifications, but the services aspects of the transaction predominate. The oven
25 supplied does not meet a minor aspect of those specifications (but does
26 substantially satisfy the specifications as a whole). Whether Restaurateur may
27 reject the oven (or must retain it subject to price adjustment), whether
28 Restaurateur has a right to cover by purchasing a substitute oven, and the measure
29 of Restaurateur's damages for the oven's nonconformity to the specifications are
30 determined by this article.

31
32 **Example 8.** Restaurateur hires Remodeler to remodel Restaurateur's kitchen by a
33 specified completion date. The transaction requires Remodeler to supply a new
34 oven, but the services aspects of the transaction predominate. Remodeler breaches
35 by failing to complete the project by the specified date. The measure of
36 Restaurateur's damages for Remodeler's failure to timely complete the project is
37 not determined by this article.

38
39 6. The rules of subsections (2) and (3) are essentially gap fillers that apply
40 when the parties' agreement is silent on what legal rules govern the different aspects of
41 their transaction. In general, parties are free to preclude the application of this article to
42 the aspects of their transaction that are not about the sale of goods.

43
44 **Example 9.** Robotics Manufacturer contracts to design, build, and sell customized
45 robotics to Car Maker. The transaction includes a sale of goods and the provision
46 of services and is therefore a hybrid transaction. The parties may, in their

1 agreement, provide that Article 2 does not govern the services aspects of the
2 transaction.

3
4 * * *

5
6 **Section 2-106. Definitions: “Contract”; “Agreement”; “Contract for Sale”;**
7 **“Sale”; “Present Sale”; “Conforming” to Contract; “Termination”; “Cancellation”;**
8 **“Hybrid Transaction”.**

9 (1) In this article unless the context otherwise requires “contract” and “agreement” are
10 limited to those relating to the present or future sale of goods. “Contract for sale” includes both a
11 present sale of goods and a contract to sell goods at a future time. A “sale” consists in the passing
12 of title from the seller to the buyer for a price (Section 2–401). A “present sale” means a sale
13 which is accomplished by the making of the contract.

14 (2) Goods or conduct including any part of a performance are “conforming” or conform
15 to the contract when they are in accordance with the obligations under the contract.

16 (3) “Termination” occurs when either party pursuant to a power created by agreement or
17 law puts an end to the contract otherwise than for its breach. On “termination” all obligations
18 which are still executory on both sides are discharged but any right based on prior breach or
19 performance survives.

20 (4) “Cancellation” occurs when either party puts an end to the contract for breach by the
21 other and its effect is the same as that of “termination” except that the cancelling party also
22 retains any remedy for breach of the whole contract or any unperformed balance.

23 (5) “Hybrid transaction” means a single transaction involving a sale of goods and:

24 (a) the provision of services;

25 (b) a lease of other goods; or

26 (c) a sale, lease, or license of property other than goods.

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Purposes of Changes and New Matter:

1. Subsection (1): “Contract for sale” is used as a general concept throughout this article, but the rights of the parties do not vary according to whether the transaction is a present sale or a contract to sell unless the article expressly so provides.

2. Subsection (2): It is in general intended to continue the policy of requiring exact performance by the seller of his obligations as a condition to his right to require acceptance. However, the seller is in part safeguarded against surprise as a result of sudden technicality on the buyer's part by the provisions of Section 2-508 on seller's cure of improper tender or delivery. Moreover, usage of trade frequently permits commercial leeways in performance and the language of the agreement itself must be read in the light of such custom or usage and also, prior course of dealing, and in a long-term contract, the course of performance.

3. Subsections (3) and (4): These subsections are intended to make clear the distinction carried forward throughout this article between termination and cancellation.

4. In some transactions, the passing of title to goods from the seller to the buyer in return for a price is part of a larger transaction. The other aspects of the transaction might involve the seller providing services to the buyer, the seller leasing other goods to the buyer, or the seller transferring to the buyer rights to property other than goods. Such a transaction is a “hybrid transaction,” as defined in new subsection (5). Section 2-102 indicates the extent to which this article applies to a hybrid transaction.

5. A hybrid transaction is a single transaction. If contracting parties enter into separate agreements at the same time, each agreement must be evaluated separately to determine if it is a hybrid transaction.

Example 1. To sell an ongoing business, Seller and Buyer enter into three separate written agreements: (i) a sale of goods used in the business; (ii) an agreement for Seller to provide consulting services to Buyer for a period of six months; and (iii) a sale of intangible assets associated with the business. Because the parties executed three separate agreements, and the agreement for the sale of goods does not involve a sale, lease, or license of other property or the provision of services, that agreement is not a hybrid transaction.

Example 2. To sell an ongoing business, Seller and Buyer enter into two separate written agreements: (i) a sale of goods and intangible assets used in the business; and (ii) an agreement for Seller to provide consulting services to Buyer for a period of six months, and not to compete with Buyer for a period of one year. The agreement to sell goods and intangible assets is a hybrid transaction.

1 Even when contracting parties enter into a single agreement involving both a sale of goods
2 and a sale, lease, or license of other property or the provision of services, the agreement
3 would not involve a single transaction, and hence the transaction would not be a hybrid
4 transaction, if the sale of goods is unrelated to and independent of the other aspects of the
5 transaction and the terms of the agreement relating to the sale of goods are readily severable
6 from the terms of the agreement relating to the other aspects of the transaction.

7
8 **Example 3.** Farmer A and Farmer B sign a written agreement pursuant to which
9 Farmer A will sell a tractor to Farmer B and Farmer A will board and feed Farmer
10 B's cattle until the cattle are sold. The agreement specifies a price for the tractor,
11 which is due upon delivery, and specifies a mechanism for determining the price
12 for Farmer A's services, which is to be paid when the cattle are sold. The parties
13 would have entered into an agreement to buy and sell the tractor even if they had
14 not entered into an agreement to board and feed the cattle, and vice-versa. The
15 transaction is not a hybrid transaction. Article 2 applies to the sale of the tractor.
16 Other law applies to the agreement to board and feed the cattle.

17
18 **Example 4.** In a single record, Landscaper agrees to sell plants to Homeowner
19 and to install the plants on Homeowner's property. The agreement specifies a
20 total price but provides no mechanism for determining what portion of the price is
21 allocable to the sale of plants and what portion is allocable to the installation
22 services. The transaction is a hybrid transaction.

23
24 * * *

25 **Section 2-201. Formal Requirements; Statute of Frauds.**

26 (1) Except as otherwise provided in this section a contract for the sale of goods for the
27 price of \$500 or more is not enforceable by way of action or defense unless there is ~~some writing~~
28 a record sufficient to indicate that a contract for sale has been made between the parties and
29 signed by the party against whom enforcement is sought or by ~~his~~ the party's authorized agent or
30 broker. A ~~writing~~ record is not insufficient because it omits or incorrectly states a term agreed
31 upon but the contract is not enforceable under this ~~paragraph~~ subsection beyond the quantity of
32 goods shown in ~~such writing~~ the record.

33 (2) Between merchants if within a reasonable time a ~~writing~~ record in confirmation of the
34 contract and sufficient against the sender is received and the party receiving it has reason to
35 know its contents, it satisfies the requirements of subsection (1) against ~~such~~ the party unless

1 ~~written~~ a record containing a notice of objection to its contents is given within 10 days after it is
2 received.

3 * * *

4 **Official Comment**

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6 * * *

7
8 ~~Purposes of Changes: The changed phraseology of this~~ **Purposes:** This section is intended to
9 make it clear that:

10
11 1. The required ~~writing~~ record need not contain all the material terms of the contract
12 and such material terms as are stated need not be precisely stated. All that is required is that the
13 ~~writing~~ record afford a basis for believing that the offered oral evidence rests on a real
14 transaction. It may be written in lead pencil on a scratch pad or another medium. It need not
15 indicate which party is the buyer and which the seller. The only term which must appear is the
16 quantity term which need not be accurately stated but recovery is limited to the amount stated.
17 The price, time and place of payment or delivery, the general quality of the goods, or any
18 particular warranties may all be omitted.

19
20 Special emphasis must be placed on the permissibility of omitting the price term in view
21 of the insistence of some courts on the express inclusion of this term even where the parties have
22 contracted on the basis of a published price list. In many valid contracts for sale the parties do
23 not mention the price in express terms, the buyer being bound to pay and the seller to accept a
24 reasonable price which the trier of the fact may well be trusted to determine. Again, frequently
25 the price is not mentioned since the parties have based their agreement on a price list or
26 catalogue known to both of them and this list serves as an efficient safeguard against perjury.
27 Finally, "market" prices and valuations that are current in the vicinity constitute a similar check.
28 Thus, if the price is not stated in the memorandum it can normally be supplied without danger of
29 fraud. Of course, if the "price" consists of goods rather than money the quantity of goods must
30 be stated.

31
32 Only three definite and invariable requirements as to the memorandum are made by this
33 subsection. First, it must evidence a contract for the sale of goods; second, it must be "signed", a
34 word which includes any authentication which identifies the party to be charged; and third, it
35 must specify a quantity.

36
37 * * *

38
39 3. Between merchants, failure to answer a ~~written confirmation of~~ record confirming
40 a contract within ten days of receipt is tantamount to a ~~writing~~ record under subsection (2) and is
41 sufficient against both parties under subsection (1). The only effect, however, is to take away
42 from the party who fails to answer the defense of the Statute of Frauds; the burden of persuading
43 the trier of fact that a contract was in fact made orally prior to ~~the written confirmation~~ giving a

1 record confirming a contract is unaffected. Compare the effect of a failure to reply under Section
2 2-207.

3
4 4. Failure to satisfy the requirements of this section does not render the contract void
5 for all purposes, but merely prevents it from being judicially enforced in favor of a party to the
6 contract. For example, a buyer who takes possession of goods as provided in an oral contract
7 which the seller has not meanwhile repudiated, is not a trespasser. Nor would the Statute of
8 Frauds provisions of this section be a defense to a third person who wrongfully induces a party to
9 refuse to perform an oral contract, even though the injured party cannot maintain an action for
10 damages against the party so refusing to perform.

11
12 5. The requirement of “signing” is discussed in ~~the Comment to~~ Section 1-201,
13 Comment 37.

14
15 6. ~~¶~~ For purposes of subsection (1), it is not necessary that the writing record be
16 delivered to anybody. It need not be signed by both parties but it is, of course, not sufficient
17 against one who has not signed it. Prior to a dispute no one can determine which party’s signing
18 of the memorandum may be necessary but from the time of contracting each party should be
19 aware that to him it is signing by the other which is important.

20
21 7. If the making of a contract is admitted in court, either in a written pleading, by
22 stipulation or by oral statement before the court, no additional writing record is necessary for
23 protection against fraud. Under this section it is no longer possible to admit the contract in court
24 and still treat the Statute as a defense. However, the contract is not thus conclusively
25 established. The admission so made by a party is itself evidential against him of the truth of the
26 facts so admitted and of nothing more; as against the other party, it is not evidential at all.

27
28 8. In furtherance of medium neutrality, references to “writing” and “written” in the
29 former section have been changed to refer to a “record.”

30
31 * * *

32 **Section 2-202. Final ~~Written~~ Expression: Parol or Extrinsic Evidence.**

33 Terms with respect to which the confirmatory memoranda of the parties agree or which
34 are otherwise set forth in a writing record intended by the parties as a final expression of their
35 agreement with respect to such terms as are included therein may not be contradicted by
36 evidence of any prior agreement or of a contemporaneous oral agreement but may be explained
37 or supplemented:

38 (a) by course of performance, course of dealing, or usage of trade (Section 1-303);

1 and

2 (b) by evidence of consistent additional terms unless the court finds the ~~writing~~
3 record to have been intended also as a complete and exclusive statement of the terms of the
4 agreement.

5 Official Comment

6 * * *

8 Purposes:

9
10 1. This section definitely rejects:

11
12 (a) Any assumption that because a ~~writing~~ record has been worked out which is
13 final on some matters, it is to be taken as including all the matters agreed upon;

14
15 (b) The premise that the language used has the meaning attributable to such
16 language by rules of construction existing in the law rather than the meaning which arises out of
17 the commercial context in which it was used; and

18
19 (c) The requirement that a condition precedent to the admissibility of the type of
20 evidence specified in paragraph (a) is an original determination by the court that the language
21 used is ambiguous.

22
23 2. Paragraph (a) makes admissible evidence of course of dealing, usage of trade and
24 course of performance to explain or supplement the terms of any ~~writing~~ record stating the
25 agreement of the parties in order that the true understanding of the parties as to the agreement
26 may be reached. Such ~~writings~~ records are to be read on the assumption that the course of prior
27 dealings between the parties and the usages of trade were taken for granted when the document
28 was phrased. Unless carefully negated they have become an element of the meaning of the words
29 used. Similarly, the course of actual performance by the parties is considered the best indication
30 of what they intended the ~~writing~~ record to mean.

31
32 3. Under paragraph (b) consistent additional terms, not reduced to ~~writing~~ a record,
33 may be proved unless the court finds that the ~~writing~~ record was intended by both parties as a
34 complete and exclusive statement of all the terms. If the additional terms are such that, if agreed
35 upon, they would certainly have been included in the ~~document~~ record in the view of the court,
36 then evidence of their alleged making must be kept from the trier of fact.

37
38 4. In furtherance of medium neutrality, references to a "writing" in the former
39 section have been changed to refer to a "record."

40 * * *

1 **Section 2-203. Seals Inoperative.**

2 The affixing of a seal to a ~~writing~~ record evidencing a contract for sale or an offer to buy
3 or sell goods does not constitute the ~~writing~~ record a sealed instrument and the law with respect
4 to sealed instruments does not apply to such a contract or offer.

5 **Official Comment**

6 * * *

7
8 3. In furtherance of medium neutrality, the reference to a “writing” in the former
9 section has been changed to refer to a “record.”

10
11 * * *

12 **Section 2-205. Firm Offers.**

13 An offer by a merchant to buy or sell goods in a signed ~~writing~~ record which by its terms
14 gives assurance that it will be held open is not revocable, for lack of consideration, during the
15 time stated or if no time is stated for a reasonable time, but in no event may such period of
16 irrevocability exceed three months; but any such term of assurance on a form supplied by the
17 offeree must be separately signed by the offeror.

18 **Official Comment**

19
20 * * *

21
22 ~~Purposes of Changes:~~ **Purposes:**

23
24 1. This section is intended to modify the former rule which required that “firm
25 offers” be sustained by consideration in order to bind, and to require instead that they must
26 merely be characterized as such and expressed in signed ~~writings~~ records.

27
28 2. The primary purpose of this section is to give effect to the deliberate intention of a
29 merchant to make a current firm offer binding. The deliberation is shown in the case of an
30 individualized document by the merchant’s signature to the offer, and in the case of an offer
31 included on a form supplied by the other party to the transaction by the separate signing of the
32 particular clause which contains the offer. “Signed” here also includes authentication but the
33 reasonableness of the authentication herein allowed must be determined in the light of the
34 purpose of the section. The circumstances surrounding the signing may justify something less

1 than a formal signature or initialing but typically the kind of authentication involved here would
2 consist of a minimum of initialing of the clause involved. A handwritten memorandum on the
3 writer's letterhead purporting in its terms to "confirm" a firm offer already made would be
4 enough to satisfy this section, although not subscribed, since under the circumstances it could not
5 be considered a memorandum of mere negotiation and it would adequately show its own
6 authenticity. Similarly, an authorized telegram will suffice, and this is true even though the
7 original draft contained only a typewritten signature. See generally Section 1-201(b)(37)
8 (defining "sign") and Comment 37. However, despite settled courses of dealing or usages of the
9 trade whereby firm offers are made by oral communication and relied upon without more
10 evidence, such offers remain revocable under this article since authentication by a writing record
11 is the essence of this section.

12
13 3. In furtherance of medium neutrality, the references to a "writing" or "writings"
14 have been changed to refer to a signed "record."

15
16 * * *

17 **Section 2-207. Additional Terms in Acceptance or Confirmation.**

19 (1) A definite and seasonable expression of acceptance or a written confirmation which is
20 sent within a reasonable time operates as an acceptance even though it states terms additional to
21 or different from those offered or agreed upon, unless acceptance is expressly made conditional
22 on assent to the additional or different terms.

23 (2) The additional terms are to be construed as proposals for addition to the contract.
24 Between merchants such terms become part of the contract unless:

- 25 (a) the offer expressly limits acceptance to the terms of the offer;
26 (b) they materially alter it; or
27 (c) notification of objection to them has already been given or is given within a
28 reasonable time after notice of them is received.

29 (3) Conduct by both parties which recognizes the existence of a contract is sufficient to
30 establish a contract for sale although the writings of the parties do not otherwise establish a
31 contract. In such case the terms of the particular contract consist of those terms on which the
32 writings of the parties agree, together with any supplementary terms incorporated under any

other provisions of this Act.

Official Comment

* * *

8. Notwithstanding references in this section and throughout this article to “writing,” “writings,” or “written,” the use by parties of a record other than a writing may be given effect for purposes of this article under law other than the Uniform Commercial Code, such as the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001, et seq., and the Uniform Electronic Transactions Act.

Reporter’s Note

No change. No change is proposed to Section 2-207, which is provided for convenience.

* * *

Section 2-209. Modification, Rescission, and Waiver.

(1) An agreement modifying a contract within this article needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed writing or other signed record cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

* * *

Official Comment

* * *

3. Subsections (2) and (3) are intended to protect against false allegations of oral modifications. “Modification or rescission” includes abandonment or other change by mutual consent, contrary to the decision in *Green v. Doniger*, 300 N.Y. 238, 90 N.E.2d 56 (1949); it does not include unilateral “termination” or “cancellation” as defined in Section 2-106.

The Statute of Frauds provisions of this article are expressly applied to modifications by subsection (3). Under those provisions the “delivery and acceptance” test is limited to the goods which have been accepted, that is, to the past. “Modification” for the future cannot therefore be conjured up by oral testimony if the price involved is \$500.00 or more since such modification

1 must be shown at least by a signed memo. And since a memo is limited in its effect to the
2 quantity of goods set forth in it there is safeguard against oral evidence.

3
4 Subsection (2) permits the parties in effect to make their own Statute of Frauds as regards
5 any future modification of the contract by giving effect to a clause in a signed agreement which
6 expressly requires any modification to be by signed writing or other signed record. But note that
7 if a consumer is to be held to such a clause on a form supplied by a merchant it must be
8 separately signed.

9
10 4. Subsection (4) is intended, despite the provisions of subsections (2) and (3), to
11 prevent contractual provisions excluding modification except by a signed ~~writing~~ record from
12 limiting in other respects the legal effect of the parties' actual later conduct. The effect of such
13 conduct as a waiver is further regulated in subsection (5).

14
15 5. In furtherance of medium neutrality, the reference to a signed "writing" has been
16 supplemented to refer as well to a signed "record."

17
18 * * *

19 **Section 2-316. Exclusion or Modification of Warranties.**

20 (1) Words or conduct relevant to the creation of an express warranty and words or
21 conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent
22 with each other; but subject to the provisions of this Article on parol or extrinsic evidence
23 (Section 2-202) negation or limitation is inoperative to the extent that such construction is
24 unreasonable.

25 (2) Subject to subsection (3), to exclude or modify the implied warranty of
26 merchantability or any part of it the language must mention merchantability and in case of a
27 writing must be conspicuous, and to exclude or modify any implied warranty of fitness the
28 exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of
29 fitness is sufficient if it states, for example, that "There are no warranties which extend beyond
30 the description on the face hereof."

31 (3) Notwithstanding subsection (2)

32 (a) unless the circumstances indicate otherwise, all implied warranties are

1 excluded by expressions like “as is”, “with all faults,” or other language which in common
2 understanding calls the buyer's attention to the exclusion of warranties and makes plain that there
3 is no implied warranty; and

4 (b) when the buyer before entering into the contract has examined the goods or
5 the sample or model as fully as he desired or has refused to examine the goods there is no
6 implied warranty with regard to defects which an examination ought in the circumstances to have
7 revealed to him; and

8 (c) an implied warranty can also be excluded or modified by course of dealing or
9 course of performance or usage of trade.

10 (4) Remedies for breach of warranty can be limited in accordance with the provisions of
11 this Article on liquidation or limitation of damages and on contractual modification of remedy
12 (Sections 2-718 and 2-719.

13 Official Comment

14 * * *

15 10. As to the use of a record other than a writing and communications that are not
16 written, see Section 2-207, Comment 8. Whether a term is conspicuous, including a term in a
17 record other than a writing, is discussed in Section 1-201, Comment 10.

18 Reporter's Note

19 *No change.* No change is proposed to Section 2-316, which is provided for convenience.
20

21 * * *

22 Section 2-605. Waiver of Buyer's Objections by Failure to Particularize.

23 (1) The buyer's failure to state in connection with rejection a particular defect which is
24 ascertainable by reasonable inspection precludes him from relying on the unstated defect to
25 justify rejection or to establish breach
26
27
28

1 (a) where the seller could have cured it if stated seasonably; or

2 (b) between merchants when the seller has after rejection made a request in
3 writing for a full and final written statement of all defects on which the buyer proposes to rely.

4 (2) Payment against documents made without reservation of rights precludes recovery of
5 the payment for defects apparent in the documents.

6 **Official Comment**

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8 * * *

9
10 5. As to the use of a record other than a writing and communications that are not
11 written, see Section 2-207, Comment 8.

12
13 **Reporter's Note**

14
15 *No change.* No change is proposed to Section 2-605, which is provided for convenience.

16
17 * * *

18 **Section 2-607. Effect of Acceptance; Notice of Breach; Burden of Establishing**
19 **Breach After Acceptance; Notice of Claim or Litigation to Person Answerable Over.**

20 (1) The buyer must pay at the contract rate for any goods accepted.

21 (2) Acceptance of goods by the buyer precludes rejection of the goods accepted and if
22 made with knowledge of a non-conformity cannot be revoked because of it unless the acceptance
23 was on the reasonable assumption that the non-conformity would be seasonably cured, but
24 acceptance does not of itself impair any other remedy provided by this Article for non-
25 conformity.

26 (3) Where a tender has been accepted

27 (a) the buyer must within a reasonable time after ~~he~~ it discovers or should have
28 discovered any breach notify the seller of breach or be barred from any remedy; and

29 (b) if the claim is one for infringement or the like (subsection (3) of Section 2-

1 312) and the buyer is sued as a result of ~~such a~~ the breach, ~~he~~ the buyer must so notify the seller
2 within a reasonable time after ~~he~~ the buyer receives notice of the litigation or be barred from any
3 remedy over for liability established by the litigation.

4 (4) The burden is on the buyer to establish any breach with respect to the goods accepted.

5 (5) Where the buyer is sued for breach of a warranty or other obligation for which his
6 seller is answerable over

7 (a) ~~he~~ the buyer may give ~~his~~ the seller written notice of the litigation. If the
8 notice states that the seller may come in and defend and that if the seller does not do so he will
9 be bound in any action against him by ~~his~~ the buyer by any determination of fact common to the
10 two litigations, then unless the seller after seasonable receipt of the notice does come in and
11 defend ~~he~~ it is so bound.

12 (b) if the claim is one for infringement or the like (subsection (3) of Section 2-
13 312) the original seller may demand in writing that his buyer turn over to him control of the
14 litigation including settlement or else be barred from any remedy over and if he also agrees to
15 bear all expense and to satisfy any adverse judgment, then unless the buyer after seasonable
16 receipt of the demand does turn over control the buyer is so barred.

17 (6) The provisions of subsections (3), (4) and (5) apply to any obligation of a buyer to
18 hold the seller harmless against infringement or the like (subsection (3) of Section 2-312).

19 **Official Comment**

20 * * *

21
22 9. As to the use of a record other than a writing and communications that are not
23 written, see Section 2-207, Comment 8.

24 * * *

26 **Reporter's Note**

1
2 *Stylistic changes.* Only stylistic changes are proposed to Section 2-609.

3 * * *

4 **Section 2-609. Right to Adequate Assurance of Performance.**

5 (1) A contract for sale imposes an obligation on each party that the other's expectation of
6 receiving due performance will not be impaired. When reasonable grounds for insecurity arise
7 with respect to the performance of either party the other may in writing demand adequate
8 assurance of due performance and until he receives such assurance may if commercially
9 reasonable suspend any performance for which he has not already received the agreed return.

10 (2) Between merchants the reasonableness of grounds for insecurity and the adequacy of
11 any assurance offered shall be determined according to commercial standards.

12 (3) Acceptance of any improper delivery or payment does not prejudice the aggrieved
13 party's right to demand adequate assurance of future performance.

14 (4) After receipt of a justified demand failure to provide within a reasonable time not
15 exceeding thirty days such assurance of due performance as is adequate under the circumstances
16 of the particular case is a repudiation of the contract.

17 **Official Comment**

18 * * *

19 7. As to the use of a record other than a writing and communications that are not
20 written, see Section 2-207, Comment 8.

21 **Reporter's Note**

22 *No change.* No change is proposed to Section 2-609, which is provided for convenience.

23 * * *

24 **Section 2-616. Procedure on Notice Claiming Excuse.**

25 (1) Where the buyer receives notification of a material or indefinite delay or an allocation
26
27
28
29

1 justified under the preceding section he may by written notification to the seller as to any
2 delivery concerned, and where the prospective deficiency substantially impairs the value of the
3 whole contract under the provisions of this Article relating to breach of installment contracts
4 (Section 2-612), then also as to the whole,

5 (a) terminate and thereby discharge any unexecuted portion of the contract; or

6 (b) modify the contract by agreeing to take his available quota in substitution.

7 (2) If after receipt of such notification from the seller the buyer fails so to modify the
8 contract within a reasonable time not exceeding thirty days the contract lapses with respect to
9 any deliveries affected.

10 (3) The provisions of this section may not be negated by agreement except in so far as the
11 seller has assumed a greater obligation under the preceding section.

12 **Official Comment**

13 1. * * *

14
15 2. As to the use of a record other than a writing and communications that are not
16 written, see Section 2-207, Comment 8.

17 **Reporter's Note**

18
19
20 *No change.* No change is proposed to Section 2-616, which is provided for convenience.

21 * * *

22 23 **Section 2-702. Seller's Remedies on Discovery of Buyer's Insolvency.**

24 (1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for
25 cash including payment for all goods theretofore delivered under the contract, and stop delivery
26 under this Article (Section 2-705).

27 (2) Where the seller discovers that the buyer has received goods on credit while insolvent
28 he may reclaim the goods upon demand made within ten days after the receipt, but if

misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser under this Article (Section 2-403). Successful reclamation of goods excludes all other remedies with respect to them.

Official Comment

* * *

4. As to the use of a record other than a writing and communications that are not written, see Section 2-207, Comment 8.

Reporter's Note

No change. No change is proposed to Section 2-702, which is provided for convenience.

* * *

ARTICLE 2A

LEASES

* * *

Section 2A-102. Scope.

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

(2) If the lease-of-goods aspects of a hybrid lease predominate, this article applies to the transaction.

(3) If the lease-of-goods aspects of a hybrid lease do not predominate:

(a) only the provisions of this article which relate primarily to the lease-of-goods

1 aspects of the transaction apply, and not provisions that relate primarily to the transaction as a
2 whole;

3 (b) Section 2A-209 applies if the lease is a finance lease; and

4 (c) Section 2A-407 applies to the promises of the lessee in a finance lease to the
5 extent the promises are consideration for the right to possession and use of the leased goods.

6 (4) This section does not preclude the application in appropriate circumstances of other
7 law to the aspects of a hybrid lease which do not relate to the lease of goods even if the lease-of-
8 goods aspects of the transaction predominate.

9 **Official Comment**

10 * * *

11 **Purposes:**

12 1. This ~~Article~~ article governs transactions as diverse as the lease of a hand tool to an
13 individual for a few hours and the leveraged lease of a complex line of industrial equipment to a
14 multi-national organization for a number of years.

15 To achieve that end it was necessary to provide that this ~~Article~~ article applies to any
16 transaction, regardless of form, that creates a lease. Since lease is defined as a transfer of an
17 interest in goods (Section 2A-103(1)(j)) and goods is defined to include fixtures (Section 2A-
18 103(1)(h)), application is limited to the extent the transaction relates to goods, including fixtures.
19 Further, since the definition of lease does not include a sale (Section 2-106(1)) or retention or
20 creation of a security interest (Section ~~1-201(37)~~ 1-201(b)(35)), application is further limited;
21 sales and security interests are governed by other ~~Articles~~ articles of this Act.

22 2. ~~Finally, in~~ In recognition of the diversity of the transactions to be governed, the
23 sophistication of many of the parties to these transactions, and the common law tradition as it
24 applies to the bailment for hire or lease, freedom of contract has been preserved. DeKoven,
25 Proceedings After Default by the Lessee Under a True Lease of Equipment, in 1C P. Coogan, W.
26 Hogan, D. Vagts, Secured Transactions Under the Uniform Commercial Code, § 29B.02[2]
27 (1986). Thus, despite the extensive regulatory scheme established by this ~~Article~~ article, the
28 parties to a lease will be able to create private rules to govern their transaction. Sections 2A-
29 103(4) and 1-102(3). However, there are special rules in this ~~Article~~ article governing consumer
30 leases, as well as other state and federal statutes, that may further limit freedom of contract with
31 respect to consumer leases.

32 3. A court may apply this ~~Article~~ article by analogy to any transaction, regardless of

1 form, that creates a lease of personal property other than goods, taking into account the
2 expressed intentions of the parties to the transaction and any differences between a lease of
3 goods and a lease of other property. Such application has precedent as the provisions of the
4 Article on Sales (Article 2) have been applied by analogy to leases of goods. E.g., Hawkland,
5 The Impact of the Uniform Commercial Code on Equipment Leasing, 1972 Ill.L.F. 446; Murray,
6 Under the Spreading Analogy of Article 2 of the Uniform Commercial Code, 39 Fordham L.Rev.
7 447 (1971). Whether such application would be appropriate for other bailments of personal
8 property, gratuitous or for hire, should be determined by the facts of each case. See Mieske v.
9 Bartell Drug Co., 92 Wash.2d 40, 46-48, 593 P.2d 1308, 1312 (1979).

10
11 Further, parties to a transaction creating a lease of personal property other than goods, or
12 another bailment of personal property, may provide by agreement that this ~~Article~~ article applies.
13 Upholding the parties' choice is consistent with the spirit of this ~~Article~~ article.

14
15 4. Under subsection (2), if the lease-of-goods aspects of a hybrid lease predominate, this
16 article applies to the transaction. If the lease-of-goods aspects of a hybrid lease do not
17 predominate, subsection (3)(a) applies and the provisions of this article which relate primarily to
18 the lease-of-goods aspects of the transaction and not to the transaction as a whole apply.

19
20 5. Relevant factors in determining whether the lease-of-goods aspects of a hybrid lease
21 predominate include the language of the agreement and the portion of the total price that is
22 attributable to the lease of goods, although neither is determinative. An agreed-upon allocation of
23 a portion of the total price to the right to possession and use of the goods is ordinarily binding on
24 the parties, as is an agreement that the transaction includes or does not include a finance lease.

25
26 6. A finance lease, defined in Section 2A-103(1)(g), may be included in a hybrid lease in
27 which the lease-of-goods aspects of the transaction do not predominate. In such a situation,
28 subsection (3)(b) makes Section 2A-209 applicable to the transaction and subsection (3)(c)
29 addresses the application of Section 2A-407 to the promises made by the lessee under the finance
30 lease. That latter section applies to those promises that are consideration for the lessee's right to
31 possession and use of the leased goods. Whether a promise of a lessee so qualifies is a question
32 of fact but an agreed-upon allocation of a portion of the total price to the right to possession and
33 use of the leased goods is ordinarily binding on the parties. The fact that subsection (3)(b) and (c)
34 expressly make Sections 2A-209 and 2A-407 applicable if the lease is a finance lease does not
35 prevent application of other provisions of this article relating to finance leases pursuant to
36 subsection (3)(a).

37
38 **Example 1.** Lessor and Customer enter into a contract that provides for Lessor to:

39 (i) lease equipment to Customer; and (ii) provide to Customer a variety of
40 maintenance and consulting services. The services aspects of the transaction
41 predominate. Lessor did not select, manufacture, or supply the goods; instead, the
42 goods were selected by Customer, and Lessor acquired the goods from Supplier
43 for the sole purpose of leasing the goods to Customer. Assume that the lease
44 aspects of the transaction involve a finance lease under Section 2A-103(1)(g).
45 Pursuant to subsection (3)(a), Sections 2A-212 and 2A-213 apply. Under those
46 sections, because the lease aspect of the transaction is a finance lease, Lessor

1 makes no implied warranty of merchantability or implied warranty of fitness for
2 particular purpose. Pursuant to subsection (3)(b), Section 2A-209 applies to the
3 transaction. Under that section, all warranties made by Supplier to Lessor extend
4 to Customer.

5
6 **Example 2.** Same facts as Example 1. As consideration for Lessor's obligations
7 under the contract, Customer promises to pay a single monthly fee of a specified
8 amount. The contract does not indicate what portion of the monthly fee is
9 consideration for the services or what portion is consideration for possession and
10 use of the equipment. Section 2A-407 applies to the lessee's promises that are
11 consideration for the lessee's right to possession and use of the equipment. In an
12 action involving the application of Section 2A-407, the determination of what
13 portion of the monthly fee is for the right to possession and use of the equipment
14 is a question of fact.

15
16 **Example 3.** Same facts as Example 1 except that the lease-of-goods aspects of the
17 transaction predominate. Section 2A-407 applies to all of the lessee's promises
18 under the transaction.

19
20 7. If the lease-of-goods aspects of a hybrid lease predominate, then this article applies to
21 the transaction. However, the application of this article to a hybrid lease does not preclude the
22 application of principles of law and equity to supplement the provisions of this article, see
23 Section 1-103(b), nor does it preclude, in appropriate circumstances, the application of other law
24 to the non-lease-of-goods aspects of the transaction. Whether it is appropriate to apply such other
25 law will depend in part on what purposes the other law is designed to achieve and whether
26 application of the other law would be likely to interfere with the application of this article.

27
28 **Example 4.** Same facts as Example 3 (the lease-of-goods aspects of the
29 transaction predominate) except that the lease is not a finance lease. This article
30 applies to the transaction. Nevertheless, because principles of law and equity also
31 apply unless displaced by particular provisions the Uniform Commercial Code,
32 see Section 1-103(b), and this article does not displace other law relating to
33 whether Lessor's performance of services conforms to the contract, other law
34 determines whether the services conform to the contract.

35
36 8. The rules of subsections (2) and (3) are essentially gap fillers that apply when
37 the parties' agreement is silent on what legal rules govern the different aspects of their
38 transaction. In general, parties are free to preclude the application of this article to the
39 aspects of their transaction that are not about the lease of goods. See Comment 5 to
40 Section 2-102.

41 * * *

42 **Section 2A-103. Definitions and Index of Definitions.**

43
44 (1) In this article, unless the context otherwise requires:

* * *

(h.1) “Hybrid lease” means a single transaction involving a lease of goods and:

(i) the provision of services;

(ii) a sale of other goods; or

(iii) a sale, lease, or license of property other than goods.

* * *

Official Comment

* * *

(g) “Finance Lease”. * * *

* * *

Notwithstanding references in this section and throughout this article to “writing,” “writings,” or “written,” the use by parties of a record other than a writing may be given effect for purposes of this article under law other than the Uniform Commercial Code, such as the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 *et seq.*, and the Uniform Electronic Transactions Act.

* * *

(h.1) “Hybrid lease”. In some transactions, the transfer of the right to possession and use of goods for a term in return for consideration (i.e., a lease), is part of a larger transaction. The other aspects of the transaction might involve the provision of services, a sale of other goods, or a transfer of rights to property other than goods. Such a transaction is a hybrid lease. Section 2A-102 indicates the extent to which this article applies to a hybrid lease.

A hybrid lease is a single transaction. If contracting parties enter into separate agreements at the same time, each agreement must be evaluated separately to determine if it is a hybrid lease.

Example 1. Lessor and Customer A enter into a single agreement that provides for Lessor, in return for periodic payments from Customer A, to: (i) lease a photocopier to Customer A for twelve months; (ii) supply all the paper, staples, and toner needed to operate the copier during that period, and (iii) provide routine maintenance and repair services needed to keep the copier operating during that period. The transaction is a hybrid lease because it involves a lease of goods (the copier), a sale of goods (the paper, staples, and toner), and the provision of services.

Example 2. Lessor and Customer B enter into three separate written agreements at the same time: (i) a lease of a photocopier to Customer B for twelve months; (ii) a contract for Lessor to supply Customer B with all the paper, staples, and toner needed to operate the copier during that period, and (iii) a contract for Lessor to provide routine maintenance and repair services needed to keep the copier operating during that period. Because the parties executed three separate agreements, and the lease does not involve a sale, lease, or license of other property or the provision of services, the lease is not a hybrid lease.

Even when contracting parties enter into a single agreement involving both a lease of goods and a sale, lease, or license of other property or the provision of services, the agreement would not involve a single transaction, and hence the transaction would not be a hybrid lease, if the lease of goods is unrelated to the other aspects of the transaction and the terms of the agreement relating to the lease of goods are readily severable from the terms of the agreement relating to the other aspects of the transaction.

Example 3. Farmer A and Farmer B sign a written agreement pursuant to which Farmer A will lease a tractor to Farmer B for one year and Farmer B will board and feed Farmer A's cattle until the cattle are sold. The agreement specifies a rental payment for the tractor, which is due monthly, and a mechanism for determining the price for Farmer B's services, which is to be paid when the cattle are sold. The parties would have entered into an agreement to lease the tractor even if they had not entered into an agreement to board and feed the cattle, and vice-versa. The transaction is not a hybrid lease. Article 2A applies to the lease of the tractor. Other law applies to the agreement to board and feed the cattle.

* * *

Section 2A-107. Waiver or Renunciation of Claim or Right After Default.

Any claim or right arising out of an alleged default or breach of warranty may be discharged in whole or in part without consideration by a ~~written~~ waiver or renunciation in a signed and record delivered by the aggrieved party.

Official Comment

* * *

1. * * *

2. In furtherance of medium neutrality, the reference to a signed "written" waiver or renunciation has been changed to refer to a waiver in a signed "record."

* * *

1 **Section 2A-201. Statute of Frauds.**

2 (1) A lease contract is not enforceable by way of action or defense unless:

3 (a) the total payments to be made under the lease contract, excluding payments for
4 options to renew or buy, are less than \$1,000; or

5 (b) there is a ~~writing~~ record, signed by the party against whom enforcement is
6 sought or by that party's authorized agent, sufficient to indicate that a lease contract has been
7 made between the parties and to describe the goods leased and the lease term.

8 (2) Any description of leased goods or of the lease term is sufficient and satisfies
9 subsection (1)(b), whether or not it is specific, if it reasonably identifies what is described.

10 (3) A ~~writing~~ record is not insufficient because it omits or incorrectly states a term agreed
11 upon, but the lease contract is not enforceable under subsection (1)(b) beyond the lease term and
12 the quantity of goods shown in the ~~writing~~ record.

13 (4) A lease contract that does not satisfy the requirements of subsection (1), but which is
14 valid in other respects, is enforceable:

15 (a) if the goods are to be specially manufactured or obtained for the lessee and are
16 not suitable for lease or sale to others in the ordinary course of the lessor's business, and the
17 lessor, before notice of repudiation is received and under circumstances that reasonably indicate
18 that the goods are for the lessee, has made either a substantial beginning of their manufacture or
19 commitments for their procurement;

20 (b) if the party against whom enforcement is sought admits in that party's
21 pleading, testimony or otherwise in court that a lease contract was made, but the lease contract is
22 not enforceable under this provision beyond the quantity of goods admitted; or

23 (c) with respect to goods that have been received and accepted by the lessee.

(5) The lease term under a lease contract referred to in subsection (4) is:

(a) if there is a ~~writing~~ record signed by the party against whom enforcement is sought or by that party's authorized agent specifying the lease term, the term so specified;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony, or otherwise in court a lease term, the term so admitted; or

(c) a reasonable lease term.

Official Comment

* * *

Changes:

1. This section is modeled on Section 2-201, with changes to reflect the differences between a lease contract and a contract for the sale of goods. In particular, subsection (1)(b) adds a requirement that the ~~writing~~ record "describe the goods leased and the lease term", borrowing that concept, with revisions, from the provisions of Section 9-203(1)(a). Subsection (2), relying on the statutory analogue in Section 9-110, sets forth the minimum criterion for satisfying that requirement.

2. In furtherance of medium neutrality, the references to a "writing" have been changed to refer to a "record."

* * *

Section 2A-202. Final ~~Written~~ Expression: Parol or Extrinsic Evidence.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a ~~writing~~ record intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

(a) by course of dealing or usage of trade or by course of performance; and

(b) by evidence of consistent additional terms unless the court finds the ~~writing~~ record to have been intended also as a complete and exclusive statement of the terms of the

1 agreement.

2 **Official Comment**

3 * * *

4
5 In furtherance of medium neutrality, the references to a “writing” have been changed to
6 refer to a “record.”

7
8 * * *

9 **Section 2A-203. Seals Inoperative.**

10 The affixing of a seal to a ~~writing~~ record evidencing a lease contract or an offer to enter
11 into a lease contract does not render the ~~writing~~ record a sealed instrument and the law with
12 respect to sealed instruments does not apply to the lease contract or offer.

13 **Official Comment**

14
15 * * *

16
17 In furtherance of medium neutrality, the references to a “writing” have been changed to
18 refer to a “record.”

19
20 * * *

21 **Section 2A-205. Firm Offers.**

22 An offer by a merchant to lease goods to or from another person in a signed ~~writing~~
23 record that by its terms gives assurance it will be held open is not revocable, for lack of
24 consideration, during the time stated or, if no time is stated, for a reasonable time, but in no event
25 may the period of irrevocability exceed 3 months. Any such term of assurance on a form
26 supplied by the offeree must be separately signed by the offeror.

27 **Official Comment**

28
29 * * *

30
31 In furtherance of medium neutrality, the reference to a signed “writing” has been changed
32 to refer to a signed “record.”

* * *

Section 2A-208. Modification, Rescission, and Waiver.

(1) An agreement modifying a lease contract needs no consideration to be binding.

(2) A signed lease agreement that excludes modification or rescission except by a signed ~~writing~~ record may not be otherwise modified or rescinded, but, except as between merchants, such a requirement on a form supplied by a merchant must be separately signed by the other party.

* * *

Official Comment

* * *

Changes:

1. Revised to reflect leasing practices and terminology, except that the provisions of subsection 2-209(3) were omitted.

2. In furtherance of medium neutrality, the reference to a signed “writing” has been changed to refer to a signed “record.”

* * *

Section 2A-214. Exclusion or Modification of Warranties.

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit a warranty must be construed wherever reasonable as consistent with each other; but, subject to the provisions of Section 2A-202 on parol or extrinsic evidence, negation or limitation is inoperative to the extent that the construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention “merchantability”, be by a writing, and be conspicuous. Subject to subsection (3), to exclude or modify any implied warranty of

1 fitness the exclusion must be by a writing and be conspicuous. Language to exclude all implied
2 warranties of fitness is sufficient if it is in writing, is conspicuous and states, for example, “There
3 is no warranty that the goods will be fit for a particular purpose”.

4 (3) Notwithstanding subsection (2), but subject to subsection (4),

5 (a) unless the circumstances indicate otherwise, all implied warranties are
6 excluded by expressions like “as is,” or “with all faults,” or by other language that in common
7 understanding calls the lessee's attention to the exclusion of warranties and makes plain that
8 there is no implied warranty, if in writing and conspicuous;

9 (b) if the lessee before entering into the lease contract has examined the goods or
10 the sample or model as fully as desired or has refused to examine the goods, there is no implied
11 warranty with regard to defects that an examination ought in the circumstances to have revealed;
12 and

13 (c) an implied warranty may also be excluded or modified by course of dealing,
14 course of performance, or usage of trade.

15 (4) To exclude or modify a warranty against interference or against infringement (Section
16 2A-211) or any part of it, the language must be specific, be by a writing, and be conspicuous,
17 unless the circumstances, including course of performance, course of dealing, or usage of trade,
18 give the lessee reason to know that the goods are being leased subject to a claim or interest of
19 any person.

20 Official Comment

21 * * *

22 Purposes:

23 1. * * *

2. As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g). Whether a term is conspicuous, including a term in a record other than a writing, is discussed in Section 1-201, Comment 10.

* * *

Reporter's Note

No change. No change is proposed to Section 2A-214, which is provided for convenience.

* * *

Section 2A-303. Alienability of Party's Interest Under Lease Contract or of Lessor's Residual Interest in Goods; Delegation of Performance; Transfer of Rights.

(1) As used in this section, “creation of a security interest” includes the sale of a lease contract that is subject to Article 9, Secured Transactions, by reason of Section 9-109(a)(3).

(2) Except as provided in subsection (3) and Section 9-407, a provision in a lease agreement which (i) prohibits the voluntary or involuntary transfer, including a transfer by sale, sublease, creation or enforcement of a security interest, or attachment, levy, or other judicial process, of an interest of a party under the lease contract or of the lessor's residual interest in the goods, or (ii) makes such a transfer an event of default, gives rise to the rights and remedies provided in subsection (4), but a transfer that is prohibited or is an event of default under the lease agreement is otherwise effective.

(3) A provision in a lease agreement which (i) prohibits a transfer of a right to damages for default with respect to the whole lease contract or of a right to payment arising out of the transferor's due performance of the transferor's entire obligation, or (ii) makes such a transfer an event of default, is not enforceable, and such a transfer is not a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract within the purview

1 of subsection (4).

2 (4) Subject to subsection (3) and Section 9-407:

3 (a) if a transfer is made which is made an event of default under a lease
4 agreement, the party to the lease contract not making the transfer, unless that party waives the
5 default or otherwise agrees, has the rights and remedies described in Section 2A-501(2);

6 (b) if paragraph (a) is not applicable and if a transfer is made that (i) is prohibited
7 under a lease agreement or (ii) materially impairs the prospect of obtaining return performance
8 by, materially changes the duty of, or materially increases the burden or risk imposed on, the
9 other party to the lease contract, unless the party not making the transfer agrees at any time to the
10 transfer in the lease contract or otherwise, then, except as limited by contract, (i) the transferor is
11 liable to the party not making the transfer for damages caused by the transfer to the extent that
12 the damages could not reasonably be prevented by the party not making the transfer and (ii) a
13 court having jurisdiction may grant other appropriate relief, including cancellation of the lease
14 contract or an injunction against the transfer.

15 (5) A transfer of “the lease” or of “all my rights under the lease”, or a transfer in similar
16 general terms, is a transfer of rights and, unless the language or the circumstances, as in a
17 transfer for security, indicate the contrary, the transfer is a delegation of duties by the transferor
18 to the transferee. Acceptance by the transferee constitutes a promise by the transferee to perform
19 those duties. The promise is enforceable by either the transferor or the other party to the lease.

20 (6) Unless otherwise agreed by the lessor and the lessee, a delegation of performance
21 does not relieve the transferor as against the other party of any duty to perform or of any liability
22 for default.

23 (7) In a consumer lease, to prohibit the transfer of an interest of a party under the lease

1 contract or to make a transfer an event of default, the language must be specific, by a writing,
2 and conspicuous.

3 **Official Comment**

4 * * *

5 10. As to the use of a record other than a writing and communications that are not
6 written, see Section 2A-103, Comment (g).

7
8 * * *

9
10 **Reporter's Note**

11
12 *No change.* No change is proposed to Section 2A-303, which is provided for
13 convenience.

14
15 * * *

16 **Section 2A-309. Lessor's and Lessee's Rights When Goods Become Fixtures.**

17 (1) In this section:

18 (a) goods are "fixtures" when they become so related to particular real estate that
19 an interest in them arises under real estate law;

20 (b) a "fixture filing" is the filing, in the office where a record of a mortgage on the
21 real estate would be filed or recorded, of a financing statement covering goods that are or are to
22 become fixtures and conforming to the requirements of Section 9-502(a) and (b);

23 (c) a lease is a "purchase money lease" unless the lessee has possession or use of
24 the goods or the right to possession or use of the goods before the lease agreement is
25 enforceable;

26 (d) a mortgage is a "construction mortgage" to the extent it secures an obligation
27 incurred for the construction of an improvement on land including the acquisition cost of the
28 land, if the recorded writing so indicates; and

1 (e) “encumbrance” includes real estate mortgages and other liens on real estate
2 and all other rights in real estate that are not ownership interests.

3 (2) Under this Article a lease may be of goods that are fixtures or may continue in goods
4 that become fixtures, but no lease exists under this Article of ordinary building materials
5 incorporated into an improvement on land.

6 (3) This Article does not prevent creation of a lease of fixtures pursuant to real estate law.

7 (4) The perfected interest of a lessor of fixtures has priority over a conflicting interest of
8 an encumbrancer or owner of the real estate if:

9 (a) the lease is a purchase money lease, the conflicting interest of the
10 encumbrancer or owner arises before the goods become fixtures, the interest of the lessor is
11 perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and
12 the lessee has an interest of record in the real estate or is in possession of the real estate; or

13 (b) the interest of the lessor is perfected by a fixture filing before the interest of
14 the encumbrancer or owner is of record, the lessor's interest has priority over any conflicting
15 interest of a predecessor in title of the encumbrancer or owner, and the lessee has an interest of
16 record in the real estate or is in possession of the real estate.

17 (5) The interest of a lessor of fixtures, whether or not perfected, has priority over the
18 conflicting interest of an encumbrancer or owner of the real estate if:

19 (a) the fixtures are readily removable factory or office machines, readily
20 removable equipment that is not primarily used or leased for use in the operation of the real
21 estate, or readily removable replacements of domestic appliances that are goods subject to a
22 consumer lease, and before the goods become fixtures the lease contract is enforceable; or

23 (b) the conflicting interest is a lien on the real estate obtained by legal or equitable

1 proceedings after the lease contract is enforceable; or

2 (c) the encumbrancer or owner has consented in writing to the lease or has
3 disclaimed an interest in the goods as fixtures; or

4 (d) the lessee has a right to remove the goods as against the encumbrancer or
5 owner. If the lessee's right to remove terminates, the priority of the interest of the lessor
6 continues for a reasonable time.

7 (6) Notwithstanding subsection (4)(a) but otherwise subject to subsections (4) and (5), the
8 interest of a lessor of fixtures, including the lessor's residual interest, is subordinate to the
9 conflicting interest of an encumbrancer of the real estate under a construction mortgage recorded
10 before the goods become fixtures if the goods become fixtures before the completion of the
11 construction. To the extent given to refinance a construction mortgage, the conflicting interest of
12 an encumbrancer of the real estate under a mortgage has this priority to the same extent as the
13 encumbrancer of the real estate under the construction mortgage.

14 (7) In cases not within the preceding subsections, priority between the interest of a lessor
15 of fixtures, including the lessor's residual interest, and the conflicting interest of an
16 encumbrancer or owner of the real estate who is not the lessee is determined by the priority rules
17 governing conflicting interests in real estate.

18 (8) If the interest of a lessor of fixtures, including the lessor's residual interest, has
19 priority over all conflicting interests of all owners and encumbrancers of the real estate, the
20 lessor or the lessee may (i) on default, expiration, termination, or cancellation of the lease
21 agreement but subject to the agreement and this Article, or (ii) if necessary to enforce other
22 rights and remedies of the lessor or lessee under this Article, remove the goods from the real
23 estate, free and clear of all conflicting interests of all owners and encumbrancers of the real

1 estate, but the lessor or lessee must reimburse any encumbrancer or owner of the real estate who
2 is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury,
3 but not for any diminution in value of the real estate caused by the absence of the goods removed
4 or by any necessity of replacing them. A person entitled to reimbursement may refuse permission
5 to remove until the party seeking removal gives adequate security for the performance of this
6 obligation.

7 (9) Even though the lease agreement does not create a security interest, the interest of a
8 lessor of fixtures, including the lessor's residual interest, is perfected by filing a financing
9 statement as a fixture filing for leased goods that are or are to become fixtures in accordance
10 with the relevant provisions of the Article on Secured Transactions (Article 9).

11 **Official Comment**

12 * * *

13
14
15 7. As to the use of a record other than a writing and communications that are not written,
16 see Section 2A-103, Comment (g).

17 * * *

18 19 **Reporter's Note**

20
21
22 *No change.* No change is proposed to Section 2A-309, which is provided for
23 convenience.

24 * * *

25 26 **Section 2A-310. Lessor's and Lessee's Rights When Goods Become Accessions.**

27 (1) Goods are "accessions" when they are installed in or affixed to other goods.

28 (2) The interest of a lessor or a lessee under a lease contract entered into before the goods
29 became accessions is superior to all interests in the whole except as stated in subsection (4).

30 (3) The interest of a lessor or a lessee under a lease contract entered into at the time or

1 after the goods became accessions is superior to all subsequently acquired interests in the whole
2 except as stated in subsection (4) but is subordinate to interests in the whole existing at the time
3 the lease contract was made unless the holders of such interests in the whole have in writing
4 consented to the lease or disclaimed an interest in the goods as part of the whole.

5 (4) The interest of a lessor or a lessee under a lease contract described in subsection (2) or
6 (3) is subordinate to the interest of

7 (a) a buyer in the ordinary course of business or a lessee in the ordinary course of
8 business of any interest in the whole acquired after the goods became accessions; or

9 (b) a creditor with a security interest in the whole perfected before the lease
10 contract was made to the extent that the creditor makes subsequent advances without knowledge
11 of the lease contract.

12 (5) When under subsections (2) or (3) and (4) a lessor or a lessee of accessions holds an
13 interest that is superior to all interests in the whole, the lessor or the lessee may (a) on default,
14 expiration, termination, or cancellation of the lease contract by the other party but subject to the
15 provisions of the lease contract and this Article, or (b) if necessary to enforce his [or her] other
16 rights and remedies under this Article, remove the goods from the whole, free and clear of all
17 interests in the whole, but he [or she] must reimburse any holder of an interest in the whole who
18 is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury
19 but not for any diminution in value of the whole caused by the absence of the goods removed or
20 by any necessity for replacing them. A person entitled to reimbursement may refuse permission
21 to remove until the party seeking removal gives adequate security for the performance of this
22 obligation.

23 **Official Comment**

* * *

Purposes:

* * *

As to the use of a record other than a writing and communications that are not written,
see Section 2A-103, Comment (g).

* * *

Reporter's Note

No change. No change is proposed to Section 2A-310, which is provided for convenience.

* * *

Section 2A-401. Insecurity: Adequate Assurance of Performance.

(1) A lease contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.

(2) If reasonable grounds for insecurity arise with respect to the performance of either party, the insecure party may demand in writing adequate assurance of due performance. Until the insecure party receives that assurance, if commercially reasonable the insecure party may suspend any performance for which he [or she] has not already received the agreed return.

(3) A repudiation of the lease contract occurs if assurance of due performance adequate under the circumstances of the particular case is not provided to the insecure party within a reasonable time, not to exceed 30 days after receipt of a demand by the other party.

(4) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to commercial standards.

(5) Acceptance of any nonconforming delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

1 **Official Comment**

2 * * *

3 As to the use of a record other than a writing and communications that are not written,
4 see Section 2A-103, Comment (g).

5
6 * * *

7 **Reporter's Note**

8
9 *No change.* No change is proposed to Section 2A-401 which is provided for convenience.

10
11 * * *

12 **Section 2A-406. Procedure on Excused Performance.**

13 (1) If the lessee receives notification of a material or indefinite delay or an allocation
14 justified under Section 2A-405, the lessee may by written notification to the lessor as to any
15 goods involved, and with respect to all of the goods if under an installment lease contract the
16 value of the whole lease contract is substantially impaired (Section
17 2A-510):

18 (a) terminate the lease contract. (Section 2A-505(2)); or

19 (b) except in a finance lease that is not a consumer lease, modify the lease
20 contract by accepting the available quota in substitution, with due allowance from the rent
21 payable for the balance of the lease term for the deficiency but without further right against the
22 lessor.

23 (2) If, after receipt of a notification from the lessor under Section 2A-405, the lessee fails
24 so to modify the lease agreement within a reasonable time not exceeding 30 days, the lease
25 contract lapses with respect to any deliveries affected.

26 **Official Comment**

27 * * *

As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g).

Reporter's Note

No change. No change is proposed to Section 2A-406, which is provided for convenience.

* * *

Section 2A-514. Waiver of Lessee's Objections.

(1) In rejecting goods, a lessee's failure to state a particular defect that is ascertainable by reasonable inspection precludes the lessee from relying on the defect to justify rejection or to establish default:

(a) if, stated seasonably, the lessor or the supplier could have cured it (Section 2A-513); or

(b) between merchants if the lessor or the supplier after rejection has made a request in writing for a full and final written statement of all defects on which the lessee proposes to rely.

(2) A lessee's failure to reserve rights when paying rent or other consideration against documents precludes recovery of the payment for defects apparent in the documents.

Official Comment

* * *

Purposes:

1. * * *

2. As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g).

* * *

Reporter's Note

1 *No change.* No change is proposed to Section 2A-514, which is provided for
2 convenience.
3 * * *

4 **Section 2A-516. Effect of Acceptance of Goods; Notice of Default; Burden of**
5 **Establishing Default After Acceptance; Notice of Claim or Litigation to Person**
6 **Answerable Over.**

7 (1) A lessee must pay rent for any goods accepted in accordance with the lease contract,
8 with due allowance for goods rightfully rejected or not delivered.

9 (2) A lessee's acceptance of goods precludes rejection of the goods accepted. In the case
10 of a finance lease, if made with knowledge of a nonconformity, acceptance cannot be revoked
11 because of it. In any other case, if made with knowledge of a nonconformity, acceptance cannot
12 be revoked because of it unless the acceptance was on the reasonable assumption that the
13 nonconformity would be seasonably cured. Acceptance does not of itself impair any other
14 remedy provided by this Article or the lease agreement for nonconformity.

15 (3) If a tender has been accepted:

16 (a) within a reasonable time after the lessee discovers or should have discovered
17 any default, the lessee shall notify the lessor and the supplier, if any, or be barred from any
18 remedy against the party not notified;

19 (b) except in the case of a consumer lease, within a reasonable time after the
20 lessee receives notice of litigation for infringement or the like (Section 2A-211) the lessee shall
21 notify the lessor or be barred from any remedy over for liability established by the litigation; and

22 (c) the burden is on the lessee to establish any default.

23 (4) If a lessee is sued for breach of a warranty or other obligation for
24 which a lessor or a supplier is answerable over the following apply:

1 (a) The lessee may give the lessor or the supplier, or both, written notice of the
2 litigation. If the notice states that the person notified may come in and defend and that if the
3 person notified does not do so that person will be bound in any action against that person by the
4 lessee by any determination of fact common to the two litigations, then unless the person notified
5 after seasonable receipt of the notice does come in and defend that person is so bound.

6 (b) The lessor or the supplier may demand in writing that the lessee turn over
7 control of the litigation including settlement if the claim is one for infringement or the like
8 (Section 2A-211) or else be barred from any remedy over. If the demand states that the lessor or
9 the supplier agrees to bear all expense and to satisfy any adverse judgment, then unless the lessee
10 after seasonable receipt of the demand does turn over control the lessee is so barred.

11 (5) Subsections (3) and (4) apply to any obligation of a lessee to hold the lessor or the
12 supplier harmless against infringement or the like (Section 2A-211).

13 Official Comment

14 * * *

15
16 4. As to the use of a record other than a writing and communications that are not
17 written, see Section 2A-103, Comment (g).

18 * * *

20 Reporter's Note

21
22
23 *No change.* No change is proposed to Section 2A-516, which is provided for
24 convenience.

25 * * *

27 Prefatory Note to Payments Amendments

28
29 The changes relating to payments address both statutory text and official comments and
30 concern the following five topics:

31
32 *Negotiability.* An amendment to Section 3-104 specifies that negotiability is not negated

1 by the inclusion of either a choice-of-law term or a choice-of-forum term in an instrument.

2
3 *Remote Deposit Capture.* Amendments to Sections 3-105 and 3-604, and to the official
4 comments to Sections 3-309 and 4-207, clarify that an instrument is “issued” if a drawer sends
5 an image of and information describing an item but never delivers the item.

6
7 *Scope of Article 4A – Definition of Payment Order.* An amendment to the official
8 comment to Section 4A-104 (which includes the comments to Section 4A-103) clarifies when an
9 instruction sent pursuant to a so-called “smart contract” constitutes a payment order.

10
11 *References to a “Writing.”* Amendments to Sections 4A-103, 4A-202, 4A-203, 4A-207,
12 4A-208, 4A-210, 4A-211 and 4A-305 change the references to a “writing” or “written” to a
13 “record.”

14
15 *Security Procedures.* Amendments to Sections 4A-201 and 4A-202, and to the official
16 comment to Section 4A-203, clarify that: (i) a security procedure may impose obligations on the
17 receiving bank, the customer, or both; (ii) a security procedure may require the use of symbols,
18 sounds, or biometrics; and (iii) a requirement that a payment order be sent from a known email
19 address, IP address, or phone number is not by itself a security procedure.

20 21 **ARTICLE 3**

22 **NEGOTIABLE INSTRUMENTS**

23 **Section 3-104. Negotiable Instrument.**

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

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

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

30 (3) does not state any other undertaking or instruction by the person promising or
31 ordering payment to do any act in addition to the payment of money, but the promise or order
32 may contain (i) an undertaking or power to give, maintain, or protect collateral to secure
33 payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose

1 of collateral, ~~or~~ (iii) a waiver of the benefit of any law intended for the advantage or protection of
2 an obligor, (iv) a term that specifies the law that governs the promise or order, or (v) an
3 undertaking to resolve in a specified forum a dispute concerning the promise or order.

4 * * *

5 Official Comment

6
7 1. The definition of “negotiable instrument” defines the scope of Article 3 since
8 Section 3-102 states: “This Article applies to negotiable instruments.” The definition in Section
9 3-104(a) incorporates other definitions in Article 3. An instrument is either a “promise,” defined
10 in Section 3-103(a)(12), or “order,” defined in Section 3-103(a)(8). A promise is a written
11 undertaking to pay money signed by the person undertaking to pay. An order is a written
12 instruction to pay money signed by the person giving the instruction. Thus, the term “negotiable
13 instrument” is limited to a signed writing that orders or promises payment of money. “Money” is
14 defined in Section 1-201(b)(24) and is not limited to United States dollars. It also includes a
15 medium of exchange established by a foreign government or monetary units of account
16 established by an intergovernmental organization or by agreement between two or more nations.
17 Five other requirements are stated in Section 3–104(a): First, the promise or order must be
18 “unconditional.” The quoted term is explained in Section 3-106. Second, the amount of money
19 must be “a fixed amount . . . with or without interest or other charges described in the promise or
20 order.” Section 3-112(b) relates to “interest.” Third, the promise or order must be “payable to
21 bearer or to order.” The quoted phrase is explained in Section 3-109. An exception to this
22 requirement is stated in subsection (c). Fourth, the promise or order must be payable “on demand
23 or at a definite time.” The quoted phrase is explained in Section 3-108. Fifth, the promise or
24 order may not state “any other undertaking or instruction by the person promising or ordering
25 payment to do any act in addition to the payment of money” with ~~three~~ five exceptions. The
26 quoted phrase is based on the first sentence of N.I.L. Section 5 which is the precursor of “no
27 other promise, order, obligation or power given by the maker or drawer” appearing in former
28 Section 3-104(1)(b). The words “instruction” and “undertaking” are used instead of “order” and
29 “promise” that are used in the N.I.L. formulation because the latter words are defined terms that
30 include only orders or promises to pay money. The first three exceptions stated in Section
31 3-104(a)(3) are based on and are intended to have the same meaning as former Section
32 3-112(1)(b), (c), (d), and (e), as well as N.I.L. § 5(1), (2), and (3). The final two exceptions stated
33 in Section 3-104(a)(3) deal with choice-of-law and choice-of forum clauses. The latter of these
34 includes an agreement to arbitrate. Subsection (b) states that “instrument” means a “negotiable
35 instrument.” This follows former Section 3-102(1)(e) which treated the two terms as
36 synonymous.

37 * * *

38 Section 3-105. Issue of Instrument.

39
40
41 (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, the first transmission by the drawer to the payee of an image of an item and information derived from the item that enables the depositary bank to collect the item by transferring or presenting under federal law an electronic check.

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

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

Official Comment

1. Under former Section 3–102(1)(a) “issue” was defined as the first delivery to a “holder or a remitter” but the term “remitter” was neither defined nor otherwise used. In revised Article 3, Section 3–105(a) defines “issue” more broadly to include the first delivery to anyone by the drawer or maker for the purpose of giving rights to anyone on the instrument. “Delivery” with respect to instruments is defined in Section 1–201(14) Section 1-201(b)(15) as meaning “voluntary transfer of possession.” The reference in subsection (a)(2) to transmission of an image of an item and information derived from the item is derived from Section 4–110(a), dealing with electronic presentment.

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

* * *

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

(a) A person not in possession of an instrument is entitled to enforce the instrument if:

1 (1) the person seeking to enforce the instrument:

2 (A) was entitled to enforce the instrument when loss of possession
3 occurred; or

4 (B) has directly or indirectly acquired ownership of the instrument from a
5 person who was entitled to enforce the instrument when loss of possession occurred;

6 (2) the loss of possession was not the result of a transfer by the person or a lawful
7 seizure; and

8 (3) the person cannot reasonably obtain possession of the instrument because the
9 instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful
10 possession of an unknown person or a person that cannot be found or is not amenable to service
11 of process.

12 (b) A person seeking enforcement of an instrument under subsection (a) must prove the
13 terms of the instrument and the person's right to enforce the instrument. If that proof is made,
14 Section 3–308 applies to the case as if the person seeking enforcement had produced the
15 instrument. The court may not enter judgment in favor of the person seeking enforcement unless
16 it finds that the person required to pay the instrument is adequately protected against loss that
17 might occur by reason of a claim by another person to enforce the instrument. Adequate
18 protection may be provided by any reasonable means.

19 **Official Comment**

20 * * *

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

25 **Example:** The payee of a check creates an image of the check, destroys the check, and
26

1 transmits the image and information derived from the check for payment. Due to an error
2 in transmission, the depository bank never receives the transmission. The payee may be
3 able to enforce the check if the payee can prove the terms of the check and otherwise
4 satisfy the requirements of this section. The result would be different if there were no
5 error in the transmission and the payor discharged its obligation on the check.

6
7 * * *

8
9 **Reporter's Note**

10
11 *No change.* No change is proposed to Section 3-309, which is provided for convenience.

12
13 * * *

14 **Section 3-604. Discharge by Cancellation or Renunciation.**

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

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

26 ~~(c) In this section, "signed," with respect to a record that is not a writing, includes the~~
27 ~~attachment to or logical association with the record of an electronic symbol, sound, or process~~
28 ~~with the present intent to adopt or accept the record.~~

29 **Official Comment**

1. Section 3–604 replaces former Section 3–605.

2. 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. The destruction of the check also does not affect whether the check has been issued. See Section 3-105(a) and Comment 1.

3. Former subsection (c) has been deleted as unnecessary in view of the definition of “sign” in Section 1-201.

* * *

ARTICLE 4

BANK DEPOSITS AND COLLECTIONS

* * *

Section 4-207. Transfer Warranties.

(a) A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that:

(1) the warrantor is a person entitled to enforce the item;

(2) all signatures on the item are authentic and authorized;

(3) the item has not been altered;

(4) the item is not subject to a defense or claim in recoupment (Section 3-305(a))

of any party that can be asserted against the warrantor; and

(5) the warrantor has no knowledge of any insolvency proceeding commenced

with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer; and

(6) with respect to any remotely-created consumer item, that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn.

1 (b) If an item is dishonored, a customer or collecting bank transferring the item and
2 receiving settlement or other consideration is obliged to pay the amount due on the item (i)
3 according to the terms of the item at the time it was transferred, or (ii) if the transfer was of an
4 incomplete item, according to its terms when completed as stated in Sections 3-115 and 3-407.
5 The obligation of a transferor is owed to the transferee and to any subsequent collecting bank
6 that takes the item in good faith. A transferor cannot disclaim its obligation under this
7 subsection by an indorsement stating that it is made “without recourse” or otherwise disclaiming
8 liability.

9 (c) A person to whom the warranties under subsection (a) are made and who took the
10 item in good faith may recover from the warrantor as damages for breach of warranty an amount
11 equal to the loss suffered as a result of the breach, but not more than the amount of the item plus
12 expenses and loss of interest incurred as a result of the breach.

13 (d) The warranties stated in subsection (a) cannot be disclaimed with respect to checks.
14 Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the
15 claimant has reason to know of the breach and the identity of the warrantor, the warrantor is
16 discharged to the extent of any loss caused by the delay in giving notice of the claim.

17 (e) A cause of action for breach of warranty under this section accrues when the claimant
18 has reason to know of the breach.

19 Official Comment

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

26
27 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, 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, a person might also make a warranty that no person will be asked to make payment based on a check already paid. See 12 C.F.R. § 229.34(a).

* * *

Reporter's Note

No change. No change is proposed to Section 4-207, which is provided for convenience.

ARTICLE 4A

FUNDS TRANSFERS

Section 4A-103. Payment Order – Definitions.

(a) In this article:

(1) “Payment order” means an instruction of a sender to a receiving bank, transmitted orally, ~~electronically, or in writing~~ or in a record, to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary if:

(i) the instruction does not state a condition to payment to the beneficiary other than time of payment,

(ii) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and

(iii) the instruction is transmitted by the sender directly to the receiving bank or to an agent, funds-transfer system, or communication system for transmittal to the receiving bank.

* * *

Official Comment

1 1. This section is discussed in the Comment following Section 4A-104.

2
3 2. In furtherance of medium neutrality, the reference to in “writing” has been
4 changed to refer to in a “record.”

5
6 **Section 4A-104. Funds Transfer – Definitions.**

7 In this Article:

8 (a) “Funds transfer” means the series of transactions, beginning with the
9 originator's payment order, made for the purpose of making payment to the beneficiary of the
10 order. The term includes any payment order issued by the originator's bank or an intermediary
11 bank intended to carry out the originator's payment order. A funds transfer is completed by
12 acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the
13 originator's payment order.

14 (b) “Intermediary bank” means a receiving bank other than the originator's bank
15 or the beneficiary's bank.

16 (c) “Originator” means the sender of the first payment order in a funds transfer.

17 (d) “Originator's bank” means (i) the receiving bank to which the payment order
18 of the originator is issued if the originator is not a bank, or (ii) the originator if the originator is a
19 bank.

20 **Official Comment**

21 * * *

22
23
24 3. Further limitations on the scope of Article 4A are found in the three requirements
25 found in subparagraphs (i), (ii), and (iii) of Section 4A-103(a)(1). Subparagraph (i) states that the
26 instruction to pay is a payment order only if it “does not state a condition to payment to the
27 beneficiary other than time of payment.” An instruction to pay a beneficiary sometimes is subject
28 to a requirement that the beneficiary perform some act such as delivery of documents.

29
30 ~~For example,~~ **Example:** a New York bank may have issued a letter of credit in favor of
31 X, a California seller of goods to be shipped to the New York bank's customer in New
32 York. The terms of the letter of credit provide for payment to X if documents are

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

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

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

1 **Reporter's Note**

2
3 *No change.* No change is proposed to Section 4A-104, which is provided for
4 convenience.

5 * * *

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

16 **Official Comment**

17
18 A large percentage of payment orders and communications amending or cancelling
19 payment orders are transmitted electronically and it is standard practice to use security
20 procedures that are designed to assure the authenticity of the message through steps designed to
21 assure the identity of the sender, the integrity of the message, or both. Security procedures can
22 also be used to detect error in the content of messages or to detect payment orders that are
23 transmitted by mistake as in the case of multiple transmission of the same payment order.
24 Security procedures might also apply to communications that are transmitted by telephone or in
25 ~~writing~~ a record. Section 4A-201 defines these security procedures. The second sentence of the
26 definition provides several examples of a security procedure, but this list is not exhaustive. The
27 inclusion of the phrase "or similar security devices" means that, as new technologies emerge,
28 what can be a security procedure will change. The definition of security procedure limits the
29 term to a procedure "established by agreement of a customer and a receiving bank." The term
30 does not apply to procedures that the receiving bank may follow unilaterally in processing
31 payment orders. The question of whether loss that may result from the transmission of a spurious
32 or erroneous payment order will be borne by the receiving bank or the sender or purported sender
33 is affected by whether a security procedure was or was not in effect and whether there was or
34 was not compliance with the procedure. Security procedures are referred to in Sections 4A-202
35 and 4A-203, which deal with authorized and verified payment orders, and Section 4A-205,

1 which deals with erroneous payment orders.

2
3 Requiring that a payment order be sent from a known email, IP address or phone number
4 is not by itself a “security procedure” within the meaning of this section because it is possible to
5 make a payment order with a different origin appear to have been sent from such an address or
6 phone number. However, requiring that a payment order have such an apparent origin in
7 combination with other security protocols might be a security procedure.
8

9 **Section 4A-202. Authorized and Verified Payment Orders.**

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

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

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

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

* * *

Official Comment

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

2. In furtherance of medium neutrality, references to “written” and “writing” have been changed to refer to a “record.”

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

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

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

(2) The receiving bank is not entitled to enforce or retain payment of the payment order if the customer proves that the order was not caused, directly or indirectly, by a person (i) entrusted at any time with duties to act for the customer with respect to payment orders or the security procedure, or (ii) who obtained access to transmitting facilities of the customer or who obtained, from a source controlled by the customer and without authority of the receiving bank, 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
8
9 3. Subsection (b) of Section 4A-202 is based on the assumption that losses due to
10 fraudulent payment orders can best be avoided by the use of commercially reasonable security
11 procedures, and that the use of such procedures should be encouraged. The subsection is
12 designed to protect both the customer and the receiving bank. A receiving bank needs to be able
13 to rely on objective criteria to determine whether it can safely act on a payment order.
14 Employees of the bank can be trained to “test” a payment order according to the various steps
15 specified in the security procedure. The bank is responsible for the acts of these employees.
16 Subsection (b)(ii) requires the bank to prove that it accepted the payment order in good faith and
17 “in compliance with the bank’s obligations under the security procedure.” If the fraud was not
18 detected because the bank’s employee did not perform the acts required by the security
19 procedure, the bank has not complied. Subsection (b)(ii) also requires the bank to prove that it
20 complied with any agreement or instruction that restricts acceptance of payment orders issued in
21 the name of the customer. If an agreement establishing a security procedure places obligations on
22 both the sender and the receiving bank, the receiving bank need prove only that it complied with
23 the obligations placed on the receiving bank. A customer may want to protect itself by imposing
24 limitations on acceptance of payment orders by the bank. For example, the customer may
25 prohibit the bank from accepting a payment order that is not payable from an authorized account,
26 that exceeds the credit balance in specified accounts of the customer, or that exceeds some other
27 amount. Another limitation may relate to the beneficiary. The customer may provide the bank
28 with a list of authorized beneficiaries and prohibit acceptance of any payment order to a
29 beneficiary not appearing on the list. Such limitations may be incorporated into the security
30 procedure itself or they may be covered by a separate agreement or instruction. In either case, the
31 bank must comply with the limitations if the conditions stated in subsection (b) are met.
32 Normally limitations on acceptance would be incorporated into an agreement between the
33 customer and the receiving bank, but in some cases the instruction might be unilaterally given by
34 the customer. If standing instructions or an agreement state limitations on the ability of the
35 receiving bank to act, provision must be made for later modification of the limitations. Normally
36 this would be done by an agreement that specifies particular procedures to be followed. Thus,
37 subsection (b) states that the receiving bank is not required to follow an instruction that violates a
38 ~~written~~ an agreement evidenced by a record. The receiving bank is not bound by an instruction
39 unless it has adequate notice of it. ~~Subsections (25), (26), and (27) of Section 1-201 apply~~
40 Section 1-202 applies.

41
42 Subsection (b)(i) assures that the interests of the customer will be protected by providing

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

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

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

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

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

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

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

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

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

34
35 9. In furtherance of medium neutrality, references to “written” and “writing” have
36 been changed to refer to a “record.”

37
38 * * *

39
40 **Section 4A-206. Transmission of Payment Order Through Funds-Transfer or**
41 **Other Communication System.**

42 (a) If a payment order addressed to a receiving bank is transmitted to a funds-transfer
43 system or other third-party communication system for transmittal to the bank, the system is

1 deemed to be an agent of the sender for the purpose of transmitting the payment order to the
2 bank. If there is a discrepancy between the terms of the payment order transmitted to the system
3 and the terms of the payment order transmitted by the system to the bank, the terms of the
4 payment order of the sender are those transmitted by the system. This section does not apply to a
5 funds-transfer system of the Federal Reserve Banks.

6 (b) This section applies to cancellations and amendments of payment orders to the same
7 extent it applies to payment orders.

8 **Official Comment**

9
10 1. A payment order may be issued to a receiving bank directly by delivery of a
11 ~~writing or electronic device~~ record or by an oral ~~or electronic~~ communication. If an agent of the
12 sender is employed to transmit orders on behalf of the sender, the sender is bound by the order
13 transmitted by the agent on the basis of agency law. Section 4A-206 is an application of that
14 principle to cases in which a funds transfer or communication system acts as an intermediary in
15 transmitting the sender's order to the receiving bank. The intermediary is deemed to be an agent
16 of the sender for the purpose of transmitting payment orders and related messages for the sender.
17 Section 4A-206 deals with error by the intermediary.

18 * * *

20 **Reporter's Note**

21
22 *No change.* No change is proposed to Section 4A-206, which is provided for
23 convenience.

25 **Section 4A-207. Misdescription of Beneficiary.**

26 * * *

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

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

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

* * *

Official Comment

In furtherance of medium neutrality, the reference to a "writing" has been changed to refer to a "record."

Section 4A-208. Misdescription of Intermediary Bank or Beneficiary's Bank.

* * *

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

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

executing or attempting to execute the order.

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

* * *

Official Comment

In furtherance of medium neutrality, the reference to a “writing” has been changed to refer to a “record.”

* * *

Section 4A-210. Rejection 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

1 noncomplying means.

2 * * *

3 **Official Comment**

4 In furtherance of medium neutrality, the reference to a “writing” has been changed to
5 refer to a “record.”

6
7 **Section 4A-211. Cancellation and Amendment of Payment Order.**

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

13 * * *

14 **Official Comment**

15
16 * * *

17
18 2. Subsection (a) allows a cancellation or amendment of a payment order to be
19 communicated to the receiving bank “orally, ~~electronically~~, or in ~~writing~~ a record.” The quoted
20 phrase is consistent with the language of Section 4A-103(a) applicable to payment orders.
21 Cancellations and amendments are normally subject to verification pursuant to security
22 procedures to the same extent as payment orders. Subsection (a) recognizes this fact by
23 providing that in cases in which there is a security procedure in effect between the sender and the
24 receiving bank the bank is not bound by a communication cancelling or amending an order
25 unless verification has been made. This is necessary to protect the bank because under subsection
26 (b) a cancellation or amendment can be effective by unilateral action of the sender. Without
27 verification the bank cannot be sure whether the communication was or was not effective to
28 cancel or amend a previously verified payment order.

29
30 * * *

31 9. In furtherance of medium neutrality, the reference to a “writing” has been
32 changed to refer to a “record.”

33
34 * * *

Section 4A-305. Liability for Late or Improper Execution or Failure to Execute Payment Order.

(a) If a funds transfer is completed but execution of a payment order by the receiving bank in breach of Section 4A-302 results in delay in payment to the beneficiary, the bank is obliged to pay interest to either the originator or the beneficiary of the funds transfer for the period of delay caused by the improper execution. Except as provided in subsection (c), additional damages are not recoverable.

(b) If execution of a payment order by a receiving bank in breach of Section 4A-302 results in (i) noncompletion of the funds transfer, (ii) failure to use an intermediary bank designated by the originator, or (iii) issuance of a payment order that does not comply with the terms of the payment order of the originator, the bank is liable to the originator for its expenses in the funds transfer and for incidental expenses and interest losses, to the extent not covered by subsection (a), resulting from the improper execution. Except as provided in subsection (c), additional damages are not recoverable.

(c) In addition to the amounts payable under subsections (a) and (b), damages, including consequential damages, are recoverable to the extent provided in an express ~~written~~ agreement of the receiving bank, evidenced by a record.

(d) If a receiving bank fails to execute a payment order it was obliged by express agreement to execute, the receiving bank is liable to the sender for its expenses in the transaction and for incidental expenses and interest losses resulting from the failure to execute. Additional damages, including consequential damages, are recoverable to the extent provided in an express ~~written~~ agreement of the receiving bank, evidenced by a record, but are not otherwise recoverable.

(e) Reasonable attorney's fees are recoverable if demand for compensation under subsection (a) or (b) is made and refused before an action is brought on the claim. If a claim is made for breach of an agreement under subsection (d) and the agreement does not provide for damages, reasonable attorney's fees are recoverable if demand for compensation under subsection (d) is made and refused before an action is brought on the claim.

(f) Except as stated in this section, the liability of a receiving bank under subsections (a) and (b) may not be varied by agreement.

Official Comment

1. Subsection (a) covers cases of delay in completion of a funds transfer resulting from an execution by a receiving bank in breach of Section 4A-302(a). The receiving bank is obliged to pay interest on the amount of the order for the period of the delay. The rate of interest is stated in Section 4A-506. With respect to wire transfers (other than ACH transactions) within the United States, the expectation is that the funds transfer will be completed the same day. In those cases, the originator can reasonably expect that the originator's account will be debited on the same day as the beneficiary's account is credited. If the funds transfer is delayed, compensation can be paid either to the originator or to the beneficiary. The normal practice is to compensate the beneficiary's bank to allow that bank to compensate the beneficiary by back-valuing the payment by the number of days of delay. Thus, the beneficiary is in the same position that it would have been in if the funds transfer had been completed on the same day. Assume on Day 1, Originator's Bank issues its payment order to Intermediary Bank which is received on that day. Intermediary Bank does not execute that order until Day 2 when it issues an order to Beneficiary's Bank which is accepted on that day. Intermediary Bank complies with subsection (a) by paying one day's interest to Beneficiary's Bank for the account of Beneficiary.

2. Subsection (b) applies to cases of breach of Section 4A-302 involving more than mere delay. In those cases the bank is liable for damages for improper execution but they are limited to compensation for interest losses and incidental expenses of the sender resulting from the breach, the expenses of the sender in the funds transfer and attorney's fees. This subsection reflects the judgment that imposition of consequential damages on a bank for commission of an error is not justified.

* * *

Subsection (c) allows the measure of damages in subsection (b) to be increased by an express ~~written~~ agreement of the receiving bank, evidenced by a record. An originator's bank might be willing to assume additional responsibilities and incur additional liability in exchange for a higher fee.

3. Subsection (d) governs cases in which a receiving bank has obligated itself by express agreement to accept payment orders of a sender. In the absence of such an agreement there is no obligation by a receiving bank to accept a payment order. Section 4A-212. The measure of damages for breach of an agreement to accept a payment order is the same as that stated in subsection (b). As in the case of subsection (b), additional damages, including consequential damages, may be recovered to the extent stated in an express ~~written~~ agreement of the receiving bank, evidenced by a record.

4. Reasonable attorney's fees are recoverable only in cases in which damages are limited to statutory damages stated in subsection (a), (b) and (d). If additional damages are recoverable because provided for by an express ~~written~~ agreement, evidenced by a record, attorney's fees are not recoverable. The rationale is that there is no need for statutory attorney's fees in the latter case, because the parties have agreed to a measure of damages which may or may not provide for attorney's fees.

5. The effect of subsection (f) is to prevent reduction of a receiving bank's liability under Section 4A-305.

6. In furtherance of medium neutrality, references to a “written” agreement have been changed to refer to an agreement “evidenced by a record.”

ARTICLE 5

LETTERS OF CREDIT

* * *

Section 5-104. Formal Requirements.

A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties or the standard practice referred to in Section 5-108(e) signed.

Official Comment

1. Neither Section 5-104 nor the definition of letter of credit in Section 5-102(a)(10) requires inclusion of all the terms that are normally contained in a letter of credit in order for an undertaking to be recognized as a letter of credit under Article 5. For example, a letter of credit will typically specify the amount available, the expiration date, the place where presentation should be made, and the documents that must be presented to entitle a person to honor. Undertakings that have the formalities required by Section 5-104 and meet the conditions specified in Section 5-102(a)(10) will be recognized as letters of credit even though they omit one or more of the items usually contained in a letter of credit.

1 2. The ~~authentication~~ requirement that a record be signed as specified in this section is
2 authentication or adoption only of the identity of the issuer, confirmer, or adviser. The reference
3 in the former version of this section to authentication by agreement of the parties or standard
4 practice referred to in Section 5-108(e) is no longer necessary because those forms of
5 authentication are subsumed by the revised and expanded definition of “sign” in Section 1-201,
6 which is broad and flexible.

7
8 ~~An authentication agreement may be by system rule, by standard practice, or by direct~~
9 ~~agreement between the parties. The reference to practice is intended to incorporate future~~
10 ~~developments in the UCP and other practice rules as well as those that may arise spontaneously~~
11 ~~in commercial practice.~~

12
13 3. Many banking transactions, including the issuance of many letters of credit, are
14 now conducted mostly by electronic means. For example, S.W.I.F.T. is currently used to
15 transmit letters of credit from issuing to advising banks. The letter of credit text so transmitted
16 may be printed at the advising bank, stamped "original" and provided to the beneficiary in that
17 form. The printed document may then be used as a way of controlling and recording payments
18 and of recording and authorizing assignments of proceeds or transfers of rights under the letter of
19 credit. Nothing in this section should be construed to conflict with that practice.

20
21 To be a record sufficient to serve as a letter of credit or other undertaking under this
22 section, data must have a durability consistent with that function. Because consideration is not
23 required for a binding letter of credit or similar undertaking (Section 5-105) yet those
24 undertakings are to be strictly construed (Section 5-108), parties to a letter of credit transaction
25 are especially dependent on the continued availability of the terms and conditions of the letter of
26 credit or other undertaking. By declining to specify any particular medium in which the letter of
27 credit must be established or communicated, Section 5-104 leaves room for future developments.

28
29 * * *

30 **Section 5-116. Choice of Law and Forum.**

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

36 (b) Unless subsection (a) applies, the liability of an issuer, nominated person, or adviser
37 for action or omission is governed by the law of the jurisdiction in which the person is located.

1 The person is considered to be located at the address indicated in the person's undertaking. If
2 more than one address is indicated, the person is considered to be located at the address from
3 which the person's undertaking was issued.

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

8 (d) A branch of a bank is considered to be located at the address indicated in the branch's
9 undertaking. If more than one address is indicated, the branch is considered to be located at the
10 address from which the undertaking was issued.

11 ~~(e)~~ (e) Except as otherwise provided in this subsection, the liability of an issuer,
12 nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform
13 Customs and Practice for Documentary Credits, to which the letter of credit, confirmation, or
14 other undertaking is expressly made subject. If (i) this article would govern the liability of an
15 issuer, nominated person, or adviser under subsection (a) or (b), (ii) the relevant undertaking
16 incorporates rules of custom or practice, and (iii) there is conflict between this article and those
17 rules as applied to that undertaking, those rules govern except to the extent of any conflict with
18 the nonvariable provisions specified in Section 5-103(c).

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

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

Official Comment

1. Subsection (a) refers to a record signed by the affected parties. The former reference to an authentication pursuant to an agreement of the parties or standard practice is no longer necessary in view of the definition of “sign” in Section 1-201. See Section 5-104, Comment 2.

2. Although it would be possible for the parties to agree otherwise, the law normally chosen by agreement under subsection (a) and that provided in the absence of agreement under subsection (b) is the substantive law of a particular jurisdiction not including the choice of law principles of that jurisdiction. Thus, two parties, an issuer and an applicant, both located in Oklahoma might choose the law of New York. Unless they agree otherwise, the section anticipates that they wish the substantive law of New York to apply to their transaction and they do not intend that a New York choice of law principle might direct a court to Oklahoma law. By the same token, the liability of an issuer located in New York is governed by New York substantive law -- in the absence of agreement -- even in circumstances in which choice of law principles found in the common law of New York might direct one to the law of another State. Subsection (b) states the relevant choice of law principles and it should not be subordinated to some other choice of law rule. Within the States of the United States *renvoi* will not be a problem once every jurisdiction has enacted Section 5-116 because every jurisdiction will then have the same choice of law rule and in a particular case all choice of law rules will point to the same substantive law.

Subsection (b) does not state a choice of law rule for the “liability of an applicant.” However, subsection (b) does state a choice of law rule for the liability of an issuer, nominated person, or adviser, and since some of the issues in suits by applicants against those persons involve the “liability of an issuer, nominated person, or adviser,” subsection (b) states the choice of law rule for those issues. Because an issuer may have liability to a confirmer both as an issuer (Section 5-108(a), Comment 5 to Section 5-108) and as an applicant (Section 5-107(a), Comment 1 to Section 5-107, Section 5-108(i)), subsection (b) may state the choice of law rule for some but not all of the issuer's liability in a suit by a confirmer.

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

4. Because the confirmer or other nominated person may choose different law from that chosen by the issuer or may be located in a different jurisdiction and fail to choose law, it is possible that a confirmer or nominated person may be obligated to pay (under their law) but will not be entitled to payment from the issuer (under its law). Similarly, the rights of an unreimbursed issuer, confirmer, or nominated person against a beneficiary under Section 5-109,

1 5-110, or 5-117, will not necessarily be governed by the same law that applies to the issuer's or
2 confirmer's obligation upon presentation. Because the UCP and other practice are incorporated
3 in most international letters of credit, disputes arising from different legal obligations to honor
4 have not been frequent. Since Section 5-108 incorporates standard practice, these problems
5 should be further minimized -- at least to the extent that the same practice is and continues to be
6 widely followed.

7
8 ~~3.~~ 5. This section does not permit what is now authorized by the nonuniform Section 5-
9 102(4) in New York. Under the current law in New York a letter of credit that incorporates the
10 UCP is not governed in any respect by Article 5. Under revised Section 5-116 letters of credit
11 that incorporate the UCP or similar practice will still be subject to Article 5 in certain respects.
12 First, incorporation of the UCP or other practice does not override the nonvariable terms of
13 Article 5. Second, where there is no conflict between Article 5 and the relevant provision of the
14 UCP or other practice, both apply. Third, practice provisions incorporated in a letter of credit
15 will not be effective if they fail to comply with Section 5-103(c). Assume, for example, that a
16 practice provision purported to free a party from any liability unless it were "grossly negligent"
17 or that the practice generally limited the remedies that one party might have against another.
18 Depending upon the circumstances, that disclaimer or limitation of liability might be ineffective
19 because of Section 5-103(c).

20
21 Even though Article 5 is generally consistent with UCP 500, it is not necessarily
22 consistent with other rules or with versions of the UCP that may be adopted after Article 5's
23 revision, or with other practices that may develop. Rules of practice incorporated in the letter of
24 credit or other undertaking are those in effect when the letter of credit or other undertaking is
25 issued. Except in the unusual cases discussed in the immediately preceding paragraph, practice
26 adopted in a letter of credit will override the rules of Article 5 and the parties to letter of credit
27 transactions must be familiar with practice (such as future versions of the UCP) that is explicitly
28 adopted in letters of credit.

29
30 4. 6. In several ways Article 5 conflicts with and overrides similar matters governed by
31 Articles 3 and 4. For example, "draft" is more broadly defined in letter of credit practice than
32 under Section 3-104. The time allowed for honor and the required notification of reasons for
33 dishonor are different in letter of credit practice than in the handling of documentary and other
34 drafts under Articles 3 and 4.

35
36 ~~5.~~ 7. Subsection ~~(e)~~ (g) must be read in conjunction with existing law governing
37 subject matter jurisdiction. If the local law restricts a court to certain subject matter jurisdiction
38 not including letter of credit disputes, subsection ~~(e)~~ (g) does not authorize parties to choose that
39 forum. For example, the parties' agreement under Section ~~5-116(e)~~ 5-116(g) would not confer
40 jurisdiction on a probate court to decide a letter of credit case.

41
42 If the parties choose a forum under subsection ~~(e)~~ (g) and if -- because of other law -- that
43 forum will not take jurisdiction, the parties' agreement or undertaking should then be construed
44 (for the purpose of forum selection) as though it did not contain a clause choosing a particular
45 forum. That result is necessary to avoid sentencing the parties to eternal purgatory where neither
46 the chosen State nor the State which would have jurisdiction but for the clause will take

1 jurisdiction -- the former in disregard of the clause and the latter in honor of the clause.

2 * * *

3 4 **ARTICLE 7**

5 **DOCUMENTS OF TITLE**

6 **Section 7-102. Definitions and Index of Definitions.**

7 (a) In this article, unless the context otherwise requires:

8 * * *

9 (9) "Person entitled under the document" means the holder, in the case of a
10 negotiable document of title, or the person to which delivery of the goods is to be made by the
11 terms of, or pursuant to instructions in a record under, a nonnegotiable document of title.

12 (10) ~~"Record" means information that is inscribed on a tangible medium or that is~~
13 ~~stored in an electronic or other medium and is retrievable in perceivable form. [Reserved]~~

14 (11) ~~"Sign" means, with present intent to authenticate or adopt a record:~~

15 ~~(A) to execute or adopt a tangible symbol; or~~

16 ~~(B) to attach to or logically associate with the record an electronic sound,~~
17 ~~symbol, or process. [Reserved]~~

18 * * *

19 20 **Official Comment**

21 * * *

22
23 6. "Person entitled under the document" is moved from former Section 7-403.

24
25 In the case of a negotiable document of title, the person entitled is the holder. See Section
26 1-201(b)(21) (defining "holder"). For a nonnegotiable document of title, the person entitled is the
27 person provided in the terms of the document or instructions under the document. A transferee of
28 a nonnegotiable document to which the document has been delivered acquires the transferee's
29 rights and rights that the transferor had actual authority to convey. Section 7-504(a). However,
30 until but not after the bailee receives notice of a transfer, such a transferee's rights are subject to

1 those of persons identified in Section 7-504(b), including “as against the bailee, by good faith
2 dealings of the bailee with the transferor. Moreover, such a transferee is *not* a person entitled
3 under the document unless so provided in the document or in instructions under the document.
4

5 Neither the definition nor the official comments to Article 7 provide an explanation of
6 what constitutes an “instruction under” a nonnegotiable document. In practice the term is
7 generally understood to include an instruction to the bailee, by the person named in the
8 document, to deliver the goods to a transferee of the document or to another person. An
9 instruction under a nonnegotiable document should be distinguished from a mere “notice” or
10 “notification” to the bailee of a transfer or security interest, as contemplated by Sections 7-
11 504(b) and 9-312(d)(2). However, an instruction could, functionally, also constitute such a
12 notice.
13

14 * * *

15
16 5. ~~The definitions of “record” and “sign” are included to facilitate electronic~~
17 ~~mediums. See comment 9 to Section 9-102 discussing “record” and the comment to amended~~
18 ~~Section 2-103 discussing “sign.” Paragraphs (10) and (11) of subsection (a) have been deleted as~~
19 ~~unnecessary. Equivalent definitions of “record” and “sign” are now included in Section 1-201.~~
20

21 * * *

22 23 **Section 7-106. Control of Electronic Document of Title.¹**

24 (a) **General rule.** A person has control of an electronic document of title if a system
25 employed for evidencing the transfer of interests in the electronic document reliably establishes
26 that person as the person to which the electronic document was issued or transferred.

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

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

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

¹ Subsection captions are included in this draft for convenience. They will be deleted in the final text because, unlike Articles 9 and 12, the UCC makes no provision for subsection captions in Article 7.

1 (A) the person to which the document was issued; or
2 (B) if the authoritative copy indicates that the document has been
3 transferred, the person to which the document was most recently transferred;
4 (3) the authoritative copy is communicated to and maintained by the person
5 asserting control or its designated custodian;
6 (4) copies or amendments that add or change an identified ~~assignee~~ transferee of
7 the authoritative copy can be made only with the consent of the person asserting control;
8 (5) each copy of the authoritative copy and any copy of a copy is readily
9 identifiable as a copy that is not the authoritative copy; and
10 (6) any amendment of the authoritative copy is readily identifiable as authorized
11 or unauthorized.

12 **(c) [One or more authoritative electronic copies.]** A system satisfies subsection (a),
13 and a person has control of an electronic document of title, if an electronic copy of the document,
14 a record attached to or logically associated with the electronic copy, or a system in which the
15 electronic copy is recorded:

16 (1) enables the person readily to identify each electronic copy as an authoritative
17 copy or nonauthoritative copy;

18 (2) enables the person readily to identify itself in any way, including by name,
19 identifying number, cryptographic key, office, or account number, as the person to which each
20 authoritative electronic copy was issued or transferred; and

21 (3) gives the person exclusive power, subject to subsection (h), to:

22 (A) prevent others from adding or changing the person to which each
23 authoritative electronic copy has been issued or transferred; and

1 (B) transfer control of each authoritative electronic copy.

2 (d) [Meaning of exclusive.] A power is exclusive under subsection (c)(3)(A) and (B),
3 even if:

4 (1) the authoritative electronic copy, a record attached to or logically associated
5 with the electronic copy, or a system in which the electronic copy is recorded limits the use of
6 the document of title or has a protocol that is programmed to cause a change, including a transfer
7 or loss of control; or

8 (2) the power is shared with another person.

9 (e) [When person does not share power.] A person does not share a power with another
10 person if:

11 (1) the person can exercise a power only if the power also is exercised by the
12 other person; and

13 (2) the other person either:

14 (A) can exercise the power without exercise of the power by the person; or

15 (B) is the transferor to the person of an interest in the document of title.

16 (f) [Presumption of exclusivity of certain powers.] If a person has the powers specified
17 in subsection (c)(3)(A) and (B), the powers are presumed to be exclusive.

18 (g) [Obtaining control through another person.] A person has control of an electronic
19 document of title if another person, other than the transferor of an interest in the document:

20 (1) has control of the document and acknowledges that it has control on behalf of
21 the person; or

22 (2) obtains control of the document after having acknowledged that it will obtain
23 control of the document on behalf of the person.

(h) [No requirement to acknowledge.] A person that has control under this section is
not required to acknowledge that it has or will obtain control on behalf of another person.

(i) [No duties or confirmation.] If a person acknowledges that it has or will obtain control on behalf of another person, unless the person otherwise agrees or law other than this article otherwise provides, the person does not owe any duty to the other person and is not required to confirm the acknowledgment to any other person.

Official Comment

Prior Uniform Statutory Provision: Uniform Electronic Transactions Act Section 16.

~~Purpose:~~

1. The revision of this section on control of electronic documents of title preserves subsection (a), the general rule, subsection (b), the “safe harbor” from the former section. The minor stylistic revisions are not substantive. The other revisions add an additional “safe harbor” in subsection (c) and a new subsection (f) on control through another person. The requirements for obtaining control under subsection (c) are inspired by Section 12-105 on control of controllable electronic records. See Section 12-105 and Comments.

2. ~~The~~ This section defines “control” for electronic documents of title. Subsections (a) and (b) and derives its rules derive from the Uniform Electronic Transactions Act § 16 on transferrable records. Unlike under UETA § Section 16, however, a document of title may be reissued in an alternative medium pursuant to Section 7-105. At any point in time in which a document of title is in electronic form, the control concept of this section is relevant. As under UETA § 16, the control concept embodied in this section provides the legal framework for developing systems for electronic documents of title.

2. 3. Control of an electronic document of title substitutes for the concept of indorsement (for negotiable documents) and possession in the tangible document of title context. See Section 7-501. A person with a tangible document of title delivers the document by voluntarily transferring possession and a person with an electronic document of title delivers the document by voluntarily transferring control. (Delivery is defined in Section 1-201(b)(15)).

3: 4. Subsection (a) sets forth the general rule that the “system employed for evidencing the transfer of interests in the electronic document reliably establishes that person as the person to which the electronic document was issued or transferred.” The key to having a system that satisfies this test is that identity of *the* person to which the document was issued or transferred must be reliably established. Of great importance to the functioning of the control concept under subsection (a), as well as under the subsection (b) safe harbor, is to be able to demonstrate and identify, at any point in time, *the person* entitled under the electronic document.

1 For example, a carrier may issue an electronic bill of lading by having the required information
2 in a database that is encrypted and accessible by virtue of a password. If the computer system in
3 which the required information is maintained identifies the person as *the* person to which the
4 electronic bill of lading was issued or transferred, that person has control of the electronic
5 document of title. That identification may be by virtue of passwords or other encryption
6 methods. Registry systems may satisfy this test. For example, see the electronic warehouse
7 receipt system established pursuant to 7 C.F.R. Part 735. This Article leaves to the market place
8 the development of sufficient technologies and business practices that will meet the test.

10 An electronic document of title is evidenced by a record consisting of information stored
11 in an electronic medium. Section 1-201(b)(16A) (defining “electronic”), (31) (defining
12 “record”). For example, a record in a computer database could be an electronic document of title
13 assuming that it otherwise meets the definition of document of title. To the extent that third
14 parties wish to deal in paper mediums, Section 7-105 provides a mechanism for exiting the
15 electronic environment by having the issuer reissue the document of title in a tangible medium.
16 Thus if a person entitled to enforce an electronic document of title causes the information in the
17 record to be printed onto paper without the issuer’s involvement in issuing the document of title
18 pursuant to Section 7-105, that paper is not a document of title.

20 ~~4. 5.~~ Subsection (a) sets forth the general test for control. Subsection (b) sets forth a
21 safe harbor test that if satisfied, results in control under the general test in subsection (a). ~~The~~
22 ~~test in subsection (b) is also used in Section 9-105 although Section 9-105 does not include the~~
23 ~~general test of subsection (a).~~ Under subsection (b), at any point in time, a party should be able
24 to identify the single authoritative copy which is unique and identifiable as the authoritative
25 copy. This does not mean that once created that the authoritative copy need be static and never
26 moved or copied from its original location. To the extent that backup systems exist which result
27 in multiple copies, the key to this idea is that at any point in time, the one authoritative copy
28 needs to be unique and identifiable.

30 Parties may not by contract provide that control exists. The test for control is a factual
31 test that depends upon whether the general test in subsection (a) or the safe harbor in subsection
32 (b) or subsection (c) is satisfied.

34 ~~5. 6.~~ Article 7 has historically provided for rights under documents of title and rights of
35 transferees of documents of title as those rights relate to the goods covered by the document.
36 Third parties may possess or have control of documents of title. While misfeasance or
37 negligence in failure to transfer or misdelivery of the document by those third parties may create
38 serious issues, this Article has never dealt with those issues as it relates to tangible documents of
39 title, preferring to leave those issues to the law of contracts, agency and tort law. In the
40 electronic document of title regime, third party registry systems ~~are just beginning to develop. It~~
41 ~~is very difficult to write rules regulating those third parties without some definitive sense of how~~
42 ~~the third party registry systems will be structured. Systems that are evolving to date tend to be~~
43 ~~“closed” systems in which all participants must sign on to the master agreement which provides~~
44 ~~for rights as against the registry system as well as rights among the members. In those closed~~
45 ~~systems, the document of title never leaves the system so the parties rely upon the master~~
46 ~~agreement as to rights against the registry for its failures in dealing with the document. This~~

1 article contemplates that those “closed” systems will continue to evolve and that the control
2 mechanism in this statute provides a method for the participants in the closed system to achieve
3 the benefits of obtaining control allowed by this article. This article also contemplates that
4 parties will evolve open systems where parties need not be subject to a master agreement. In an
5 open system a party that is expecting to obtain rights through an electronic document may not be
6 a party to the master agreement. continue to evolve. To the extent that ~~open~~ these systems evolve
7 by use of the control ~~concept~~ concepts contained in this section, the law of contracts, agency, and
8 torts as it applies to the registry’s misfeasance or negligence concerning the transfer of control of
9 the electronic document will allocate the risks and liabilities of the parties as that other law now
10 does so for third parties who hold tangible documents and fail to deliver the documents.

11
12 7. The subsection (c) “safe harbor” generally follows Section 12-105 for control of
13 controllable electronic records as well as revised Section 9-105 on control of chattel paper
14 evidenced by electronic records. See generally Sections 9-105 and 12-105 and Comments. It
15 differs from subsection (b), which (as explained above) is based on a “single authoritative copy”
16 of an electronic document of title and so is unavailable when the relevant record is maintained on
17 a blockchain or other distributed ledger. The utility of distributed ledger technology (including
18 blockchain technology) depends on there being multiple authoritative copies of a record. It is
19 important to note that compliance with the new conditions for control in subsection (c) also
20 would satisfy the conditions provided in subsection (b). However, subsection (b) has been
21 retained out of an abundance of caution and to provide assurances that existing systems for
22 control of electronic documents of title will continue to be viable after the revised Section 7-106
23 becomes effective. The new conditions for “control” in subsection (c) are meant to reflect the
24 functions that possession serves with respect to writings, but in a more accurate and
25 technologically flexible way than does the current definition in subsection (b).

26
27 8. Under subsection (c), to obtain control of an electronic document of title a person
28 must be able to identify each electronic copy as authoritative or nonauthoritative and identify
29 itself as the person to which each authoritative electronic copy has been issued or transferred. In
30 addition, the person must have the exclusive power to prevent others from adding or changing an
31 identified person to which each authoritative electronic copy has been issued or transferred and
32 to transfer control of each authoritative copy. However, once it is established that a person has
33 received those powers, subsection (f) provides a presumption of exclusivity. Consequently, a
34 person asserting control need not prove exclusivity in order to make out a *prima facie* case.
35 Application of the presumption will be governed also by Section 1-206 (effects of a presumption
36 under the UCC) and applicable non-UCC law (including rules of procedure and evidence). In
37 addition, subsection (d) contains two qualifications of the term “exclusive” as used in subsection
38 (a)(1)(B). A power can be “exclusive” under subsection (a)(1)(B) even if one or both of these
39 qualifications apply.

40
41 Subsection (e) provides that in certain circumstances a power is not shared within the
42 meaning of subsection (d)(2) and, consequently, the relaxation of the exclusivity requirement
43 provided by subsection (d)(2) does not apply. Subsection (e) provides that a person does not
44 share an exclusive power with another person if the person can exercise the power only with the
45 other person’s cooperation but the other person either (i) can exercise of the power unilaterally
46 without the person’s cooperation or (ii) is the transferor to the person of an interest in the

1 controllable electronic record. It follows that a person in that situation does not have control
2 because it does not have the requisite exclusive power. Concerning the exclusivity of powers,
3 including shared control and limitations on shared control and examples, see generally Section
4 12-105, Comment 5.

5 9. Control through another person.
6

7 a. Subsection (g) provides for a person to obtain control through the control of
8 another person. It follows draft revisions to the corresponding provisions for control of deposit
9 accounts (Section 9-104)(a)(4)), control of authoritative electronic copies of records evidencing
10 chattel paper (Section 9-105(f)), control of electronic money (Section 9-105A(d)), and control of
11 controllable electronic records (Section 12-105(e)). For a brief discussion and background, see
12 Section 12-105, Comment 8.
13

14 b. Subsections (h) and (i) derive from Section 9-313(f) and (g). Subsection (h)
15 makes clear that a person that has control under this section has no duty to acknowledge that it
16 has or will obtain control on behalf of another person. Arrangements for a person to
17 acknowledge that it has or will obtain control on behalf of another person are not standardized.
18 Accordingly, subsection (i) leaves to the agreement of the parties and to any other applicable law
19 any duties of a person that does acknowledge that it has or will obtain control on behalf of
20 another person and provides that a person making an acknowledgment is not required to confirm
21 the acknowledgment to another person.
22

23 For example, subsection (g) would apply to give control to a person, Alpha, when another
24 person, Beta, has control of an electronic document of title and acknowledges that it has control
25 on behalf of Alpha. However, under subsection (h), Beta is not required to so acknowledge.
26 And under subsection (i), even if Beta does so acknowledge, Beta owes no duty to Alpha, unless
27 Beta agrees or other law so provides, and Beta is not required to confirm its acknowledgment to
28 any other person.
29

30 10. Negotiable and nonnegotiable electronic documents of title. This section applies to
31 both negotiable and nonnegotiable electronic documents of title. For negotiable electronic
32 documents of title, “delivery” is a necessary condition for negotiation, and therefore for due
33 negotiation, under Section 7-501(b). “Delivery” of an electronic document of title is defined in
34 Section 1-201(b)(15) as the “voluntary transfer of control.” The person in control of a negotiable
35 document, other than pursuant to subsection (g), also is a “holder,” as defined in Section 1-
36 201(b)(21)(C). Of course, nonnegotiable documents cannot be negotiated.
37

38 A security interest in an electronic document of title, whether negotiable or
39 nonnegotiable, may be perfected by control. Section 9-314(a). But perfection of a security
40 interest by control in a nonnegotiable document does not perfect a security interest in goods
41 covered by the document and does not confer on a secured party or other purchaser the status of
42 a person entitled under the document. See Section 7-102(a)(9) (defining “person entitled under
43 the document”) and Comment 6. (On perfection of security interests in negotiable documents of
44 title and goods covered by negotiable and nonnegotiable documents of title, see generally
45 Section 9-312(a), (c), and (g) and Comment 7.) However, a system for control of electronic
46 documents in which bailees participate could be designed to provide that a transfer of control to a

1 purchaser constitutes a reissuance of the document in the name of a secured party under Section
2 9-312(d)(1) or a notice to the bailee of a security interest under Section 9-312(d)(2). A system
3 also could provide that a transfer of control constitutes an instruction under the document that
4 would make the transferee a person entitled.

5
6 * * *

7 **Section 7-403. Obligation of Bailee to Deliver; Excuse.**

8 (a) A bailee shall deliver the goods to a person entitled under a document of title if the
9 person complies with subsections (b) and (c), unless and to the extent that the bailee establishes
10 any of the following:

11 (1) delivery of the goods to a person whose receipt was rightful as against the
12 claimant;

13 (2) damage to or delay, loss, or destruction of the goods for which the bailee is not
14 liable;

15 (3) previous sale or other disposition of the goods in lawful enforcement of a lien
16 or on a warehouse's lawful termination of storage;

17 (4) the exercise by a seller of its right to stop delivery pursuant to Section 2-705
18 or by a lessor of its right to stop delivery pursuant to Section 2A-526;

19 (5) a diversion, reconsignment, or other disposition pursuant to Section 7-303;

20 (6) release, satisfaction, or any other personal defense against the claimant; or

21 (7) any other lawful excuse.

22 (b) A person claiming goods covered by a document of title shall satisfy the bailee's lien
23 if the bailee so requests or if the bailee is prohibited by law from delivering the goods until the
24 charges are paid.

25 (c) Unless a person claiming the goods is a person against which the document of title
26 does not confer a right under Section 7-503(a):

1 (1) the person claiming under a document shall surrender possession or control of
2 any outstanding negotiable document covering the goods for cancellation or indication of partial
3 deliveries; and

4 (2) the bailee shall cancel the document or conspicuously indicate in the
5 document the partial delivery or the bailee is liable to any person to which the document is duly
6 negotiated.

7 Official Comment

8 * * *

9
10 5. In addition to compliance with subsection (b), ~~Subsection~~ subsection (c)
11 conditions the bailee's duty to deliver the goods to a person entitled under a negotiable document
12 on the surrender of possession or control of the document for cancellation or indication of partial
13 deliveries. It also states the obvious duty of a bailee to take up a negotiable document or note
14 partial deliveries conspicuously thereon, and the result of failure in that duty. It is subject to only
15 one exception, that stated in subsection (a)(1) of this section and in Section 7-503(a). Subsection
16 (c) is limited to cases of delivery to a claimant; it has no application, for example, where goods
17 held under a negotiable document are lawfully sold to enforce the bailee's lien.

18
19 Subsection (c) does not specify any conditions on the duty of the bailee to deliver the
20 goods covered by a nonnegotiable document to a person entitled, other than the conditions
21 inherent in the definition of "person entitled under the document." See Section 7-102(a)(9)
22 (defining "person entitled under the document") and Comment 6.

23
24 6. When courts are considering subsection (a)(7), "any other lawful excuse," among
25 others, refers to compliance with court orders under Sections 7-601, 7-602 and 7-603.

27 Reporter's Note

28
29 *No change.* No change is proposed to Section 7-403, which is provided for convenience.

30 * * *

32 Section 7-504. Rights Acquired in Absence of Due Negotiation; Effect of 33 Diversion; Stoppage of Delivery.

34 (a) A transferee of a document of title, whether negotiable or nonnegotiable, to which the
35 document has been delivered but not duly negotiated, acquires the title and rights that its

1 transferor had or had actual authority to convey.

2 (b) In the case of a transfer of a nonnegotiable document of title, until but not after the
3 bailee receives notice of the transfer, the rights of the transferee may be defeated:

4 (1) by those creditors of the transferor which could treat the transfer as void under
5 Section 2-402 or 2A-308 ;

6 (2) by a buyer from the transferor in ordinary course of business if the bailee has
7 delivered the goods to the buyer or received notification of the buyer's rights;

8 (3) by a lessee from the transferor in ordinary course of business if the bailee has
9 delivered the goods to the lessee or received notification of the lessee's rights; or

10 (4) as against the bailee, by good-faith dealings of the bailee with the transferor.

11 * * *

12 Official Comment

13 * * *

14 2. As in the case of transfer--as opposed to "due negotiation"--of negotiable
15 documents, subsection (a) empowers the transferor of a nonnegotiable document to transfer only
16 such rights as the transferor has or has "actual authority" to convey. In contrast to situations
17 involving the goods themselves the operation of estoppel or agency principles is not here
18 recognized to enable the transferor to convey greater rights than the transferor actually has.
19 Subsection (b) makes it clear, however, that the transferee of a nonnegotiable document may
20 acquire rights greater in some respects than those of his transferor by giving notice of the transfer
21 to the bailee. New subsection (b)(3) provides for the rights of a lessee in the ordinary course.

22
23 Note that a transferee of a nonnegotiable document that takes delivery of the document
24 under subsection (a) would not, *ipso facto*, be a "person entitled under the document" with a
25 right to receive delivery of the goods from the bailee under Section 7-403(a). See Section 7-
26 102(a)(9) (defining "person entitled under the document") and Comment 6.

27
28 Subsection (b)(2) & and (3) require delivery of the goods. Delivery of the goods means
29 the voluntary transfer of physical possession of the goods. See amended Section 2-103.

30 Reporter's Note

31
32 *No change.* No change is proposed to Section 7-504, which is provided for convenience.

1 * * *

2 **ARTICLE 8**

3 **INVESTMENT SECURITIES**

4 **Prefatory Note to Article 8 Amendments**

5 Proposed amendments to the official comments to Section 8-102 primarily serve to make
6 clear that a controllable electronic record may be a financial asset credited to a securities
7 account under Article 8. *See also* Section 12-102, Comment 2. The proposed amendment to
8 Section 8-106(d) on control through another person conforms that provision to proposed
9 amendments to Sections 7-106 (control of electronic documents of title), 9-104 (control of
10 deposit accounts, and Section 9-105 (control of authoritative electronic copies of records
11 evidencing chattel paper) and to Sections 9-105A (control of electronic money) and 12-105
12 (control of controllable electronic records). The proposed amendment to Section 8-303
13 conforms the text on the rights of a protected purchaser to the corresponding provision for a
14 qualifying purchaser under Article 12. The proposed revision of the official comment to Section
15 8-501 addresses certain financial assets as to which both a securities intermediary and its
16 customer have control. These financial assets could be treated as being held directly by the
17 customer and would not be included in a security entitlement. Comment 4 to Section 8-505
18 addresses distributions made with respect to financial assets as to which there is no issuer.

19
20 **Section 8-102. Definitions and Index of Definitions.**

21 * * *

22 (a) In this article:

23 * * *

24
25 (4) “Certificated security” means a security that is represented by a certificate.

26 * * *

27
28 (6) “Communicate” means to:

29 (i) send a signed ~~writing~~ record; or

30 (ii) transmit information by any mechanism agreed upon by the persons

31 transmitting and receiving the information.

32 * * *

33 (9) “Financial asset,” except as otherwise provided in Section 8-103, means:

1 (i) a security;
2 (ii) an obligation of a person or a share, participation, or other interest in a
3 person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on
4 financial markets, or which is recognized in any area in which it is issued or dealt in as a medium
5 for investment; or

6 (iii) any property that is held by a securities intermediary for another
7 person in a securities account if the securities intermediary has expressly agreed with the other
8 person that the property is to be treated as a financial asset under this article.

9 As context requires, the term means either the interest itself or the means by which a person's
10 claim to it is evidenced, including a certificated or uncertificated security, a security certificate,
11 or a security entitlement.

12 * * *

13 (14) "Securities intermediary" means:

14 (i) a clearing corporation; or

15 (ii) a person, including a bank or broker, that in the ordinary course of its
16 business maintains securities accounts for others and is acting in that capacity.

17 * * *

18 (16) "Security certificate" means a certificate representing a security.

19 * * *

20 (18) "Uncertificated security" means a security that is not represented by a certificate.

21 * * *

22 **Official Comment**

23 * * *

24 4. "Certificated security." The term "certificated security" means a security that is
25

1 represented by a security certificate.

2
3 * * *

4
5 6. “Communicate.” The term “communicate” assures that the Article 8 rules will be
6 sufficiently flexible to adapt to changes in information technology. Sending a signed writing
7 always suffices as a communication, but the parties can agree that a different means of
8 transmitting information is to be used. Agreement is defined in Section 1-201(3) as “the bargain
9 of the parties in fact as found-in their language or by implication from other circumstances
10 including course of dealing or usage of trade or course of performance.” Thus, use of an
11 information transmission method might be found to be authorized by agreement, even though the
12 parties have not explicitly so specified in a formal agreement. The term communicate is used in
13 Sections 8-102(a)(7) (definition of entitlement order), 8-102(a)(11) (definition of instruction),
14 and 8-403 (demand that issuer not register transfer). Also in furtherance of medium neutrality,
15 the reference in paragraph (6)(i) to a “signed writing” has been changed to refer to a “signed
16 record.”

17
18 9. “Financial asset.” The definition of “financial asset,” in conjunction with the
19 definition of “securities account” in Section 8-501, sets the scope of the indirect holding system
20 rules of Part 5 of Revised Article 8. The Part 5 rules apply not only to securities held through
21 intermediaries, but also to other financial assets held through intermediaries. The term financial
22 asset is defined to include not only securities but also a broader category of obligations, shares,
23 participations, and interests.

24
25 Having separate definitions of security and financial asset makes it possible to separate
26 the question of the proper scope of the traditional Article 8 rules from the question of the proper
27 scope of the new indirect holding system- rules. Some forms of financial assets should be
28 covered by the indirect holding system rules of Part 5, but not by the rules of Parts 2, 3, and 4.
29 The term financial asset is used to cover such property. Because the term security entitlement is
30 defined in terms of financial assets rather than securities, the rules concerning security
31 entitlements set out in Part 5 of Article 8 and in Revised Article 9 apply to the broader class of
32 financial assets.

33
34 The fact that something does or could fall within the definition of financial asset does not,
35 without more, trigger Article 8 coverage. The indirect holding system rules of Revised Article 8
36 apply only if the financial asset is in fact held in a securities account, so that the interest of the
37 person who holds the financial asset through the securities account is a security entitlement.
38 Thus, questions of the scope of the indirect holding system rules cannot be framed as “Is such-
39 and-such a ‘financial asset’ under Article 8?” Rather, one must analyze whether the relationship
40 between an institution intermediary and a person on whose behalf the institution intermediary
41 holds an asset falls within the scope of the term securities account as defined in Section 8-501.
42 That question turns in large measure on whether it makes sense to apply the Part 5 rules to the
43 relationship.

44
45 It is not necessary for all of the Part 5 rules to be relevant to a particular financial asset
46 for the relevant property to qualify as a “financial asset” credited to a securities account. Many of

1 the duties set forth in Part 5 will often be relevant to a digital asset such as a “controllable
2 electronic record “(Section 12-102) treated as a financial asset credited to a securities account,
3 including the duty to exercise rights as directed by the entitlement holder, comply with the
4 entitlement holder’s entitlement orders, and change the position to another form of holding.
5

6 If the parties agree to treat a digital asset as a financial asset under Article 8 and the
7 digital asset is in fact held in a securities account for an entitlement holder, the rules applicable to
8 controllable electronic records under Article 12 would not apply to the entitlement holder’s
9 security entitlement related to the financial asset. If the financial asset itself is a controllable
10 electronic record, however, then the rules in Article 12 could apply to the securities
11 intermediary’s rights with respect to the controllable electronic record if the intermediary holds
12 the asset directly.
13

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

22 * * *

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

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

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

15
16 The definition of securities intermediary includes the requirement that the person in
17 question “in the ordinary course of its business maintain securities accounts for others”. This
18 “ordinary course” requirement does not have a fixed quantitative requirement and is determined
19 by the facts of each case and law other than the UCC may determine who may legally engage in
20 such business. Thus, a person need not necessarily satisfy a specified threshold of activity or
21 necessarily have a minimum number of customers.

22
23 * * *

24
25 16. “Security certificate.” The term “security” refers to the underlying asset, e.g.,
26 1000 shares of common stock of Acme, Inc. The term “security certificate” refers to the paper
27 certificates that have traditionally been used to embody -the underlying intangible interest.

28
29 * * *

30
31 18. “Uncertificated security.” The term “uncertificated security” means a security that
32 is not represented by a security certificate—i.e., a paper certificate. This is so even if, for
33 example, the organic documents relating to the security refer to it as being “certificated” or refer
34 to the electronic record evidencing the security as an “electronic certificate.” For uncertificated
35 securities, there is no need to draw any distinction between the underlying asset and the means
36 by which a direct holder's interest in that asset is evidenced. Compare “certificated security” and
37 “security certificate.”

38 39 **Reporter’s Note**

40
41 1. *No change.* No change is proposed to the definitions of “certificated security,”
42 “financial asset,” “securities intermediary,” “security certificate,” or “uncertificated security,”
43 which are provided for convenience

44
45 2. *Relationship between Articles 8 and 12.* These draft amendments to the official
46 comments to Article 8 are intended primarily to make clear that a controllable electronic record

1 may be a financial asset credited to a securities account under Article 8 and to identify several
2 significant aspects of the relationship between Articles 8 and 12. *See also* Section 12-102,
3 Comment 2 (second paragraph).

4
5 * * *

6 **Section 8-106. Control**

7 * * *

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

9 * * *

10 (3) ~~another person has control of the security entitlement on behalf of the~~
11 ~~purchaser or, having previously acquired control of the security entitlement, acknowledges that it~~
12 ~~has control on behalf of the purchaser.~~ person, other than the transferor of an interest in the
13 security entitlement:

14 (A) has control of the security entitlement and acknowledges that it has
15 control on behalf of the purchaser; or

16 (B) obtains control of the security entitlement after having acknowledged
17 that it will obtain control of the security entitlement on behalf of the purchaser.

18 * * *

19 (h) [No requirement to acknowledge.] A person that has control under this section is
20 not required to acknowledge that it has control on behalf of a purchaser.

21 (i) [No duties or confirmation.] If a person acknowledges that it has or will obtain
22 control on behalf of a purchaser, unless the person otherwise agrees or law other than this article
23 otherwise provides, the person does not owe any duty to the purchaser and is not required to
24 confirm the acknowledgment to any other person.

25 **Official Comment**

1 * * *

2
3 4. Subsection (d) specifies the means by which a purchaser can obtain control of a
4 security entitlement. Three mechanisms are possible, analogous to those provided in subsection
5 (c) for uncertificated securities. Under subsection (d)(1), a purchaser has control if it is the
6 entitlement holder. This subsection would apply whether the purchaser holds through the same
7 intermediary that the debtor used, or has the securities position transferred to its own
8 intermediary. Subsection (d)(2) provides that a purchaser has control if the securities
9 intermediary has agreed to act on entitlement orders originated by the purchaser if no further
10 consent by the entitlement holder is required. Under subsection (d)(2), control may be achieved
11 even though the original entitlement holder remains as the entitlement holder. Finally, a
12 purchaser may obtain control under subsection (d)(3) if another person has control and the
13 person acknowledges that it has control on the purchaser's behalf. Control under subsection
14 (d)(3) parallels the delivery of certificated securities and uncertificated securities under Section
15 8-301. Of course, the acknowledging person cannot be the debtor. This section specifies only the
16 minimum requirements that such an arrangement must meet to confer "control"; the details of the
17 arrangement can be specified by agreement. The arrangement might cover all of the positions in
18 a particular account or subaccount, or only specified positions. There is no requirement that the
19 control party's right to give entitlement orders be exclusive. The arrangement might provide that
20 only the control party can give entitlement orders, or that either the entitlement holder or the
21 control party can give entitlement orders. See subsection (f).

22
23 The following examples illustrate the application of subsection (d):

24
25 * * *

26
27 Example 9. Debtor grants Alpha Bank a security interest in a security entitlement that
28 includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co.
29 Beta Bank agrees with Alpha to act as Alpha's collateral agent with respect to the security
30 entitlement. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to
31 receive dividends and distributions, and will continue to have the right to direct dispositions, but
32 Beta also has the right to direct dispositions. Because Able has agreed that it will comply with
33 entitlement orders originated by Beta without further consent by Debtor, Beta has control of the
34 security entitlement (see Example 3). Because Beta has acknowledged that it has control on
35 behalf of Alpha, Alpha also has control under subsection (d)(3). It is not necessary for Able to
36 enter into an agreement directly with Alpha or for Able to be aware of Beta's agency relationship
37 with Alpha.

38
39 * * *

40
41 5A. The most recent revisions to subsection (d)(3) conform that provision for control
42 through another person to the corresponding provisions for control of other assets. See Section
43 12-105, Comment 8.; see also Sections 7-106(g) (control of electronic document of title); 9-
44 104(a)(4) (control of deposit account); 9-105(g) (control of an electronic copy of a record
45 evidencing chattel paper); 9-105A(e) (control of electronic money). Subsections (h) and (i)
46 derive from Section 9-313(f) and (g). Subsection (h) makes clear that a person that has control

1 under this section has no duty to acknowledge that it has or will obtain control on behalf of a
2 purchaser. Arrangements for a person to acknowledge that it has or will obtain control on behalf
3 of another person are not standardized. Accordingly, subsection (i) leaves to the agreement of the
4 parties and to any other applicable law any duties of a person that does acknowledge that it has
5 or will obtain control on behalf of another person and provides that a person making an
6 acknowledgment is not required to confirm the acknowledgment to any other person.

7
8 * * *

9 **Section 8-110. Applicability; Choice of Law.**

10 (a) The local law of the issuer's jurisdiction, as specified in subsection (d), governs:

11 (1) the validity of a security;

12 (2) the rights and duties of the issuer with respect to registration of transfer;

13 (3) the effectiveness of registration of transfer by the issuer;

14 (4) whether the issuer owes any duties to an adverse claimant to a security; and

15 (5) whether an adverse claim can be asserted against a person to whom transfer of

16 a certificated or uncertificated security is registered or a person who obtains control of an
17 uncertificated security.

18 (b) The local law of the securities intermediary's jurisdiction, as specified in subsection

19 (e), governs:

20 (1) acquisition of a security entitlement from the securities intermediary;

21 (2) the rights and duties of the securities intermediary and entitlement holder

22 arising out of a security entitlement;

23 (3) whether the securities intermediary owes any duties to an adverse claimant to

24 a security entitlement; and

25 (4) whether an adverse claim can be asserted against a person who acquires a

26 security entitlement from the securities intermediary or a person who purchases a security

27 entitlement or interest therein from an entitlement holder.

1 (c) The local law of the jurisdiction in which a security certificate is located at the time of
2 delivery governs whether an adverse claim can be asserted against a person to whom the security
3 certificate is delivered.

4 (d) "Issuer's jurisdiction" means the jurisdiction under which the issuer of the security is
5 organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified
6 by the issuer. An issuer organized under the law of this State may specify the law of another
7 jurisdiction as the law governing the matters specified 'in subsection (a)(2) through (5).

8 (e) The following rules determine a “securities intermediary's jurisdiction” for purposes
9 of this section:

10 (1) If an agreement between the securities intermediary and its entitlement holder
11 governing the securities account expressly provides that a particular jurisdiction is the securities
12 intermediary's jurisdiction for purposes of this part, this article, or this [Act], that jurisdiction is
13 the securities intermediary's jurisdiction.

14 (2) If paragraph (1) does not apply and an agreement between the securities
15 intermediary and its entitlement holder governing the securities account expressly provides that
16 the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities
17 intermediary's jurisdiction.

18 (3) If neither paragraph (1) nor paragraph (2) applies and an agreement between
19 the securities intermediary and its entitlement holder governing the securities account expressly
20 provides that the securities account is maintained at an office in a particular jurisdiction, that
21 jurisdiction is the securities intermediary's jurisdiction.

22 (4) If none of the preceding paragraphs applies, the securities intermediary's
23 jurisdiction is the jurisdiction in which the office identified in an account statement as the office

1 serving the entitlement holder's account is located.

2 (5) If none of the preceding paragraphs applies, the securities intermediary's
3 jurisdiction is the jurisdiction in which the chief executive office of the securities intermediary is
4 located.

5 (f) A securities intermediary's jurisdiction is not determined by the physical location of
6 certificates representing financial assets, or by the jurisdiction in which is organized the issuer of
7 the financial asset with respect to which an entitlement holder has a security entitlement, or by
8 the location of facilities for data processing or other record keeping concerning the account.

9 (g) The local law of the issuer's jurisdiction or the securities intermediary's jurisdiction
10 governs the matters specified in subsections (a) and (b) even if a matter or transaction does not
11 bear any relation to that jurisdiction.

12 Official Comment

13
14 * * *

15
16 5A. New subsection (g) reflects what is stated in former Comment 3—that the local
17 law of the issuer's jurisdiction or securities intermediary's jurisdiction governs even if a matter
18 or transaction bears no relation to that jurisdiction. This also is implicit in Section 1-301(c),
19 which provides that the applicable law provided in this section (and other similar provisions)
20 governs.

21
22 * * *

23 Section 8-303. Protected Purchaser.

24
25 (a) "Protected purchaser" means a purchaser of a certificated or uncertificated security, or
26 of an interest therein, who:

27 (1) gives value;

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

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

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

Official Comment

2. To qualify as a protected purchaser under subsection (a), a purchaser must give value, take without notice of any adverse claim, and obtain control. Value is used in the broad sense defined in Section ~~4-201(44)~~ 1-204. See also Section 8-116 (securities intermediary as purchaser for value). Adverse claim is defined in Section 8-102(a)(1). Section 8-105 specifies whether a purchaser has notice of an adverse claim. Control is defined in Section 8-106. To qualify as a protected purchaser under subsection (b), there must be a time at which all of the requirements are satisfied. Thus if a purchaser obtains notice of an adverse claim before giving value or satisfying the requirements for control, the purchaser cannot be a protected purchaser. See also Section 8-304(d). The requirement that a protected purchaser obtain control expresses the point that to qualify for the adverse claim cut-off rule a purchaser must take through a transaction that is implemented by the appropriate mechanism. By contrast, the rules in Part 2 provide that any purchaser for value of a security without notice of a defense may take free of the issuer's defense based on that defense. See Section 8-202.

The most recent revision of subsection (b) deleted the reference to the acquisition of the rights of a purchaser. However, because a protected purchaser acquires the rights of a purchaser under Section 8-302, the revised text does not diminish a protected purchaser's rights. The revision aligns the text more closely to that of Section 12-104(e) on the rights of a qualifying purchaser of a controllable electronic record, controllable account, or controllable payment intangible.

* * *

Section 8-501. Securities Account; Acquisition of Security Entitlement from Securities Intermediary.

* * *

(d) If a securities intermediary holds a financial asset for another person, and the financial asset is registered in the name of, payable to the order of, or specially indorsed to the other person, and has not been indorsed to the securities intermediary or in blank, the other person is treated as holding the financial asset directly rather than as having a security entitlement with respect to the financial asset.

* * *

1 **Official Comment**

2 * * *

3 4. Part 5 of Article 8 sets out a carefully designed system of rules for the indirect
4 holding system. Persons who hold securities through brokers or custodians have security
5 entitlements that are governed by Part 5, rather than being treated as the direct holders of
6 securities. Subsection (d) specifies the limited circumstance in which a customer who leaves a
7 financial asset with a broker or other securities intermediary has a direct interest in the financial
8 asset, rather than a security entitlement. The customer can be a direct holder only if the security
9 certificate, or other financial asset, is registered in the name of, payable to the order of, or
10 specially indorsed to the customer, and has not been indorsed by the customer to the securities
11 intermediary or in blank. The distinction between those circumstances where the customer can be
12 treated as direct owner and those where the customer has a security entitlement is essentially the
13 same as the distinction drawn under the federal bankruptcy code between customer name
14 securities and customer property. The distinction does not turn on any form of physical
15 identification or segregation. A customer who delivers certificates to a broker with blank
16 indorsements or stock powers is not a direct holder but has a security entitlement, even though
17 the broker holds those certificates in some form of separate safe-keeping arrangement for that
18 particular customer. The customer remains the direct holder only if there is no indorsement or
19 stock power so that further action by the customer is required to place the certificates in a form
20 where they can be transferred by the broker.

21
22 The rule of subsection (d) corresponds to the rule set out in Section 8-301(a)(3)
23 specifying when acquisition of possession of a certificate by a securities intermediary
24 counts as “delivery” to the customer.
25

26 Subsection (d) uses terminology applicable to conventional certificated securities (e.g.,
27 “indorsed”) and contemplates the limited circumstances in which a securities intermediary
28 (defined in Section 8-102(a)(14) to include only a clearing corporation or another person that in
29 the ordinary course of its business maintains securities accounts for others and that is acting in
30 that capacity) may hold a financial asset for a customer under a direct holding arrangement rather
31 than as a security entitlement. However, assets such as controllable electronic records,
32 controllable accounts, and controllable payment intangibles also might be controlled by a
33 securities intermediary for the benefit of a customer under a similar direct holding arrangement.
34 For example, the securities intermediary and the customer might share control of the financial
35 asset under an arrangement whereby the exercise of powers, such as the power to transfer
36 control, requires the exercise of the power by both the intermediary and the customer. As with
37 conventional certificated securities, whether a securities intermediary has created a security
38 entitlement in favor of an entitlement holder or is holding a financial asset directly for a customer
39 depends on the nature of the relationship and the nature of the rights of the securities
40 intermediary and the customer in the financial asset. Moreover, the person holding such an asset
41 for the benefit of another may not be acting in the capacity of a securities intermediary, even if
42 the person also regularly acts in that capacity. In such a case the relationship would be governed
43 by the agreement of the parties and the application of law other than this article.
44

45 **Reporter’s Note**

No change. No change is proposed to Section 8-501, which is provided for convenience.

* * *

Section 8-505. Duty of Securities Intermediary with Respect to Payments and Distributions.

(a) A securities intermediary shall take action to obtain a payment or distribution made by the issuer of a financial asset. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to attempt to obtain the payment or distribution.

(b) A securities intermediary is obligated to its entitlement holder for a payment or distribution made by the issuer of a financial asset if the payment or distribution is received by the securities intermediary.

Official Comment

1. One of the core elements of the securities account relationships for which the Part 5 rules were designed is that the securities intermediary passes through to the entitlement holders the economic benefit of ownership of the financial asset, such as payments and distributions made by the issuer of the financial asset. Subsection (a) expresses the ordinary understanding that a securities intermediary will take appropriate action to see to it that any payments or distributions made by the issuer are received. One of the main reasons that investors make use of securities intermediaries is to obtain the services of a professional in performing the record-keeping and other functions necessary to ensure that payments and other distributions are received.

2. Subsection (a) incorporates the same "agreement/due care" formula as the other provisions of Part 5 dealing with the duties of a securities intermediary. See Comment 4 to Section 8-504. This formulation permits the parties to specify by agreement what action, if any, the intermediary is to take with respect to the duty to obtain payments and distributions. In the absence of specification by agreement, the intermediary satisfies the duty if the intermediary exercises due care in accordance with reasonable commercial standards. The provisions of

1 Section 8-509 also apply to the Section 8-505 duty, so that compliance with applicable
2 regulatory requirements constitutes compliance with the Section 8-505 duty.

3
4 3. Subsection (b) provides that a securities intermediary is obligated to its
5 entitlement holder for those payments or distributions made by the issuer that are in fact received
6 by the intermediary. It does not deal with the details of the time and manner of payment.
7 Moreover, as with any other monetary obligation, the obligation to pay may be subject to other
8 rights of the obligor, by way of set-off counterclaim or the like. Section 8-509(c) makes this
9 point explicit.

10
11 4. This section applies to payments and distributions made by an issuer of a financial
12 asset credited to a securities account. If a distribution is made to, or made available to, a
13 securities intermediary on account of a financial asset as to which there is no issuer, the duties, if
14 any, of the securities intermediary with respect to the distribution are subject to the agreement of
15 the intermediary and the entitlement holder. However, in the absence of an agreement, this
16 section may be applied by analogy in an appropriate case. If the securities intermediary is a
17 secured party, Section 9-207(c) applies.

18 19 **Reporter's Note**

20
21 *No change.* No change is proposed to Section 8-505, which is provided for convenience.

22
23 * * *

24 25 **ARTICLE 9**

26 **SECURED TRANSACTIONS**

27 **Prefatory Note to Article 9 Amendments**

28 1. *General.* The amendments to Article 9 are extensive. Many of the amendments are
29 necessary to conform Article 9 to new Article 12, which (along with its Comments) should be
30 read along with the Article 9 amendments and Comments. Other material amendments include
31 those relating to chattel paper and money, among other matters.

32
33 2. *Article 12-related conforming amendments.* Article 12-related conforming
34 amendments to Article 9 include the addition of two new types of collateral: controllable
35 accounts (a subset of accounts) and controllable payment intangibles (a subset of payment
36 intangibles, which is a subset of general intangibles). Perfection of a security interest in a
37 controllable electronic record, controllable account, or controllable payment intangible may be
38 by control or by filing a financing statement. Control of a controllable electronic record is
39 determined under Section 12-105. Control of a controllable account or controllable payment
40 intangible is achieved by obtaining control of the controllable electronic record that evidences
41 the account or payment intangible. Section 9-107A. The rights of a secured party that takes free
42 of competing property interests as a qualifying purchaser of a controllable account, controllable
43 electronic record, or controllable payment intangible are respected under Article 9. Section 9-

1 331.

2
3 The law of the controllable record's jurisdiction under Section 12-107 governs perfection
4 by control and priority of a security interest in a controllable account, controllable electronic
5 record, or controllable payment intangible. Section 9-306B. The law of the jurisdiction in which
6 a debtor is located governs perfection by filing for such collateral. Section 9-306B.
7

8 The draft also contains several other Article 12-related conforming amendments to
9 Article 9.
10

11 3. *Chattel paper-related amendments.* These amendments primarily address two issues
12 that have arisen with respect to transactions in chattel paper.
13

14 First, the definition of "chattel paper" creates uncertainty in "bundled" or "hybrid"
15 transactions in which monetary obligations exist not only under a lease of goods but also with
16 respect to other property and services relating to the leased goods. Frequently, the value of the
17 non-goods aspect of a transaction is substantially greater than the value of the lessee's rights
18 under the lease of goods. Those who finance chattel paper and other rights to payment have
19 become uncertain as to whether these transactions give rise to chattel paper. The draft resolves
20 this issue by treating only those transactions whose predominant purpose was to give the obligor
21 (lessee) the right to possession and use of the goods as giving rise to "chattel paper."
22

23 Second, the statutory distinction between "tangible chattel paper" and "electronic chattel
24 paper" causes practical problems. As to tangible chattel paper (i.e., evidenced by writings),
25 problems arose in the case of multiple originals of writings and situations in which separate
26 writings covered different components of chattel paper. Official comments issued in connection
27 with the 1999 amendments to Article 9 addressed these issues. As to electronic chattel paper, the
28 safe harbor for control is based on a "single authoritative copy" of the chattel paper. Moreover,
29 in some situations tangible chattel paper is converted to electronic form and electronic chattel
30 paper is converted to tangible form. Additional uncertainty exists when one or more records
31 referred to in the current definition comprise one or more tangible authoritative copies of the
32 records that evidence the right to payment and rights in related property and one or more
33 authoritative electronic copies of those records also exist.
34

35 The draft provides a single rule, under which a security interest in chattel paper can be
36 perfected by taking possession of the tangible authoritative copies, if any, and obtaining control
37 of the electronic authoritative copies, if any. This single rule would address cases where some
38 records evidencing chattel paper are electronic and some are tangible or where a record in one
39 medium is replaced by a record in another.
40

41 The draft also defines chattel paper more accurately, as the right to payment of a
42 monetary obligation that is secured by a security interest in specific goods or owed under a lease
43 of specific goods, if the right to payment and interest in the goods are evidenced by a record.
44

45 Finally, the draft provides a new choice-of-law rule for perfection and priority of security
46 interests in chattel paper that is evidenced by authoritative electronic copies of records or by such

1 electronic copies and authoritative tangible copies. For such chattel paper, Section 9-306A
2 provides that perfection and priority are governed by the law of the “electronic chattel paper’s
3 jurisdiction,” based loosely on Sections 8-110 and 9-305. For chattel paper evidenced only by
4 authoritative tangible copies, Section 9-306A(d) provides that perfection by possession and
5 priority are governed by the law of the location of the tangible copies. Perfection by filing
6 continues to be governed by the law of the location of the debtor for all chattel paper.

7 8 4. Money-related amendments 9

10 Section 1-201(b)(24) defines “money” as including “a medium of exchange currently
11 authorized or adopted by a domestic or foreign government” There is no way of knowing
12 how money in an intangible form might develop, but there are indications that some countries
13 might authorize or adopt intangible tokens as a medium of exchange and others might authorize
14 or adopt deposit accounts with a central bank as money.² For many purposes, there is no need for
15 the UCC to distinguish among types of money. For Article 9 purposes, however, distinctions
16 must be drawn. Only tangible money is susceptible of perfection by possession. And the steps
17 needed for perfection by control with respect to intangible tokens, such as controllable electronic
18 records, will not work for deposit accounts with a central bank, and vice versa. For this reason,
19 the draft provides a new definition of “money” for purposes of Article 9 that expressly excludes
20 deposit accounts. Thus, “electronic money,” defined in Section 9-102 as “money in an electronic
21 form,” would not include deposit accounts. The new Article 9 definition of “money” also
22 excludes money in an electronic form that cannot be subjected to control under Section 9-105A.

23
24 The existing Article 9 provisions governing “deposit accounts” would remain suitable for
25 accounts with a central bank, even if a government has adopted these accounts as money. The
26 draft makes no changes with respect to Article 9’s treatment of deposit accounts, aside from
27 distinguishing them from “money” and therefore from “electronic money.” Under the draft, a
28 security interest in electronic money as original collateral can be perfected only by control. The
29 requirements for obtaining control of electronic money under Section 9-105A are essentially the
30 same as those for obtaining control of a controllable electronic record under Article 12.

31
32 The draft also makes changes to Section 9-332, the take-free rules for transferees of
33 money, including the addition of a new rule applicable to electronic money, and transferees of
34 funds from deposit accounts.

35 36 **Section 9-102. Definitions and Index of Definitions.**

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

38 * * *

39 (2) “Account”, except as used in “account for”, “account to”, “account

² These tokens or accounts sometimes are referred to as central bank digital currency or CBDC.

statement”, “customer’s account”, “on account of”, “statement of account”, and paragraphs (14) (“commodity account”) and (29) (“deposit account”), means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card or information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a State, governmental unit of a State, or person licensed or authorized to operate the game by a State or governmental unit of a State. The term includes controllable accounts and health-care-insurance receivables. The term does not include (i) ~~rights to payment evidenced by chattel paper or an instrument~~ 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.

* * *

(7) “~~Authenticate~~” means:

(A) ~~to sign; or~~

(B) ~~with present intent to adopt or accept a record, to attach to or logically associate with the record an electronic sound, symbol, or process.~~ [Reserved]

(7A) “Assignee” means a person:

(A) in whose favor a security interest that secures an obligation is created

1 or provided for under a security agreement, whether or not the obligation is outstanding; or

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

4 (7B) “Assignor” means a person that:

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

7 (B) sells an account, chattel paper, payment intangible, or promissory
8 note.

9 * * *

10 ~~(11) “Chattel paper” means a record or records that evidence both a monetary~~
11 ~~obligation and a security interest in specific goods, a security interest in specific goods and~~
12 ~~software used in the goods, a security interest in specific goods and license of software used in~~
13 ~~the goods, a lease of specific goods, or a lease of specific goods and license of software used in~~
14 ~~the goods. In this paragraph, “monetary obligation” means a monetary obligation secured by the~~
15 ~~goods or owed under a lease of the goods and includes a monetary obligation with respect to~~
16 ~~software used in the goods. The term does not include (i) charters or other contracts involving~~
17 ~~the use or hire of a vessel or (ii) records that evidence a right to payment arising out of the use of~~
18 ~~a credit or charge card or information contained on or for use with the card. If a transaction is~~
19 ~~evidenced by records that include an instrument or series of instruments, the group of records~~
20 ~~taken together constitutes chattel paper. “Chattel paper” means:~~

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

23 (B) a right to payment of a monetary obligation owed by a lessee under a

1 lease agreement with respect to specific goods and a monetary obligation owed by the lessee in
2 connection with the transaction giving rise to the lease, if:

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

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

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

10 * * *

11 (27A) “Controllable account” means an account evidenced by a controllable
12 electronic record that provides that the account debtor undertakes to pay the person that under
13 Section 12-105 has control of the controllable electronic record.

14 (27B) “Controllable payment intangible” means a payment intangible evidenced
15 by a controllable electronic record that provides that the account debtor undertakes to pay the
16 person that under Section 12-105 has control of the controllable electronic record.

17 * * *

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

21 * * *

22 (31A) “Electronic money” means money in an electronic form.

23 * * *

(42) “General intangible” means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes controllable electronic records, payment intangibles, and software.

* * *

(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 in Section 1-201(b)(24), but does not include (i) a deposit account or (ii) money in an electronic form that cannot be subjected to control under Section 9-105A.

* * *

(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 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 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 12-102.

* * *

(c) [Article 1 definitions and principles.] Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.

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

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Example 8. To secure a loan, Borrower grants Lender a security interest in a specified item of equipment and a deposit account. The loan and the security interest are evidenced by one or more records. The right to payment is chattel paper, assuming the equipment is the primary collateral.

In Example 8, the inclusion of some incidental collateral, such as a deposit account, does not prevent characterization of the right to payment as chattel paper. Another typical example would be the inclusion of after-acquired replacement parts to be installed on the specific goods. On the other hand, to be chattel paper, a right to payment must be accompanied by a security interest in *specific* goods or a lease of *specific* goods. A right to payment secured by a security interest in rotating collateral is not chattel paper.

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

Example 10. To secure a loan, Borrower grants Lender a security interest in a specifically described item of equipment and also in all of Borrower's existing and after-acquired equipment. The loan and the security interest are evidenced by one or more records. The right to payment is not chattel paper.

Example 9 is the easy case because no "specific goods" are identified. As to Example 10, it is true that the monetary obligation is secured by "specific goods" and the definition of chattel paper does not specify that the obligation must be secured *only* by specific goods. However, if the right to payment in Example 10 were to be characterized as chattel paper, it would be possible to convert virtually any monetary obligation evidenced by records and secured by any collateral into chattel paper merely by including as collateral a specific item of goods (whether inventory, equipment, consumer goods, or farm products). The special rules for chattel paper contemplate reliance on specific goods as the primary collateral, even if some incidental property also might be included. If the inclusion of additional goods or other property indicate that primary reliance is not on the specific goods, then classification as chattel paper would not be appropriate. Of course, there may be close cases. In those situations, parties should take appropriate precautions.

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

Example 11. In one or more signed records, Customer and Car Dealer enter into a transaction pursuant to which, in exchange for a payment of \$2,000 per month: (i) Customer is entitled to possession of a specific vehicle for 36 months; (ii) Car Dealer will provide round-the-clock monitoring of the vehicle's location and condition, and alert authorities to provide road-side assistance in the event of a malfunction or accident; and

(iii) Car Dealer will, from time to time, remotely update the vehicle's automobile's operating system. The value of the right to possess and use the vehicle is significantly greater than the value of the monitoring service and updates. Because the goods aspect of the transaction predominates, under paragraph (11)(B)(ii) Customer's monetary obligation, including the portion attributable to Car Dealer's obligation to provide monitoring and updates, constitutes chattel paper.

Example 12. In one or more signed records, Customer and Cableco enter into a transaction pursuant to which, in exchange for a payment of \$200 per month, Cableco will provide Customer with specified television programming and a device needed to access the programming (a "lease" of the device). If the components of the transaction were priced separately, the price for the programming would be substantially more than the price for possession and use of the device. Because the goods aspect of this transaction does not predominate, under paragraph (11)(B)(ii) Customer's monetary obligation does not constitute chattel paper.

The latest revision to the definition of chattel paper omits the references to a "license of software used in the goods" as superfluous, inasmuch as there is no reason to single out software. Other types of property may secure an obligation or be included in a transaction involving a lease, as discussed above. See also Sections 2-102 (scope of Article 2); 2-106(5) (defining "hybrid transaction"); 2A-102 (scope of Article 2A); 2A-103(aa) (definition of "hybrid lease").

The latest revision to the definition of "chattel paper" also changed the language from "a record or records that evidence a monetary obligation" to "a right to payment of a monetary obligation . . . evidenced by a record." This semantic change was for clarification purposes only; it does not imply a change in meaning. Chattel paper is and has always been a right to payment of a monetary obligation. Because the revised definition is based on the obligation, rather than the record, the definition no longer includes the following statement, which was previously part of the definition: "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 omission of that statement also does not imply a change in meaning, except that records (writings) evidencing chattel paper are excluded from the definition of "instrument" under Section 9-102(a)(47). Although the definition refers to "a record," chattel paper can be evidenced by one or more records because, under Section 1-106, unless the statutory context otherwise requires, words in the singular number include the plural.

Reporter's Note

1. "*Account*." "Chattel paper" has been redefined to mean a right to payment rather than a record evidencing a right to payment. The amendments to the definition of "account" reflect the redefinition. The definition also includes some additional exceptions that accommodate the use of the term in other provisions.

2. "*Assignor*"; "*assignee*". Instead of referring to a "debtor," "secured party," and "security interest," all of which terms are defined in the UCC, several provisions of Article 9, including Part 4, refer to an "assignor," "assignee," and "assignment," or sometimes an

1 “assigned contract,” none of which terms are defined in the UCC. Some courts read the
2 undefined terms in an unduly narrow way. In 2020, the Permanent Editorial Board for the UCC
3 issued a Commentary clarifying the meanings of these terms and amended the official comments
4 accordingly. *PEB Commentary No. 21, Use of the Term “Assignment” in Article 9 of the*
5 *Uniform Commercial Code* (Mar. 11, 2020). New paragraphs (7A) and (7B) incorporate the
6 essence of the Commentary into the statutory text. Of course, absent a contrary agreement, an
7 assignee obtains the rights and powers of an assignor as to an account debtor on assigned
8 collateral (e.g., under Section 9-406) and as to an assignor (debtor) (e.g., under Section 9-607).

9
10 2A. “*Authenticate*.” This definition is deleted because the new definition of “sign” in
11 Section 1-201(b)(37) makes the term unnecessary. The term will be replaced with “signed” in
12 this Section and in other Sections of Article 9 and the official comments.

13
14 3. “*Chattel paper*.” Under the revised definition, “chattel paper” is a right to payment
15 rather than a record evidencing a right to payment. Records evidencing chattel paper remain
16 relevant to perfection of a security interest in chattel paper. *See* Section 9-314A.

17
18 The right to payment that constitutes “chattel paper” under subsection (a)(11)(B) may
19 include the right to payment of a variety of “bundled” or “hybrid” monetary obligations owed by
20 a lessee of specific goods. These obligations may include obligations arising in connection with
21 the transaction giving rise to the lease, such as obligations relating to other property or services.
22 However, to constitute “chattel paper,” these obligations must include the right to payment of a
23 monetary obligation owed by the lessee under the lease agreement.

24
25 A right to payment is not “chattel paper” under subsection (a)(11)(B) unless the
26 predominant purpose of the transaction giving rise to the lease was to give the lessee the right to
27 possession and use of the goods. The draft official comment explains the predominant-purpose
28 test in the context of the definition and gives examples of its application.

29
30 4. “*Controllable account*”; “*controllable payment intangible*.” The draft affords special
31 treatment to security interests in controllable accounts and controllable payment intangibles, *i.e.*,
32 those accounts and payment intangibles that are evidenced by a controllable electronic record
33 that provides that the account debtor (obligor) undertakes to pay the person having control of the
34 controllable electronic record. (Of course, a person would be an account debtor only if it were
35 actually obligated on the underlying account or payment intangible.) An undertaking to pay the
36 “person that has control” means an undertaking to pay the person that has control at the time
37 payment is made. An undertaking to pay Smith, who happens to have control of the relevant
38 controllable electronic record at the time the undertaking was made, is not an undertaking to pay
39 the person that has control.

40
41 This special treatment includes the following:

- 42
43 • Perfection of a security interest in a controllable account or controllable payment
44 intangible can be achieved by filing a financing statement or obtaining control of the
45 controllable electronic record that evidences the controllable account or controllable
46 payment intangible. Sections 9-312(a); 9-314(a); 9-107A(b).

- 1 • A security interest in a controllable electronic record, controllable account, or
2 controllable payment intangible that is perfected by control has priority over a
3 conflicting security interest that is perfected by another method. Section 9-326A.
4
- 5 • The benefit of the take-free and no-action rules for qualifying purchasers (including
6 secured parties) of controllable electronic records also extends to qualifying
7 purchasers of controllable accounts and controllable payment intangibles, whether or
8 not the qualifying purchaser also purchases the related controllable electronic record.
9 *See* Section 12-104(a) and Comments 7 and 8.
10

11 5. “*Deposit account.*” This definition is not changed and is provided here for
12 convenience of reference.
13

14 6. “*Electronic money*” and “*tangible money.*” As the Prefatory Note to Article 9
15 Amendments observes, some countries may authorize or adopt intangible tokens as a medium of
16 exchange that would be “money” as defined (and as proposed to be defined) in both Article 1
17 and Article 9. Such intangible tokens would be “electronic money” as defined in Section 9-
18 102(a)(31A). Under the draft, a security interest in electronic money as original collateral can be
19 perfected only by control. Sections 9-105A; 9-312(b)(4). The requirements for obtaining control
20 of electronic money are essentially the same as those for obtaining control of a controllable
21 electronic record under Article 12. The definition of “tangible money” uses the word “tangible”
22 with its normal meaning (as something that does have physical or corporeal existence, such as
23 goods).
24

25 7. “*Instrument.*” The change to the definition of “instrument” makes it clear that the
26 definition excludes an instrument that is a record included in the definition of “chattel paper.”
27 Note that while in many places in the UCC the term “writing” has been and is proposed to be
28 replaced by the technology neutral term, “record,” instruments (under both Articles 3 and 9)
29 must be “written” and in “writing.”
30

31 8. *Money, deposit accounts, and electronic money under Article 9.* As observed in the
32 Prefatory Note to Article 9 Amendments, some countries may authorize or adopt deposit
33 accounts with a central bank as a form of “money,” as defined in Section 1-201(b)(24) (as that
34 definition is proposed to be revised in the draft). However, the existing Article 9 provisions
35 governing “deposit accounts” would remain suitable for such accounts with a central bank, even
36 if a government has adopted these accounts as money. The draft makes no changes with respect
37 to Article 9’s treatment of deposit accounts. However, *for purposes of Article 9* and in the
38 interest of clarity, the definition of “money” in Section 9-102(a)(31A) excludes deposit accounts.
39 Under this definition, deposit accounts would not be money for Article 9 purposes even if they
40 were to become money under the Article 1 definition. In similar fashion, the definition of
41 “money” for purposes of Article 9 excludes money (as defined in Section 1-201(b)(24)) in an
42 electronic form that cannot be subjected to control under Section 9-105A, which would be a general
43 intangible under Article 9.
44

45 The principal function of the new Article 9 definition of “money” is to ensure that (i)
46 even if some deposit accounts were to become “money” as defined in Article 1, the provisions

1 relating to perfection and priority for security interests in deposit accounts, and not those for
2 money, will apply, and (ii) money, as defined in Article 1, in an electronic form that cannot be
3 subjected to control will be subject to the perfection and priority rules for general intangibles. It
4 will be necessary to ensure that this definitional strategy does not cause any difficulties for other
5 provisions of Article 9, such as references to the cognate term “monetary.” The current thinking
6 is that this will not be problematic.

7
8 9. *Proceeds.*
9

10 a. *No change to definition of proceeds.* No change to the definition of “proceeds” is
11 proposed and the definition is provided here for convenience.
12

13 b. *“Fork” involving controllable electronic record.* Sometimes there occurs a change in
14 the software (code) of a system (sometimes referred to as a “protocol” or “platform”) in which a
15 controllable electronic record is recorded. When such a change occurs in a blockchain platform,
16 the blockchain may remain intact, no new blockchain may result, and the change sometimes is
17 colloquially referred to as a “soft fork.” If, instead, such a change results in a new, separate
18 blockchain that exists alongside the original blockchain and a new controllable electronic record
19 is created, the change is sometimes referred to as a “hard fork.” But the terms “fork,” “soft fork,”
20 and “hard fork” are ambiguous and not used consistently. Even in a hard fork situation the pre-
21 fork controllable electronic record typically would remain intact (although its value might be
22 affected). A person in control of the original record may not automatically obtain control of a
23 new record. Additional steps may be required for the person in control of the original record to
24 obtain control of the new record.
25

26 c. *New controllable electronic record as proceeds.* Depending on the nature and structure
27 of the fork, a new controllable electronic record arising under a hard fork may be property
28 “distributed on account of” the original record or “rights arising out of” the original record,
29 thereby constituting proceeds of the original record under subparagraph (B) or (C), or both, of
30 the definition of “proceeds.” If the new record is identifiable “proceeds,” then the rules on
31 attachment, perfection, priority under Sections 9-203(f), 9-315, and 9-322 would apply. If a
32 security interest in the original record is perfected by control, the creation of the new record in
33 connection with a hard fork typically results in the secured party obtaining control (or having the
34 opportunity to obtain control) of the new record. If that is not the case and perfection of the
35 security interest in the original record is only by control, however, then perfection would
36 continue in the new record only until the 21st day after the security interest attaches to the new
37 record, unless one of the exceptions under subsection (d) applies. Section 9-315(c), (d). For this
38 reason, a secured party may wish to perfect its security interest by filing so that the perfection
39 would continue thereafter in any proceeds under Section 9-315(d)(1). A secured party that does
40 so may, to ensure the priority of its perfected security interest, also wish to consider obtaining a
41 release or subordination from any earlier filed secured party whose financing statement covers
42 the same type of property. Even if that is achieved, a security interest in the record that is
43 perfected by control (even if control is later obtained) would have priority over a security interest
44 perfected by filing. Section 9-326A.
45

46 d. *“Airdrops” of controllable electronic records.* New controllable electronic records also

1 may be provided to persons in control of existing records by way of an “airdrop” that does not
2 involve a fork in an existing blockchain. Depending on the circumstances, these new records
3 may or may not be proceeds of the existing, original record.
4

5 e. *New controllable electronic record as financial asset credited to securities account.* If
6 the original record were a financial asset credited to a securities account, the new record might
7 become proceeds of a security entitlement for the reasons described in Note 9.c. Concerning the
8 duties, if any, of a securities intermediary with respect to such a distribution, see Section 8-505,
9 Comment 4.
10

11 * * *

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

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

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

15 (2) the debtor, secured party, and bank have agreed in ~~an authenticated~~ a signed
16 record that the bank will comply with instructions originated by the secured party directing
17 disposition of the funds in the deposit account without further consent by the debtor; ~~or~~

18 (3) the secured party becomes the bank’s customer with respect to the deposit
19 account; or

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

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

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

25 (b) **[Debtor’s right to direct disposition.]** A secured party that has satisfied subsection

26 (a) has control, even if the debtor retains the right to direct the disposition of funds from the
27 deposit account.

28 **Reporter’s Note**

1 1. *Control on behalf of another person.* Draft subsection (a)(4) provides for a secured
2 party to obtain control of a deposit account by virtue of the acknowledgment by another person,
3 other than the debtor, in control of the deposit account.
4

5 a. Subsection (a)(4) follows draft revisions to the corresponding provisions for
6 control of electronic documents of title (Section 7-106(g)), control of an electronic copy of a
7 record evidencing chattel paper (Section 9-105(g)), control of electronic money (Section 9-
8 105A(e)), and control of controllable electronic records (Section 12-105(e)). For a brief
9 discussion, see Section 12-105, Comment 8.
10

11 b. An acknowledgment by a person in control under subsection (a)(4) would not
12 impose any duties on the bank with which the deposit account is maintained and the official
13 comments will make this clear. Indeed, the bank may have no knowledge or involvement
14 whatsoever with a control person's acknowledgment under that subsection.
15

16 c. Subsection (a)(4) should not be construed to permit the bank with which the
17 deposit account is maintained to short-circuit subsection (a)(2), which provides for control
18 through a control agreement between the bank and the control person. However, it would be
19 possible for the bank, acting in a capacity other than as the depository bank (for example, as a
20 secured party) to acknowledge that it has control on behalf of another purchaser under subsection
21 (a)(4).
22

23 d. Section 9-107B(a) makes clear that a person that has control under this section
24 has no duty to acknowledge that it has or will obtain control on behalf of another person.
25 Arrangements for a person to acknowledge that it has or will obtain control on behalf of another
26 person are not standardized. Accordingly, draft Section 9-107B(b) leaves to the agreement of the
27 parties and to any other applicable law any duties of a person that does acknowledge that it has
28 or will obtain control on behalf of another person and provides that a person making an
29 acknowledgment is not required to confirm the acknowledgment to another person.
30

31 **~~Section 9-105. Control of Electronic Chattel Paper.~~**

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

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

38 ~~(1) a single authoritative copy of the record or records exists which is unique,~~

1 ~~identifiable, and, except as otherwise provided in paragraphs (4), (5), and (6), unalterable;~~

2 ~~(2) the authoritative copy identifies the secured party as the assignee of the record~~
3 ~~or records;~~

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

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

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

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

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

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

17 **(b) {Specific facts giving control.}[Single authoritative copy.] A system satisfies**
18 **subsection (a) if the record or records evidencing the chattel paper are created, stored, and**
19 **assigned in such a manner that:**

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

22 **(2) the authoritative copy identifies the purchaser as the assignee of the record or**
23 **records;**

1 (3) the authoritative copy is communicated to and maintained by the purchaser or
2 its designated custodian;

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

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

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

9 **(c) [One or more authoritative copies.]** A system satisfies subsection (a), and a
10 purchaser has control of an electronic copy of a record evidencing chattel paper, if the electronic
11 copy, a record attached to or logically associated with the electronic copy, or a system in which
12 the electronic copy is recorded:

13 (1) enables the purchaser readily to identify each electronic copy as an
14 authoritative copy or nonauthoritative copy;

15 (2) enables the purchaser readily to identify itself in any way, including by name,
16 identifying number, cryptographic key, office, or account number, as the assignee of each
17 authoritative electronic copy; and

18 (3) gives the purchaser exclusive power, subject to subsection (d), to:

19 (A) prevent others from adding or changing an identified assignee of each
20 authoritative electronic copy; and

21 (B) transfer control of each authoritative electronic copy.

22 **(d) [Meaning of exclusive.]** A power is exclusive under subsection (b)(3)(A) and (B),
23 even if:

1 (1) the authoritative electronic copy, a record attached to or logically associated
2 with the authoritative electronic copy, or a system in which the authoritative electronic copy is
3 recorded limits the use of the authoritative electronic copy or has a protocol programmed to
4 cause a change, including a transfer or loss of control; or

5 (2) the power is shared with another person.

6 (e) [When purchaser does not share power.] The purchaser does not share a power
7 with another person if:

8 (1) the purchaser can exercise a power only if the power also is exercised by the
9 other person; and

10 (2) the other person either:

11 (A) can exercise the power without exercise of the power by the
12 purchaser; or

13 (B) is the transferor to the purchaser of an interest in the chattel paper.

14 (f) [Presumption of exclusivity of certain powers.] If a purchaser has the powers
15 specified in subsection (c)(3)(A) and (B), the powers are presumed to be exclusive.

16 (g) [Obtaining control through another person.] A purchaser has control of each
17 authoritative electronic copy of a record evidencing chattel paper if another person, other than
18 the debtor:

19 (1) has control of each authoritative electronic copy and acknowledges that it has
20 control on behalf of the purchaser; or

21 (2) obtains control of each authoritative electronic copy after having
22 acknowledged that it will obtain control of the electronic copy on behalf of the purchaser.

23 **Reporter's Note**

1 1. *The function of control.* Under the draft, as under current law, a secured party can
2 perfect a security interest in chattel paper by filing. *See* Section 9-312(a). Alternatively, a
3 secured party can perfect a security interest in chattel paper by taking possession of all
4 authoritative tangible copies of the record evidencing the chattel paper and obtaining control of
5 all authoritative electronic copies. *See* Section 9-314A. Possession and control also are
6 conditions for achieving priority under Section 9-330(a), (b), and (c).

7
8 2. *Conditions for obtaining control: In general.* As explained in the preceding Note,
9 control relates to perfection of a security interest in chattel paper. One method of perfecting a
10 security interest in chattel paper is to take possession of all tangible authoritative copies of the
11 record evidencing the chattel paper and to obtain control of all authoritative electronic records.
12 Perfection generally serves the function of enabling the public to determine that the asset in
13 question (here, chattel paper) may be encumbered with a security interest.

14
15 Subsections (a) and (b) are substantially unchanged. (The amendments to subsection (a)
16 primarily reflect the changes to the definition of chattel paper in Section 9-102.) *It is important*
17 *to note that compliance with the new conditions for control in subsection (c) would satisfy the*
18 *conditions provided in subsection (b).* However, subsection (b) has been retained out of an
19 abundance of caution and to provide assurances that existing systems for control of electronic
20 chattel paper under current law will continue to be viable after the draft revisions become
21 effective. The revised conditions for “control” provided in subsection (c) are meant to reflect the
22 functions that possession serves with respect to writings in a more accurate and technologically
23 flexible way than does the current definition. The requirements for obtaining control under
24 subsection (c) are inspired by Section 12-105 on control of controllable electronic records. *See*
25 *generally* Section 12-105, Comments.

26
27 3. *Control of electronic copy of record evidencing chattel paper.* Under subsection (c), to
28 obtain control of an electronic copy of a record evidencing chattel paper a purchaser must be able
29 to identify each electronic copy as authoritative or nonauthoritative and identify itself as the
30 assignee of each authoritative copy. In addition, the purchaser must have the exclusive power to
31 prevent others from adding or changing an identified assignee and to transfer control of each
32 authoritative copy. However, once it is established that a person has received those powers,
33 subsection (f) provides a presumption of exclusivity. Consequently, a person asserting control
34 need not prove exclusivity in order to make out a *prima facie* case. Application of the
35 presumption will be governed also by Section 1-206 (effects of a presumption under the UCC)
36 and applicable non-UCC law (including rules of procedure and evidence). *See generally* Section
37 12-105, Comment 5. In addition, subsection (d) contains two qualifications of the term
38 “exclusive” as used in subsection (a)(1)(B). A power can be “exclusive” under subsection
39 (a)(1)(B) even if one or both of these qualifications apply.

40
41 Subsection (e) provides that in certain circumstances a power is not shared within the
42 meaning of subsection (d)(2) and, consequently, the relaxation of the exclusivity requirement
43 provided by subsection (d)(2) does not apply. Subsection (e) provides that a person does not
44 share an exclusive power with another person if the person can exercise the power only with the
45 other person’s cooperation but the other person either (i) can exercise the power unilaterally
46 without the person’s cooperation or (ii) is the transferor to the person of an interest in the

1 controllable electronic record. It follows that a person in that situation does not have control
2 because it does not have the requisite exclusive power. Concerning the exclusivity of powers,
3 including shared control and limitations on shared control and examples, see generally Section
4 12-105, Comment 5.

5
6 The utility of distributed ledger technology (including blockchain technology) depends
7 on there being multiple authoritative copies of a record. The safe harbor under existing Section
8 9-105(b) contemplates a “single authoritative copy” and so is unavailable when the relevant
9 record is maintained on a blockchain or other distributed ledger. Subsection (c) allows a
10 purchaser to obtain control when there are multiple authoritative copies.

11
12 *4. Control on behalf of another person.*

13
14 a. Subsection (g) provides for a purchaser to obtain control of an electronic copy
15 by virtue of the acknowledgment by another person in control of the electronic copy. It follows
16 draft revisions to the corresponding provisions for control of electronic documents of title
17 (Section 7-106(g)), control of deposit accounts (Section 9-104(a)(4)), control of electronic
18 money (Section 9-105A(e)), and control of controllable electronic records (Section 12-105(e)).
19 For a brief discussion, see Section 12-105, Comment 8.

20
21 b. Section 9-107B(a) makes clear that a person that has control under this section
22 has no duty to acknowledge that it has or will obtain control on behalf of another person.
23 Arrangements for a person to acknowledge that it has or will obtain control on behalf of another
24 person are not standardized. Accordingly, Section 9-107B(b) leaves to the agreement of the
25 parties and to any other applicable law any duties of a person that does acknowledge that it has
26 or will obtain control on behalf of another person and provides that a person making an
27 acknowledgment is not required to confirm the acknowledgment to another person.

28
29 For example, subsection (g) would apply to give control to a person, Alpha, when another
30 person, Beta, has control of an electronic copy of a record evidencing chattel paper and
31 acknowledges that it has control on behalf of Alpha. However, under Section 107B(a), Beta is
32 not required to so acknowledge. And under Section 107B(b), even if Beta does so acknowledge,
33 Beta owes no duty to Alpha unless Beta agrees or other law so provides and Beta is not required
34 to confirm its acknowledgment to any other person.

35
36 *5. References to “secured party” changed to “purchaser.”* References to a “secured
37 party” in this section have been changed to refer to a “purchaser.” This change aligns the text
38 with the priority rules of Section 9-330(a), (b), and (c).

39
40 **Section 9-105A. Control of Electronic Money.**

41 **(a) [General rule: control of electronic money.]** A person has control of electronic
42 money if:

43 (1) the electronic money, a record attached to or logically associated with the

1 electronic money, or a system in which the electronic money is recorded gives the person:

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

4 (B) exclusive power, subject to subsection (b), to:

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

7 (ii) transfer control of the electronic money to another person or
8 cause another person to obtain control of other electronic money as a result of the transfer of the
9 electronic money; and

10 (2) the electronic money, a record attached to or logically associated with the
11 electronic money, or a system in which the electronic money is recorded enables the person
12 readily to identify itself in any way, including by name, identifying number, cryptographic key,
13 office, or account number, as having the powers under paragraph (1).

14 **(b) [Meaning of exclusive.] A power is exclusive under subsection (a)(1)(B), even if:**

15 (1) the electronic money, a record attached to or logically associated with the
16 electronic money, or a system in which the electronic money is recorded limits the use of the
17 electronic money or has a protocol programmed to cause a change, including a transfer or loss of
18 control; or

19 (2) the power is shared with another person.

20 **(c) [When purchaser does not share power.] A person does not share a power with**
21 **another person if:**

22 (1) the person can exercise a power only if the power also is exercised by the
23 other person; and

(2) the other person either:

(A) can exercise the power without exercise of the power by the person; or

(B) is the transferor to the person of an interest in the electronic money.

(d) [Presumption of exclusivity of certain powers.] If a person has the powers specified in subsection (a)(1)(B), the powers are presumed to be exclusive.

(e) [Control through another person.] A person has control of electronic money if another person, other than the transferor of an interest in the electronic money:

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

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

Reporter's Note

1. “*Control.*” A security interest in electronic money as original collateral may be perfected only by control as provided in this section. *See* Section 9-312(b)(4). The requirements for obtaining control generally track those in Section 12-105 for controllable electronic records. *See generally* Section 12-105, Comments.

2. Control on behalf of another person.

a. Subsection (e) provides for a person to obtain control of electronic money by virtue of the acknowledgment by another person in control of the electronic copy. It follows draft revisions to the corresponding provisions for control of electronic documents of title (Section 7-106(g)), control of deposit accounts (Section 9-104(a)(4)), control of an electronic copy of a record evidencing chattel paper (Section 9-105(g), and control of controllable electronic records (Section 12-105(e)). For a brief discussion, see Section 12-105, Comment 8.

b. Section 9-107B(a) makes clear that a person that has control under this section has no duty to acknowledge that it has or will obtain control on behalf of another person. Arrangements for a person to acknowledge that it has or will obtain control on behalf of another person are not standardized. Accordingly, Section 9-107B(b) leaves to the agreement of the parties and to any other applicable law any duties of a person that does acknowledge that it has or will obtain control on behalf of another person and provides that a person making an acknowledgment is not required to confirm the acknowledgment to another person.

* * *

Section 9-107A. Control of Controllable Electronic Record, Controllable

Account, or Controllable Payment Intangible.

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

(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* Sections 9-312 and 9-314. Under Section 9-107A(a), a secured party has control of a controllable electronic record as provided in Section 12-105. Under Section 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. *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* Sections 9-312, 9-314. Under Section 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 Section 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.” Section 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 9-107B. No Requirement to Acknowledge or Confirm; No Duties.

(a) [No requirement to acknowledge.] A person that has control under Section 9-104, 9-105, or 9-105A is not required to acknowledge that it has or will obtain control on behalf of another person.

(b) [No duties or confirmation.] If a person acknowledges that it has or will obtain control on behalf of another person, unless the person otherwise agrees or law other than this article otherwise provides, the person does not owe any duty to the other person and is not required to confirm the acknowledgment to any other person.

Reporter's Note

1. *Source of these provisions.* Section 9-107B derives from Section 9-313(f) and (g).

2. *Purpose.* Subsection (a) makes clear that a person that has control under the specified sections has no duty to acknowledge that it has or will obtain control on behalf of another person. Arrangements for a person to acknowledge that it has control on behalf of another person are not standardized. Accordingly, subsection (b) leaves to the agreement of the parties and to any other applicable law any duties of a person that does acknowledge that it has or will obtain control on behalf of any other person.

* * *

Section 9-203. Attachment and Enforceability of Security Interest; Proceeds; Supporting Obligations; Formal Requisites.

* * *

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

(1) value has been given;

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

(3) one of the following conditions is met:

(A) the debtor has ~~authenticated~~ signed a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;

* * *

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

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

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

* * *

Reporter's Note

Substitute for signed security agreement. Under subsection (b)(3)(B) and (D), possession of tangible collateral and control of intangible collateral may substitute for a signed security agreement that provides a description of the collateral. With respect to chattel paper, some of the authoritative records that evidence the right to payment may be tangible and some electronic. Accordingly, new subparagraph (b)(3)(E) would provide that possession of the tangible authoritative records, if any, and control of the electronic records, if any, under Section 9-314A may substitute for a signed security agreement.

Section 9-204. After-Acquired Property; Future Advances.

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

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

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

(2) a commercial tort claim.

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

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

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

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

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

Official Comment

* * *

3. **After-Acquired Consumer Goods.** Subsection (b)(1) makes ineffective an after-acquired property clause covering consumer goods (defined in Section 9-109), except as accessions (see Section 9-335), acquired more than 10 days after the secured party gives value. Subsection (b)(1) is unchanged in substance from the corresponding provision in former Section 9-204(2). However, a term granting a security interest in consumer goods that will be purchase-money collateral in the transaction is not “a term constituting an after-acquired property clause.” Consequently, subsection (b)(1) does not prevent the security interest from attaching even if the collateral is not an accession and the debtor acquires rights in the collateral more than 10 days after the secured party gives value.

1 * * *

2
3 **Reporter's Note**

4 *Acquisition of proceeds and commingled goods.* The proposed revision would clarify the
5 appropriate result when a debtor acquires consumer goods or a commercial tort claim as
6 proceeds of collateral and when a consumer acquires an interest in commingled goods. This
7 clarification would override the erroneous holdings of several cases addressing commercial tort
8 claims that are proceeds. The official comment will be revised accordingly. The proposed
9 addition to Comment 3, would provide additional clarification.

10
11 * * *

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

14 * * *

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

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

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

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

23 * * *

24 **Reporter's Note**

25
26 *New methods of control.* Cross-references have been added to reflect the new methods of
27 “control” for electronic money (Section 9-105A) and for controllable electronic records,
28 controllable accounts, and controllable payment intangibles (Section 9-107A).

29
30 **Section 9-208. Additional Duties of Secured Party Having Control of Collateral.**

31 (a) **[Applicability of section.]** This section applies to cases in which there is no

1 outstanding secured obligation and the secured party is not committed to make advances, incur
2 obligations, or otherwise give value.

3 (b) **[Duties of secured party after receiving demand from debtor.]** Within 10 days
4 after receiving ~~an authenticated~~ a signed demand by the debtor:

5 (1) a secured party having control of a deposit account under Section 9-104(a)(2)
6 shall send to the bank with which the deposit account is maintained ~~an authenticated~~ a signed
7 statement that releases the bank from any further obligation to comply with instructions
8 originated by the secured party;

9 (2) a secured party having control of a deposit account under Section 9-104(a)(3)
10 shall:

11 (A) pay the debtor the balance on deposit in the deposit account; or

12 (B) transfer the balance on deposit into a deposit account in the debtor's
13 name;

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

16 ~~(A) communicate the authoritative copy of the electronic chattel paper to~~
17 ~~the debtor or its designated custodian;~~

18 ~~(B) if the debtor designates a custodian that is the designated custodian~~
19 ~~with which the authoritative copy of the electronic chattel paper is maintained for the secured~~
20 ~~party, communicate to the custodian an authenticated record releasing the designated custodian~~
21 ~~from any further obligation to comply with instructions originated by the secured party and~~
22 ~~instructing the custodian to comply with instructions originated by the debtor; and~~

23 ~~(C) take appropriate action to enable the debtor or its designated custodian~~

1 ~~to make copies of or revisions to the authoritative copy which add or change an identified~~
2 ~~assignee of the authoritative copy without the consent of the secured party; and~~

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

6 (4) a secured party having control of investment property under Section 8-
7 106(d)(2) or 9-106(b) shall send to the securities intermediary or commodity intermediary with
8 which the security entitlement or commodity contract is maintained ~~an authenticated~~ a signed
9 record that releases the securities intermediary or commodity intermediary from any further
10 obligation to comply with entitlement orders or directions originated by the secured party;

11 (5) a secured party having control of a letter-of-credit right under Section 9-107
12 shall send to each person having an unfulfilled obligation to pay or deliver proceeds of the letter
13 of credit to the secured party ~~an authenticated~~ a signed release from any further obligation to pay
14 or deliver proceeds of the letter of credit to the secured party; ~~and~~

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

16 ~~(A) give control of the electronic document to the debtor or its designated~~
17 ~~custodian;~~

18 ~~(B) if the debtor designates a custodian that is the designated custodian~~
19 ~~with which the authoritative copy of the electronic document is maintained for the secured party,~~
20 ~~communicate to the custodian an authenticated record releasing the designated custodian from~~
21 ~~any further obligation to comply with instructions originated by the secured party and instructing~~
22 ~~the custodian to comply with instructions originated by the debtor; and~~

23 ~~(C) take appropriate action to enable the debtor or its designated custodian~~

1 ~~to make copies of or revisions to the authoritative copy which add or change an identified~~
2 ~~assignee of the authoritative copy without the consent of the secured party;~~

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

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

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

11 **Reporter's Note**

12
13 1. *New methods of control.* Provisions have been modified or added to take account of the
14 new methods of “control” for chattel paper, electronic documents, electronic money, and
15 controllable electronic records.

16
17 2. “*Signed.*” Consistent with the new definition of “sign” in Section 1-201, the cognate
18 term “signed” replaces references to “authenticated” in this section.

19
20 * * *

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

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

25 (1) Except as otherwise provided in this section, while a debtor is located in a
26 jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or
27 nonperfection, and the priority of a security interest in collateral.

28 (2) 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) The local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in as-extracted collateral.

Reporter's Note

Negotiable tangible documents. The revisions to Section 9-301(3) clarify its application only to negotiable tangible (not electronic) documents and tangible (not electronic) money.

* * *

Section 9-304. Law Governing Perfection and Priority of Security Interests in Deposit Accounts.

(a) **[Law of bank's jurisdiction governs.]** The local law of a bank's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a deposit account maintained with that bank, even if a transaction does not bear any relation to the bank's jurisdiction.

(b) **[Bank's jurisdiction.]** The following rules determine a bank's jurisdiction for purposes of this part:

1 (1) If an agreement between the bank and its customer governing the deposit
2 account expressly provides that a particular jurisdiction is the bank's jurisdiction for purposes of
3 this part, this article, or [the Uniform Commercial Code], that jurisdiction is the bank's
4 jurisdiction.

5 (2) If paragraph (1) does not apply and an agreement between the bank and its
6 customer governing the deposit account expressly provides that the agreement is governed by the
7 law of a particular jurisdiction, that jurisdiction is the bank's jurisdiction.

8 (3) If neither paragraph (1) nor paragraph (2) applies and an agreement between
9 the bank and its customer governing the deposit account expressly provides that the deposit
10 account is maintained at an office in a particular jurisdiction, that jurisdiction is the bank's
11 jurisdiction.

12 (4) If none of the preceding paragraphs applies, the bank's jurisdiction is the
13 jurisdiction in which the office identified in an account statement as the office serving the
14 customer's account is located.

15 (5) If none of the preceding paragraphs applies, the bank's jurisdiction is the
16 jurisdiction in which the chief executive office of the bank is located.

17 **Official Comment**

18 * * *

19 **4. No relation to bank's jurisdiction required.** As to the final clause of subsection
20 (a), see Section 8-110, Comment 5A.

21 **Section 9-305. Law Governing Perfection and Priority of Security Interests in** 22 **Investment Property.**

23 (a) **[Governing law: general rules.]** Except as otherwise provided in subsection (c), the
24 following rules apply:
25

1 (1) While a security certificate is located in a jurisdiction, the local law of that
2 jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a
3 security interest in the certificated security represented thereby.

4 (2) The local law of the issuer's jurisdiction as specified in Section 8-110(d)
5 governs perfection, the effect of perfection or nonperfection, and the priority of a security
6 interest in an uncertificated security.

7 (3) The local law of the securities intermediary's jurisdiction as specified in
8 Section 8-110(e) governs perfection, the effect of perfection or nonperfection, and the priority of
9 a security interest in a security entitlement or securities account.

10 (4) The local law of the commodity intermediary's jurisdiction governs
11 perfection, the effect of perfection or nonperfection, and the priority of a security interest in a
12 commodity contract or commodity account.

13 (5) The local law of the issuer's jurisdiction, the securities intermediary's
14 jurisdiction, or the commodity intermediary's jurisdiction governs perfection, the effect of
15 perfection or nonperfection, and the priority of a security interest, even if a transaction does not
16 bear any relation to that jurisdiction.

17 **(b) [Commodity intermediary's jurisdiction.]** The following rules determine a
18 commodity intermediary's jurisdiction for purposes of this part:

19 (1) If an agreement between the commodity intermediary and commodity
20 customer governing the commodity account expressly provides that a particular jurisdiction is
21 the commodity intermediary's jurisdiction for purposes of this part, this article, or [the Uniform
22 Commercial Code], that jurisdiction is the commodity intermediary's jurisdiction.

23 (2) If paragraph (1) does not apply and an agreement between the commodity

intermediary and commodity customer governing the commodity account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(3) If neither paragraph (1) nor paragraph (2) applies and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(4) If none of the preceding paragraphs applies, the commodity intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the commodity customer's account is located.

(5) If none of the preceding paragraphs applies, the commodity intermediary's jurisdiction is the jurisdiction in which the chief executive office of the commodity intermediary is located.

(c) [When perfection governed by law of jurisdiction where debtor located.] The local law of the jurisdiction in which the debtor is located governs:

(1) perfection of a security interest in investment property by filing;

(2) automatic perfection of a security interest in investment property created by a broker or securities intermediary; and

(3) automatic perfection of a security interest in a commodity contract or commodity account created by a commodity intermediary.

Official Comment

* * *

6. No relation of transaction to issuer's, securities intermediary's, or commodity intermediary jurisdiction required. As to new subsection (a)(5), see Section 8-

1 110, Comment 5A.

2
3 * * *

4 **Section 9-306A. Law Governing Perfection and Priority of Security Interests in**
5 **Chattel Paper.**

6 **(a) [Chattel paper evidenced by authoritative electronic copy.]** Except as provided in
7 subsection (e), if chattel paper is evidenced only by an authoritative electronic copy of the chattel
8 paper or is evidenced by an authoritative electronic copy and an authoritative tangible copy, the
9 local law of the electronic chattel paper's jurisdiction governs perfection, the effect of perfection
10 or nonperfection, and the priority of a security interest in the chattel paper, even if a transaction
11 does not bear any relation to the electronic chattel paper's jurisdiction.

12 **(b) [Electronic chattel paper's jurisdiction.]** The following rules determine the
13 electronic chattel paper's jurisdiction under this section:

14 (1) If the authoritative electronic copy of the record evidencing chattel paper, or a
15 record attached to or logically associated with the electronic copy and readily available for
16 review, expressly provides that a particular jurisdiction is the electronic chattel paper's
17 jurisdiction for purposes of this part, this article, or [the Uniform Commercial Code], that
18 jurisdiction is the electronic chattel paper's jurisdiction.

19 (2) If paragraph (1) does not apply and the rules of the system in which the
20 authoritative electronic copy is recorded are readily available for review and expressly provide
21 that a particular jurisdiction is the electronic chattel paper's jurisdiction for purposes of this part,
22 this article, or [the Uniform Commercial Code], that jurisdiction is the electronic chattel paper's
23 jurisdiction.

24 (3) If paragraphs (1) and (2) do not apply and the authoritative electronic copy, or

1 a record attached to or logically associated with the electronic copy and readily available for
2 review, expressly provides that the chattel paper is governed by the law of a particular
3 jurisdiction, that jurisdiction is the electronic chattel paper's jurisdiction.

4 (4) If paragraphs (1) through (3) do not apply and the rules of the system in which
5 the authoritative electronic copy is recorded are readily available for review and expressly
6 provide that the chattel paper or the system is governed by the law of a particular jurisdiction,
7 that jurisdiction is the electronic chattel paper's jurisdiction.

8 (5) If paragraphs (1) through (4) do not apply, the electronic chattel paper's
9 jurisdiction is the jurisdiction in which the debtor is located.

10 **(c) [Chattel paper evidenced by authoritative tangible copy.]** If an authoritative
11 tangible copy of a record evidences chattel paper and the chattel paper is not evidenced by an
12 authoritative electronic copy, while the authoritative tangible copy of the record evidencing
13 chattel paper is located in a jurisdiction, the local law of that jurisdiction governs:

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

16 (2) the effect of perfection or nonperfection and the priority of a security interest
17 in the chattel paper.

18 **(d) [When perfection governed by law of jurisdiction where debtor is located.]** The
19 local law of the jurisdiction in which the debtor is located governs perfection of a security
20 interest in chattel paper by filing.

21 **Reporter's Note**

22 1. *Source of these provisions.* Section 9-306A(a) and (b) derive from Sections 8-110(e)
23 and 9-305 on law governing perfection and priority of security interests in investment property
24 (as do Section 9-306B and 12-107).
25

1 2. *Applicability of this Section.* This section determines the law governing perfection and
2 priority of security interests in chattel paper. Subsections (a) and (b) apply to chattel paper that is
3 evidenced by an authoritative electronic copy of the chattel paper, whether or not it also is
4 evidenced by an authoritative tangible copy. Subsection (c) applies to chattel paper that is
5 evidenced by an authoritative tangible copy but not evidenced by an authoritative electronic
6 copy. Subsection (e) applies to perfection by filing for all chattel paper.
7

8 3. *Authoritative electronic copy: electronic chattel paper's jurisdiction.* Subsection (a)
9 specifies the law governing perfection and priority of security interests in chattel paper
10 evidenced by an authoritative electronic copy of the chattel paper, even if it is also evidenced by
11 an authoritative tangible copy. Subject to subsection (d) on perfection by filing, the law
12 governing perfection and priority is the local law of the electronic chattel paper's jurisdiction.
13 Drawing on Sections 8-110 and 9-305, it is the authoritative electronic copy itself, records
14 attached thereto or associated therewith, or the system in which the authoritative electronic copy
15 is recorded that determines the electronic chattel paper's jurisdiction and, therefore, the
16 governing law. Subsection (b) provides a "waterfall" of rules based on provisions that identify a
17 particular jurisdiction as the electronic chattel paper's jurisdiction or alternatively that provide
18 the governing law of the chattel paper or of the system in which the electronic copy is recorded.
19 When no such identification or provision is made, it is the debtor's location that is the electronic
20 chattel paper's jurisdiction. As to the final clause of subsection (a), see Section 8-110, Comment
21 5A.
22

23 4. *Rationale for subsection (a).* A major buyer of, or secured lender against, chattel paper
24 may arrange for authoritative electronic copies of chattel paper that it wishes to have assigned to
25 it to be submitted into a system for the control and assignment of the chattel paper. The secured
26 parties and lessors that will be assigning the chattel paper may be located in many different
27 jurisdictions. As to assignments of the chattel paper by these secured parties and lessors, but for
28 this section perfection and priority would be governed by the law of each assignor-debtor's
29 location under Section 9-301(1). Under this section, however, the law of a single jurisdiction—
30 the electronic chattel paper's jurisdiction—could govern perfection and priority with respect to
31 all of the assignments. By avoiding the application of the laws of multiple jurisdictions to
32 perfection and priority, this rule could substantially reduce transaction costs.
33

34 5. *Authoritative tangible copy.* Subsection (c) ties the choice-of-law rules to the location
35 of the authoritative tangible copy when no authoritative electronic copy exists. In that
36 circumstance, the local law of the jurisdiction where the authoritative tangible copy is physically
37 located governs perfection of a security interest in the chattel paper by possession under Section
38 9-314A and priority. Like existing law, subsection (c) assumes that all the authoritative tangible
39 copies are located in the same jurisdiction. However, assuming the secured party is in possession
40 of all the tangible copies, even if the copies are located in more than one jurisdiction the situation
41 is unlikely to be problematic.
42

43 6. *Perfection by filing.* Subsection (d) provides that the local law of the jurisdiction where
44 the debtor is located governs perfection by filing for all chattel paper.
45

46 **Section 9-306B. Law Governing Perfection and Priority of Security Interests in**

1 **Controllable Accounts, Controllable Electronic Records, and Controllable Payment**
2 **Intangibles.**

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

8 (b) **[When perfection governed by law of jurisdiction where debtor is located.]** The
9 local law of the jurisdiction in which the debtor is located governs:

10 (1) perfection of a security interest in a controllable account, controllable
11 electronic record, or controllable payment intangible by filing; and

12 (2) automatic perfection of a security interest in a controllable payment intangible
13 created by a sale of the controllable payment intangible.

14 **Reporter's Note**

15
16 1. *Perfection by control and priority.* Subsection (a) deals with perfection of a security
17 interest in a controllable account, controllable electronic record, or controllable payment
18 intangible other than by filing—i.e., perfection by control under Section 12-105—and priority.
19 For these purposes the governing law is that of the controllable electronic record's jurisdiction
20 under Section 12-107(c) and (d).

21
22 2. *Perfection by filing.* Under subsection (b) the local law of the jurisdiction of the
23 debtor's location governs perfection of a security interest in a controllable account, controllable
24 electronic record, or controllable payment intangible by filing (but not priority, as to which
25 subsection (a) would apply).

26 * * *

27
28 **Section 9-310. When Filing Required to Perfect Security Interest or Agricultural**
29 **Lien; Security Interests and Agricultural Liens to Which Filing Provisions Do Not**
30 **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, investment property, or letter-of-credit rights which is perfected by control under Section 9-314;

(9) in chattel paper which is perfected by possession and control under Section 9-314A;

~~(9)~~(10) in proceeds which is perfected under Section 9-315; or

~~(10)~~(11) that is perfected under Section 9-316.

* * *

Reporter's Note

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

* * *

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

(a) **[Perfection by filing permitted.]** A security interest in chattel paper, controllable accounts, controllable electronic records, controllable payment intangibles, negotiable

1 ~~documents~~, instruments, ~~or~~ investment property, or negotiable documents may be perfected by
2 filing.

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

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

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

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

11 (4) a security interest in electronic money may be perfected only by control under
12 Section 9-314.

13 (c) **[Goods covered by negotiable document.]** While goods are in the possession of a
14 bailee that has issued a negotiable document covering the goods:

15 (1) a security interest in the goods may be perfected by perfecting a security
16 interest in the document; and

17 (2) a security interest perfected in the document has priority over any security
18 interest that becomes perfected in the goods by another method during that time.

19 (d) **[Goods covered by nonnegotiable document.]** While goods are in the possession of
20 a bailee that has issued a nonnegotiable document covering the goods, a security interest in the
21 goods may be perfected by:

22 (1) issuance of a document in the name of the secured party;

23 (2) the bailee's receipt of notification of the secured party's interest; or

1 (3) filing as to the goods.

2 (e) [Temporary perfection: new value.] A security interest in certificated securities,
3 negotiable documents, or instruments is perfected without filing or the taking of possession or
4 control for a period of 20 days from the time it attaches to the extent that it arises for new value
5 given under ~~an authenticated~~ a signed security agreement.

6 * * *

7 **Official Comment**

8 * * *

9 **7. Goods Covered by Document of Title.** Subsection (c) applies to goods in the
10 possession of a bailee who has issued a negotiable document covering the goods. Subsection (d)
11 applies to goods in the possession of a bailee who has issued a nonnegotiable document of title,
12 including a document of title that is “non-negotiable” under Section 7-104. Section 9-313
13 governs perfection of a security interest in goods in the possession of a bailee who has not issued
14 a document of title.

15
16 Subsection (c) clarifies the perfection and priority rules in former Section 9-304(2).
17 Consistently with the provisions of Article 7, subsection (c) takes the position that, as long as a
18 negotiable document covering goods is outstanding, title to the goods is, so to say, locked up in
19 the document. Accordingly, a security interest in goods covered by a negotiable document may
20 be perfected by perfecting a security interest in the document. The security interest also may be
21 perfected by another method, e.g., by filing. The priority rule in subsection (c) governs only
22 priority between (i) a security interest in goods which is perfected by perfecting in the document
23 and (ii) a security interest in the goods which becomes perfected by another method while the
24 goods are covered by the document.

25
26 **Example 1:** While wheat is in a grain elevator and covered by a negotiable warehouse
27 receipt, Debtor creates a security interest in the wheat in favor of SP-1 and SP-2. SP-1
28 perfects by filing a financing statement covering “wheat.” Thereafter, SP-2 perfects by
29 filing a financing statement describing the warehouse receipt. Subsection (c)(1) provides
30 that SP-2’s security interest is perfected. Subsection (c)(2) provides that SP-2’s security
31 interest is senior to SP-1’s.

32
33 **Example 2:** The facts are as in Example 1, but SP-1’s security interest attached and was
34 perfected before the goods were delivered to the grain elevator. Subsection (c)(2) does not
35 apply, because SP-1’s security interest did not become perfected during the time that the
36 wheat was in the possession of a bailee. Rather, the first-to-file-or-perfect priority rule
37 applies. See Sections 9-322 and 7-503.
38

1 A secured party may become “a holder to whom a negotiable document of title has been duly
2 negotiated” under Section 7-501. If so, the secured party acquires the rights specified by Article
3 7. Article 9 does not limit those rights, which may include the right to priority over an earlier-
4 perfected security interest. See Section 9-331(a).

5
6 Subsection (d) takes a different approach to the problem of goods covered by a
7 nonnegotiable document. Here, title to the goods is not looked on as being locked up in the
8 document. For example, a transferee that takes delivery of a nonnegotiable document receives,
9 under Section 7-504(a), “the title and rights” of the transferor, but the transferee would not
10 thereby become a “person entitled under the document” with a right to receive delivery of the
11 goods from the bailee. ~~and the~~ The secured party may perfect its security interest directly in the
12 goods by filing as to them. The subsection provides two other methods of perfection: issuance of
13 the document in the secured party’s name (as consignee of a straight bill of lading or the person
14 to whom delivery would be made under a non-negotiable warehouse receipt) and receipt of
15 notification of the secured party’s interest by the bailee. Issuance (or reissuance) of the
16 nonnegotiable document in the secured party’s name would allow the secured party to become a
17 “person entitled under the document.” However, the bailee’s receipt of notification would not
18 confer on the secured party the status of a person entitled unless the notification resulted from an
19 instruction under the document. See Section 7-102(a)(9) (defining “person entitled under the
20 document”) and Comment 6. Perfection under subsection (d) occurs when the bailee receives
21 notification of the secured party’s interest in the goods, regardless of who sends the notification.
22 Receipt of notification is effective to perfect, regardless of whether the bailee responds. Unlike
23 former Section 9-304(3), from which it derives, subsection (d) does not apply to goods in the
24 possession of a bailee who has not issued a document of title. Section 9-313(c) covers that case
25 and provides that perfection by possession as to goods not covered by a document requires the
26 bailee’s acknowledgment.

27
28 Subsection (a) makes clear that a security interest in negotiable documents (and other
29 collateral mentioned there) may be perfected by filing, but it makes no mention of nonnegotiable
30 documents. However, under the general rule of Section 9-310, a security interest in a
31 nonnegotiable document can be perfected by filing. A security interest in an electronic
32 document, negotiable or nonnegotiable, can be perfected by control under Section 7-106. Section
33 9-314(a). But a security interest in a nonnegotiable tangible document cannot be perfected by
34 possession. Section 9-313(a). Although a perfected security interest in a nonnegotiable document
35 might provide useful benefits for the secured party, it would not perfect a security interest in the
36 goods. And by perfecting a security interest in the nonnegotiable document the secured party
37 would not thereby become a “person entitled under the document.” Indeed, unless
38 the secured party also took delivery of the document (i.e., possession or control under Section 1-
39 201(b)(15)), it would not obtain the rights of a transferee under Section 7-504(a).

40
41 * * *

42 43 Reporter’s Note

44 1. *Perfection for controllable accounts, controllable electronic records, controllable*
45 *payment intangibles, tangible money, and electronic money.* Perfection for controllable accounts,

1 controllable electronic records, and controllable payment intangibles may be by filing, for
2 tangible money may be only by possession, and for electronic money may be only by control.

3
4 2. “*Signed.*” Consistent with the new definition of “sign” in Section 1-201, the cognate
5 term “signed” replaces the reference to “authenticated” in this section.

6
7 **Section 9-313. When Possession by or Delivery to Secured Party Perfects**

8 **Security Interest Without Filing.**

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

14 * * *

15 (c) **[Collateral in possession of person other than debtor.]** With respect to collateral
16 other than certificated securities and goods covered by a document, a secured party takes
17 possession of collateral in the possession of a person other than the debtor, the secured party, or a
18 lessee of the collateral from the debtor in the ordinary course of the debtor’s business, when:

19 (1) the person in possession ~~authenticates~~ signs a record acknowledging that it
20 holds possession of the collateral for the secured party’s benefit; or

21 (2) the person takes possession of the collateral after having ~~authenticated~~ signed
22 a record acknowledging that it will hold possession of the collateral for the secured party’s
23 benefit.

24 * * *

25 **Reporter’s Note**

26 *Perfection by possession.* Perfection by possession of tangible chattel paper has been
27 deleted from this section. Instead, perfection by possession and control would be governed by

1 Section 9-314A.

2
3 **Section 9-314. Perfection by Control.**

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

9 (b) **[Specified collateral: time of perfection by control; continuation of perfection.]** A
10 security interest in ~~deposit accounts, electronic chattel paper, letter-of-credit rights, or electronic~~
11 ~~documents,~~ controllable accounts, controllable electronic records, controllable payment
12 intangibles, deposit accounts, electronic documents, electronic money, or letter-of-credit rights is
13 perfected by control under Section 7-106, 9-104, ~~9-105,~~ 9-105A, ~~or 9-107,~~ or 9-107A when the
14 secured party obtains control and remains perfected by control only while the secured party
15 retains control.

16 * * *

17 **Reporter's Note**

18
19 1. *Perfection by control.* Perfection by control of controllable accounts, controllable
20 electronic records, controllable payment intangibles, and electronic money has been added to this
21 section. Perfection by control of electronic chattel paper has been deleted from this section.
22 Instead, Section 9-314A would govern perfection for chattel paper by possession and control.

23
24 2. *Shared control between debtor and secured party.* Sections 7-106 (control of electronic
25 documents), 9-105 (control of authoritative electronic records evidencing chattel paper), 9-105A
26 (control of electronic money), and 12-105 (control of controllable electronic records, on which
27 control of controllable accounts and controllable payment intangibles under Section 9-107A
28 depends) contemplate the possibility that both a debtor and a secured party may have control of
29 the relevant collateral. Such shared control between a debtor and secured party does not
30 *necessarily* impair perfection of a security interest under this section or Section 9-314A. On
31 shared control, see generally Section 12-105, Comment 5. However, if a secured party can
32 exercise a power only if the power is exercised also by the debtor, control would not be shared

1 and, consequently, the secured party would not have control (and its security interest would not
2 be perfected by control). This result follows from Section 12-105(c) and corresponding
3 subsections in the other provisions on control cited above.

4
5 Under Section 12-105(c), because a debtor would be a “transferor of an interest” in a
6 controllable electronic record or a controllable account or payment intangible evidenced by the
7 record, the debtor’s “blocking power” with respect to the secured party’s exercise of the power
8 would disqualify the secured party from sharing (and, consequently, enjoying) control and
9 perfection by control. Similarly, a purchaser would be disqualified from having control and
10 thereby from enjoying the status and benefits of a qualifying purchaser under Sections 12-
11 102(a)(2) and 12-104(e) if the purchaser takes from a transferor of an interest having such a
12 blocking power (whether or not the transferor is a debtor). See Section 12-105, Comment 5
13 (discussing the rationale for this limitation on shared control).

14
15 **Section 9-314A. Perfection by Possession and Control of Chattel Paper.**

16 **(a) [Perfection by possession and control.]** A secured party may perfect a security
17 interest in chattel paper by taking possession of each authoritative tangible copy of the record
18 evidencing the chattel paper and obtaining control of each authoritative electronic copy of the
19 electronic record evidencing the chattel paper.

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

23 **(c) [Application of Section 9-313 to perfection by possession of chattel Paper.]**
24 Section 9-313(c) and (f) through (i) applies to perfection by possession of an authoritative
25 tangible copy of a record evidencing chattel paper.

26 **Reporter’s Note**
27

28 1. “*Authoritative copy.*” This section provides that to perfect a security interest in chattel
29 paper other than by filing, a secured party must obtain control of all authoritative electronic
30 copies and take possession of all authoritative tangible copies.

31
32 Existing Section 9-105(b) distinguishes between authoritative and nonauthoritative copies
33 of electronic chattel paper. Like current law, the draft refers to copies that are “authoritative.”
34 And, like current law, the draft does not define the term. However, the draft would apply this
35 concept also to tangible records that evidence chattel paper.

1 To show that it has possession of all tangible authoritative copies of a record evidencing
2 chattel paper, a purchaser can produce the copies in its possession and provide evidence that
3 these are authoritative copies. The purchaser need not prove that no other tangible authoritative
4 copies exist. The purchaser's possession of the tangible authoritative copies gives the purchaser
5 the power to prevent others from taking possession of the copies and to transfer possession of the
6 copies.

7
8 Perfection of a security interest in chattel paper by taking possession of the collateral
9 generally has been understood to mean taking possession of the wet-ink "original." Experience
10 has shown that the concept of an original breaks down when one allows for the possibility of the
11 same monetary obligation being evidenced in different media over time, such as where electronic
12 records evidencing the chattel paper are "papered out" (replaced with tangible records
13 evidencing the same chattel paper) or tangible records are "converted" to electronic records.

14
15 To accommodate current practices and future technology, the draft would allow the
16 parties considerable flexibility in determining the method used to establish whether a particular
17 copy is authoritative, provided that third parties are able to reasonably identify the authoritative
18 copies that must be possessed or controlled to achieve perfection. For example, the parties could
19 develop a system or protocol where each copy is watermarked as authoritative or
20 nonauthoritative or where the terms of the records themselves describe how to determine which
21 copies are authoritative and which are not.

22
23 *2. Time of perfection.* Subsection (b) is modeled on Sections 9-313(d) and 9-314(b).

24
25 *3. Applicability of Section 9-313.* Subsection (c) makes specified subsections of Section
26 9-313 applicable to possession of tangible authoritative copies of records evidencing chattel
27 paper.

28
29 *4. Shared control.* As to the sharing of control of an authoritative electronic copy of a
30 record evidencing chattel paper (see Section 9-105(c)(2)) by a debtor and a secured party, see
31 Section 9-314, Reporter's Note 2.

32
33 * * *

34 **Section 9-316. Continued Perfection of Security Interest Following Change in** 35 **Governing Law.**

36 (a) **[General rule: effect on perfection of change in governing law.]** A security interest
37 perfected pursuant to the law of the jurisdiction designated in Section 9-301(1), ~~or 9-305(c), 9-~~
38 306A(d), or 9-306B(b) remains perfected until the earliest of:

39 (1) the time perfection would have ceased under the law of that jurisdiction;

1 (2) the expiration of four months after a change of the debtor's location to another
2 jurisdiction; or

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

5 * * *

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

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

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

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

collateral for value.

* * *

Reporter's Note

1. *Change in location of debtor.* Subsection (a) has been amended to refer to additional provisions providing for perfection by filing to be governed by the law of the jurisdiction in which the debtor is located, *See* Sections 9-306A and 9-306B.

2. *Changes in controllable electronic record's jurisdiction and electronic chattel paper's jurisdiction.* Changes in the controllable electronic record's jurisdiction and the electronic chattel paper's jurisdiction have been added to subsection (f) to conform to the treatment for other collateral subject to similar rules on governing law. *See* Sections 9-306B and 12-107.

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

Interest or Agricultural Lien.

* * *

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

* * *

(d) **[Licensees and buyers of certain collateral.]** ~~A~~ Subject to subsections (f) through (i), a licensee of a general intangible or a buyer, other than a secured party, of collateral other than ~~tangible chattel paper, electronic money, tangible documents, goods, instruments, or a certificated security~~ takes free of a security interest if the licensee or buyer gives value without knowledge of the security interest and before it is perfected.

* * *

(f) [Buyers of chattel paper.] A buyer, other than a secured party, of chattel paper takes

1 free of a security interest if, without knowledge of the security interest and before it is perfected,
2 the buyer gives value and:

3 (1) receives delivery of each authoritative tangible copy of the record evidencing
4 the chattel paper; and

5 (2) if each authoritative electronic copy of the record evidencing the chattel paper
6 can be subjected to control under Section 9-105, obtains control of each authoritative electronic
7 copy.

8 (g) [Buyers of electronic documents.] A buyer of an electronic document takes free of a
9 security interest if, without knowledge of the security interest and before it is perfected, the
10 buyer gives value and, if each authoritative electronic copy of the document can be subjected to
11 control under Section 7-106, obtains control of each authoritative electronic copy.

12 (h) [Buyers of controllable electronic records.] A buyer of a controllable electronic
13 record takes free of a security interest if, without knowledge of the security interest and before it
14 is perfected, the buyer gives value and obtains control of the controllable electronic record.

15 (i) [Buyers of controllable accounts and controllable payment intangibles.] A buyer,
16 other than a secured party, of a controllable account or a controllable payment intangible takes
17 free of a security interest if, without knowledge of the security interest and before it is perfected,
18 the buyer gives value and obtains control of the controllable account or controllable payment
19 intangible.

20 **Reporter's Note**

21
22 1. *New rule for buyers of chattel paper.* The new take-free rule in subsection (f) for
23 buyers of chattel paper reflects the corresponding changes in the definition of chattel paper and
24 methods of perfection. *See* Sections 9-102(a)(11) (defining “chattel paper”); 9-314A (perfection
25 by possession and control). Note that subsection (f) applies only to a buyer of chattel paper
26 “other than a Secured party,” and most buyers of chattel paper are secured parties. *See* Sections
27 9-109(a)(3) (Article 9 applies to a sale of chattel paper); 1-201(b)(35) (defining “security

1 interest” to include the interest of a buyer of chattel paper). However, Article 9 does not apply to
2 “a sale of . . . chattel paper , . . as part of a sale of the business out of which , . . [the chattel
3 paper] arose” and subsection (f) would apply to a buyer of chattel paper in a such a sale of
4 business transaction.

5
6 Given the addition of new subsection (f) and the removal of chattel paper from subsection
7 (a), the phrase “other than a secured party” has been deleted from subsection (a). Buyers of the
8 remaining types of collateral covered by subsection (a) are not secured parties.

9
10 2. *Control of electronic records evidencing chattel paper.* Some systems for electronic
11 copies of records evidencing chattel paper do not provide for an assignee to obtain control of
12 electronic copies under Section 9-105. For this reason, subsection (f) provides that a buyer must
13 obtain control of authoritative electronic copies of records evidencing chattel paper as a
14 condition for taking free only if the electronic copies can be subjected to control.

15
16 3. *Control of electronic documents.* As mentioned in Note 2 for chattel paper, a system
17 for electronic documents also may not provide for a transferee to obtain control of authoritative
18 electronic copies of an electronic document. Subsection (g) provides that a buyer must obtain
19 control of authoritative electronic copies of the document as a condition for taking free only if
20 the electronic copies can be subjected to control.

21
22 4. *Control of controllable electronic records, controllable accounts, and controllable*
23 *payment intangibles.* Consistent with the treatment of electronic copies of records evidencing
24 chattel paper and electronic documents in subsections (f) and (g), subsection (h) conditions the
25 take-free rule for a buyer of a controllable electronic record on the buyer’s obtaining control of
26 the electronic record. Similarly, under subsection (i), the take-free rule for a buyer, other than a
27 secured party, of a controllable account or controllable payment intangible is conditioned on the
28 buyer’s obtaining control of the account or payment intangible.

29
30 * * *

31 **Section 9-326A. Priority of Security Interest in Controllable Account,**
32 **Controllable Electronic Record, and Controllable Payment Intangible.** A security
33 interest in a controllable account, controllable electronic record, or controllable payment
34 intangible held by a secured party having control of the account, electronic record, or payment
35 intangible has priority over a conflicting security interest held by a secured party that does not
36 have control.

37 **Comment**
38

39 1. *Control priority.* This section adopts an approach to priority in controllable accounts,

1 controllable electronic records, and controllable payment intangibles that is similar to the
2 approach of Sections 9-327 (deposit accounts) and 9-328 (investment property): A security
3 interest perfected by control has priority over conflicting security interests that are not perfected
4 by control.

5
6 *2. Multiple persons having control.* This section does not apply if more than one secured
7 party has control of a controllable account, controllable electronic record, or controllable
8 payment intangible, which may occur through shared control or a person in control
9 acknowledging that it has control on behalf of another person. See, e.g., Section 12-105(c)(2)
10 (shared control), (d) (control through another person). In those situations, the residual first-to-
11 file-or-perfect rule of Section 9-322(a)(1) would apply. However, application of that first-in-
12 time rule may not be appropriate in some circumstances. For example, a person (A) having
13 control might acknowledge that it has control on behalf of another person (B), which did not
14 have control. If B had filed a financing statement covering the collateral before A obtained
15 control, however, the result would be to give B's security interest priority over A's previously
16 senior security interest. To avoid that result, A might insist on B's subordination as a condition
17 to A's acknowledgment. See Section 9-339 (subordination by agreement). In cases of multiple
18 persons having control it will be important for interested persons to adjust priorities by
19 agreement, when appropriate. See also Section 12-105, Comment 5.

20
21 * * *

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

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

26 (1) in good faith and in the ordinary course of the purchaser's business, the
27 purchaser gives new value and takes possession of each authoritative tangible copy of the record
28 evidencing the chattel paper ~~or~~ and obtains control of under Section 9-105 of each authoritative
29 electronic copy of the record evidencing the chattel paper ~~under Section 9-105~~; and

30 (2) ~~the chattel paper does~~ authoritative copies of the record evidencing the chattel
31 paper do not indicate that it the chattel paper has been assigned to an identified assignee other
32 than the purchaser.

33 (b) **[Purchaser's priority: other security interests.]** A purchaser of chattel paper has

1 priority over a security interest in the chattel paper which is claimed other than merely as
2 proceeds of inventory subject to a security interest if the purchaser gives new value and takes
3 possession of each authoritative tangible copy of the record evidencing the chattel paper or and
4 obtains control ~~of~~ under Section 9-105 of each authoritative electronic copy of the record
5 evidencing the chattel paper ~~under Section 9-105~~ in good faith, in the ordinary course of the
6 purchaser's business, and without knowledge that the purchase violates the rights of the secured
7 party.

8 * * *

9 (f) [**Indication of assignment gives knowledge.**] For purposes of subsections (b) and
10 (d), if the authoritative copies of the record evidencing chattel paper or an instrument ~~indicates~~
11 indicate that ~~it~~ the chattel paper or instrument has been assigned to an identified secured party
12 other than the purchaser, a purchaser of the chattel paper or instrument has knowledge that the
13 purchase violates the rights of the secured party.

14 **Reporter's Note**

15 1. *New rule for buyers of chattel paper.* The revisions to the rules for purchasers of
16 chattel paper reflect the corresponding changes in the definition of chattel paper and methods of
17 perfection. *See* Sections 9-102(a)(11) (defining "chattel paper"); 9-314A (perfection by
18 possession and control).

19
20 2. *Indication of earlier assignment to identified assignee.* Subsections (a) and (f) each
21 refer to the possibility that records evidencing chattel paper may indicate that the chattel paper
22 has been assigned to an identified assignee. Those subsections should be read and interpreted in
23 a manner consistent with Section 9-105 on control of authoritative electronic copies of records
24 evidencing chattel paper. Accordingly, references in subsections (a) and (f) to an indication in a
25 record evidencing chattel paper also embrace, for authoritative electronic copies of such records,
26 records attached to or logically associated with the authoritative electronic copies and systems in
27 which the authoritative electronic copies are recorded. *See* Section 9-105(c) and (d)(1).

28
29 **Section 9-331. Priority of Rights of Purchasers of Controllable Accounts,**
30 **Controllable Electronic Records, Controllable Payment Intangibles, Instruments,**

1 **Documents, Instruments, and Securities Under Other Articles; Priority of Interests in**
2 **Financial Assets and Security Entitlements and Protections Against Assertions of**
3 **Claims Under ~~Article 8~~ Articles 8 and 12.**

4 (a) **[Rights under Articles 3, 7, ~~and 8~~, and 12 not limited.]** This article does not limit
5 the rights of a holder in due course of a negotiable instrument, a holder to which a negotiable
6 document of title has been duly negotiated, ~~or a protected purchaser of a security,~~ or a qualifying
7 purchaser of a controllable account, controllable electronic record, or controllable payment
8 intangible. These holders or purchasers take priority over an earlier security interest, even if
9 perfected, to the extent provided in Articles 3, 7, ~~and 8~~, and 12.

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

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

15 **Official Comment**

16 * * *

17
18 3. * * *

19
20 The state-law Uniform Electronic Transactions Act (UETA) and the federal Electronic
21 Signature in Global and National Commerce Act, 15 U.S.C. §§ 7001 *et seq.* (E-SIGN), provide
22 certain rules for records referred to and defined as “transferable records.” See UETA § 16 and E-
23 SIGN 15 U.S.C. § 7021. When certain conditions have been met, those acts confer on a person
24 the status of a “holder” (as defined in former Section 1-201(20), current Section 1-201(b)(21)) of
25 an “equivalent record” under former Section 9-308 (now, in part, Section 9-330) and the rights
26 and defenses of a “purchaser” under that section, among other effects. E-SIGN also refers to the
27 rights and defenses of a purchaser under current Section 9-330. As a matter of the application of
28 the Uniform Commercial Code, those are not the only sections of the Uniform Commercial Code
29 that would logically be affected by UETA and E-SIGN. For example, the rights of a holder in
30 due course under Section 9-331(a) would also be covered by the application of those acts, when
31 the conditions for applicability have been satisfied.

(formerly subsection (b)) make a corresponding change for a transfer of funds from a deposit account. To qualify for the take-free protection under subsection (c), the transferee must “receive[] the funds without acting in collusion [etc.] . . .” The draft amendments to Section 9-332(a) and (c) are intended to clarify what is implicit under the original text. Although “funds” is not defined in the UCC, if deposit accounts with a central bank or another bank were to become money, as defined in Section 1-201(b)(24), transfers from such deposit accounts would be covered by subsection (c) and not subsection (b). *See* Section 9-102(a)(54A) (defining “money” for purposes of Article 9 to exclude deposit accounts).

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

4. *Transfer of interest in deposit account*. With respect to subsection (c), because a deposit account is a monetary obligation (debt) of the depositary bank to its depositor, a transfer of the deposit account itself does not transfer the funds credited to the deposit account. *See* Section 9-332, Comment 2 (5th paragraph) (distinguishing “*transfers of funds from a deposit account*” from “*transfers of the deposit account itself or an interest therein*.” (Emphasis in original.) The depositor’s creditors (whether secured parties or lien creditors) do not have any interest in the deposited funds (or any other assets of the depositary bank) as a result of having an interest in the deposit account (the right to payment of the bank’s obligation). This is so, for example, whether a security interest in a deposit account arises as original collateral or as proceeds. It follows that a transferee of an interest in the deposit account, such as a garnishing lien creditor, does not take free of a security interest in a deposit account under subsection (c). A transferee takes free under subsection (c) only upon the actual receipt of funds from the deposit account. The proper construction of current subsection (b) and draft subsection (c) rejects cases that treat garnishment of a deposit account as an immediate transfer of an interest in funds credited to the deposit account.

The last event that provides a recovery for a creditor in a garnishment action virtually always would be a transfer of funds from a deposit account. However, this does not mean that a perfected security interest will always be cut off by a garnishing creditor. By intervening in the garnishment proceeding to assert its senior security interest before funds are disbursed, the secured party might assert and retain its priority. However, the relevant procedural law may not provide the secured party with adequate advance notice. In some cases, a control agreement that perfects a security interest in the deposit account may require the garnished bank to provide prompt notice to the secured party. But not all control agreements will so provide. Moreover, the secured party’s priority is not absolute. *See, e.g.*, Section 9-401, Comment 6 (explaining that the

1 equitable doctrine of marshaling may be appropriate in the case of a lien creditor's interest in
2 collateral when a senior secured party is oversecured).

3
4 *5. Temporal aspect of collusion test.* In order for a transferee to take free of a security
5 interest under this section the transferee must receive delivery of tangible money, obtain control
6 of electronic money, or receive funds from a deposit account without acting in collusion.
7 Whether the transferee is acting without collusion is determined as of the time of delivery to the
8 transferee or obtaining control or receipt of funds by the transferee.

9
10 * * *

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

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

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

- 23 (1) if it does not reasonably identify the rights assigned;
- 24 (2) to the extent that an agreement between an account debtor and a seller of a
25 payment intangible limits the account debtor's duty to pay a person other than the seller and the
26 limitation is effective under law other than this article; or
- 27 (3) at the option of an account debtor, if the notification notifies the account
28 debtor to make less than the full amount of any installment or other periodic payment to the

1 assignee, even if:

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

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

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

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

12 * * *

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

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

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

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

22 [List here any statutes, rules, and regulations containing provisions
23 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

Controllable accounts and controllable payment intangibles. For controllable accounts and controllable payment intangibles, subsections (a) through (c) and (g) are replaced by analogous provisions in Section 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) [When no duty owed by secured party.]** 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

1 (C) how to communicate with the person; or

2 (2) to a secured party or lienholder that has filed a financing statement against a

3 person, unless the secured party knows:

4 (A) that the person is a debtor; and

5 (B) the identity of the person.

6 **(b) [When secured party owes duty to debtor.] A secured party owes a duty based on**
7 **its status as a secured party to a person that is a debtor if, at the time the secured party obtains**
8 **control of collateral that is a controllable account, controllable electronic record, or controllable**
9 **payment intangible, the secured party knows that the information specified in subsection**
10 **(a)(1)(A), (B), or (C) is not provided by the collateral, a record attached to or logically associated**
11 **with the collateral, or the system in which the collateral is recorded.**

12 **Reporter's Note to Sections 9-605 and 9-628**

13
14 *Liability to unknown persons.* Practices are developing under which lenders extend
15 secured credit without knowing, or having the ability to discover, the identity of their borrowers.
16 Existing Sections 9-605 and 9-628 would excuse these secured parties from having duties to their
17 debtors, including, *e.g.*, the duty to notify the debtor before disposing of the collateral and the
18 duty to account to the debtor for any surplus arising from a disposition. In many cases these
19 debtors may be aware that their identities are unknown to their secured parties. By failing to
20 make their identities and contact information known, these debtors may be knowingly impairing
21 the ability of their secured parties to comply with their duties under Article 9. However, such
22 debtor complicity notwithstanding, if secured parties were relieved of their duties in these
23 circumstances, arguably it would conflict with the policy of Section 9-602, which prohibits a
24 waiver or variance of many rights of debtors and duties of secured parties.

25
26 Comment 2 to Section 9-628 observes, “[w]ithout this group of provisions [in Sections 9-
27 605 and 9-628], a secured party could incur liability to unknown persons and under
28 circumstances that would not allow the secured party to protect itself.” That comment also notes
29 that “[t]he broadened definition of the term ‘debtor’ underscores the need for these provisions.”
30 For example, a debtor may dispose of collateral subject to a security interest, resulting in the
31 transferee becoming a debtor, but the secured party may have no knowledge of the disposition or
32 that the transferee has become a debtor. In that situation the secured party will have no means of
33 giving notice to or accounting to the transferee debtor. Sections 9-605 and 9-628 contemplate
34 such situations by relieving the secured party of its duties to the debtor.
35

1 The draft amendments to Sections 9-605 and 9-628 reflect the policy that a secured party
2 should not be free to avoid statutory duties or absolve itself from liability to a debtor when the
3 secured party knows that the collateral, records attached to or logically associated with the
4 collateral, and the system in which the collateral is recorded do not provide the secured party
5 with the information necessary to fulfill its statutory duties. As discussed in the following
6 paragraph, the secured party's knowledge that it may not be able to comply with its duties
7 enables the secured party to protect itself from being in breach of these duties. (A person has
8 knowledge of or knows a fact if it has "actual knowledge." Section 1-202(b).) The exceptions
9 from the exculpatory protections otherwise afforded to secured parties are determined by the
10 secured party's knowledge at the time the secured party obtains control of a controllable account,
11 controllable electronic record, or controllable payment intangible.

12
13 Obtaining control serves as a rough proxy for the context in which a secured party may
14 know that it may be unable to comply with its duties, usually because the transferor is
15 pseudonymous. The carve-out from the exculpatory protection is limited to duties owed to a
16 debtor—the transferor of a controllable account, controllable electronic record, or controllable
17 payment intangible over which the secured party obtains control. The secured party in such
18 situations could protect itself by choosing not to enter into a transaction in which it might be
19 unable to comply with its statutory duties or by conditioning its participation on disclosure of the
20 debtor's identity and contact information. Ideally, systems providing for the transfer of
21 controllable electronic records would provide mechanisms that would permit compliance with
22 such duties (such as methods of communication and making payments that would preserve a
23 debtor's pseudonymity, where that is desired). The amendments to Sections 9-605 and 9-608
24 provide incentives for system design that would allow for compliance with Article 9 duties.

25
26 Secured parties that enter into transactions with knowledge that they may not be able to
27 comply with their Article 9 duties do so at their own peril. Of course, if a secured party possesses
28 or is able to obtain the information necessary to comply with its duties, there is no need for the
29 exculpation from those duties. Note, however, that the limitation on a secured party's relief from
30 duties and liability relates only to secured transactions involving controllable accounts,
31 controllable electronic records, or controllable payment intangibles. Designing systems for these
32 assets that would afford secured parties with opportunities to comply with their Article 9 duties,
33 as suggested above, could eliminate the risks to secured parties and also provide for the
34 protection of debtors' rights.

35
36 * * *

37 **Section 9-610. Disposition of Collateral After Default.**

38 (a) **[Disposition after default.]** After default, a secured party may sell, lease, license, or
39 otherwise dispose of any or all of the collateral in its present condition or following any
40 commercially reasonable preparation or processing.

41 (b) **[Commercially reasonable disposition.]** Every aspect of a disposition of collateral,

including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms.

(c) **[Purchase by secured party.]** A secured party may purchase collateral:

(1) at a public disposition; or

(2) at a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

* * *

Official Comment

* * *

9. **“Recognized Market.”** A “recognized market,” as used in subsection (c)(2), ~~and~~ Section 9-611(d), ~~and~~ Section 9-627(b)(1) and (2), is one in which the items sold are fungible and ~~prices are not subject to individual negotiation. For example, the New York Stock Exchange is a recognized market. A market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or are disposed of through dealer auctions, which generally produces market prices~~ that are not lower than those that would be expected to result from, as applicable, (i) commercially reasonable dispositions to persons other than the secured party, (ii) commercially reasonable dispositions made with otherwise required notifications to the debtor or other affected persons, or (iii) dispositions otherwise made in a commercially reasonable manner. (As used here, “fungible” items are those that are considered interchangeable in the relevant market and not only items that are strictly “identical” to the other items.) The intended goals of the recognized market exceptions are to ensure that neither the debtor nor other affected parties would be disadvantaged by the special treatment given to recognized markets and to facilitate the efficiencies and cost savings that the special treatment may provide. The purpose of including in subsection (c)(2) collateral that is “the subject of widely distributed standard price quotations” and the criteria for determining whether price quotations meet this standard in subsection (c)(2) are the same as for a recognized market, although the availability of such standard price quotations may be based on, but distributed independently of, a “market” in which acquisitions and dispositions are made. Although a recognized market need not be subject to direct or indirect (e.g., self-regulatory) regulation or supervision, the existence of regulatory requirements or guidelines that are designed to arrive at prices consistent with those contemplated by subsection (c)(2) may provide useful guidance for applying the regulated market standard.

1 Traditionally, it has been understood that a market in which prices are individually
2 negotiated is not a recognized market, even if the items are the subject of widely disseminated
3 price guides (such as the Kelly Blue Book for automobiles) or are disposed of through
4 specialized auctions (such as those conducted for dealers in livestock and automobiles).
5 However, this does not suggest that such dispositions of livestock or automobiles, for example,
6 could not be commercially reasonable.

7
8 The New York Stock Exchange, NASDAQ, the Chicago Mercantile Exchange, and ICE
9 Futures U.S., Inc. are examples of recognized markets. Such exchanges match buy and sell
10 orders submitted by or on behalf of buyers and sellers that are not typically known to each other
11 and do not involve individual negotiations. Other parties, such as inter-dealer brokers in the on-
12 the-run U.S. Treasury market and broker-dealers in the equities market, often operate similar
13 trading facilities that would likewise not involve known buyers or sellers or individual
14 negotiations and may constitute recognized markets. These markets provide for robust trading
15 with active bidding on fungible assets. There is no reason to believe that prices obtained on these
16 markets would be less favorable to debtors, other obligors, and other interested persons than if
17 collateral were disposed of in an off-market public or private disposition.

18
19 Trading environments generally referred to as “over-the-counter” or “OTC” markets,
20 however, typically have involved prospective buyers and sellers that can know each other and
21 have direct communication in order to make trades. Unlike typical exchanges, OTC markets
22 normally do involve the individual negotiation of a price. See Carl S. Bjerre, *Investment*
23 *Securities*, 71 Bus. Law. 1311, 1316-17 (2016) (contrasting exchanges and typical OTC markets
24 for equity securities and explaining that OTC markets have tended to feature thinner markets
25 with less liquidity and more variability of pricing).

26
27 In considering the recognized market exceptions, it is important to appreciate that
28 recognized markets and other systems that produce equivalent “widely distributed standard price
29 quotations” are not limited to traditional exchanges, such as those mentioned above. In
30 particular, the exchange-OTC dichotomy no longer offers such a reliable, bright-line test for
31 determining status as a recognized market or as a source of widely distributed standard price
32 quotations. To be sure, some OTC markets do not qualify for the exceptions. However, recent
33 years have witnessed a variety of new trading platforms, the use of new technologies, and new
34 sources of providing and consuming information. In particular, there now exist markets, in
35 particular for debt securities (including United States Treasury securities), that might be
36 classified as OTC markets under the traditional taxonomy, but which qualify for the exceptions
37 as recognized markets or as sources of data for widely distributed standard price quotations.
38 Market participants rely on prices provided by these markets to the same extent and for the same
39 purposes (including in connection with default and enforcement of security interests) as they rely
40 on prices generated by traditional securities and commodities exchanges. These prices are widely
41 available from business publications and online sources as well as from private subscription-
42 based service providers. It can safely be assumed that these financial markets and the data that
43 they provide to the public will continue to evolve. The touchstone for determining whether a
44 market structure is a recognized market or one that produces equivalent price quotations is a
45 functional one. It is not based on the “type” of market (e.g., “exchange,” “OTC,” or other
46 classification). It is based on whether the market or distribution provides reliable and trusted data

1 on prices consistent with purposes of subsection (c)(2) and the corresponding provisions of
2 Sections 9-611 and 9-627.

3
4 **Reporter's Note**

5 1. *Contexts of “recognized market” exceptions.* With the exception of Section 9-
6 627(b)(1), the special treatment afforded by the relevant sections involving a “recognized
7 market” rely on prices determined in such a market but do not involve dispositions actually made
8 on a recognized market. The official comment therefore does not limit its discussion to such
9 dispositions and uses neutral references to “exceptions” and “special treatment” that the relevant
10 sections provide.

11
12 2. *No change.* No change is proposed to Section 9-610, which is provided for
13 convenience.

14
15 **Section 9-611. Notification Before Disposition of Collateral.**

16 (a) [**“Notification date.”**] In this section, “notification date” means the earlier of the date
17 on which:

18 (1) a secured party sends to the debtor and any secondary obligor ~~an authenticated~~
19 a signed notification of disposition; or

20 (2) the debtor and any secondary obligor waive the right to notification.

21 (b) [**Notification of disposition required.**] Except as otherwise provided in subsection
22 (d), a secured party that disposes of collateral under Section 9-610 shall send to the persons
23 specified in subsection (c) a reasonable authenticated notification of disposition.

24 (c) [**Persons to be notified.**] To comply with subsection (b), the secured party shall send
25 ~~an authenticated~~ a signed notification of disposition to:

26 (1) the debtor;

27 (2) any secondary obligor; and

28 (3) if the collateral is other than consumer goods:

29 (A) any other person from which the secured party has received, before
30 the notification date, ~~an authenticated~~ a signed notification of a claim of an interest in the

1 collateral;

2 (B) any other secured party or lienholder that, 10 days before the
3 notification date, held a security interest in or other lien on the collateral perfected by the filing
4 of a financing statement that:

5 (i) identified the collateral;
6 (ii) was indexed under the debtor's name as of that date; and
7 (iii) was filed in the office in which to file a financing statement
8 against the debtor covering the collateral as of that date; and

9 (C) any other secured party that, 10 days before the notification date, held
10 a security interest in the collateral perfected by compliance with a statute, regulation, or treaty
11 described in Section 9-311(a).

12 (d) **[Subsection (b) inapplicable: perishable collateral; recognized market.]**

13 Subsection (b) does not apply if the collateral is perishable or threatens to decline speedily in
14 value or is of a type customarily sold on a recognized market.

15 (e) **[Compliance with subsection (c)(3)(B).]** A secured party complies with the
16 requirement for notification prescribed by subsection (c)(3)(B) if:

17 (1) not later than 20 days or earlier than 30 days before the notification date, the
18 secured party requests, in a commercially reasonable manner, information concerning financing
19 statements indexed under the debtor's name in the office indicated in subsection (c)(3)(B); and

20 (2) before the notification date, the secured party:

21 (A) did not receive a response to the request for information; or

22 (B) received a response to the request for information and sent ~~an~~
23 ~~authenticated~~ a signed notification of disposition to each secured party or other lienholder named

1 in that response whose financing statement covered the collateral.

2 **Official Comment**

3 * * *

4 **7. Recognized Market; Perishable Collateral.** New subsection (d) makes it
5 clear that there is no obligation to give notification of a disposition in the case of perishable
6 collateral or collateral customarily sold on a recognized market (e.g., marketable securities).
7 ~~Former Section 9-504(3) might be read (incorrectly) to relieve the secured party from its duty to~~
8 ~~notify a debtor but not from its duty to notify other secured parties in connection with~~
9 ~~dispositions of such collateral. As to what constitutes a recognized market, see Section 9-610,~~
10 Comment 9.

11 * * *

13 **Reporter's Note**

14 “*Signed.*” Consistent with the new definition of “signed” in Section 1-201, that term
15 replaces references to “authenticated.”

16 * * *

19 **Section 9-613. Contents and Form of Notification Before Disposition of** 20 **Collateral: General.**

21 Except in a consumer-goods transaction, the following rules apply:

22 (1) The contents of a notification of disposition are sufficient if the notification:

23 (A) describes the debtor and the secured party;

24 (B) describes the collateral that is the subject of the intended disposition;

25 (C) states the method of intended disposition;

26 (D) states that the debtor is entitled to an accounting of the unpaid
27 indebtedness and states the charge, if any, for an accounting; and

28 (E) states the time and place of a public disposition or the time after which
29 any other disposition is to be made.

30 (2) Whether the contents of a notification that lacks any of the information

specified in paragraph (1) are nevertheless sufficient is a question of fact.

(3) The contents of a notification providing substantially the information specified in paragraph (1) are sufficient, even if the notification includes:

(A) information not specified by that paragraph; or

(B) minor errors that are not seriously misleading.

(4) A particular phrasing of the notification is not required.

(5) The following form of notification and the form appearing in Section 9-614(3), when completed, each provides sufficient information:

~~NOTIFICATION OF DISPOSITION OF COLLATERAL~~

To: ~~[Name of debtor, obligor, or other person to which the notification is sent]~~

From: ~~[Name, address, and telephone number of secured party]~~

Name of Debtor(s): ~~[Include only if debtor(s) are not an addressee]~~
~~[For a public disposition:]~~

We will sell [or lease or license, as applicable] the ~~[describe collateral]~~ [to the highest qualified bidder] in public as follows:

Day and Date:

Time:

Place:

~~[For a private disposition:]~~

We will sell [or lease or license, as applicable] the ~~[describe collateral]~~ privately sometime after ~~[day and date]~~.

You are entitled to an accounting of the unpaid indebtedness secured by the property that we intend to sell [or lease or license, *as applicable*] [for a charge of \$ _____]. You may request an accounting by calling us at [telephone number]

~~[End of Form]~~

NOTIFICATION OF DISPOSITION OF COLLATERAL

To: (Name of debtor, obligor, or other person to which the notification is sent)

From: (Name, address, and telephone number of secured party)

Name of Debtor(s): (Include only if debtor(s) are not an addressee)

We will sell (or lease or license, as applicable) the (describe collateral) (include, if applicable: to the highest qualified bidder) in public as follows:

Day and Date: (day and date)

Time: _____ (time)

Place: _____ (place)³

We will sell (or lease or license, as applicable) the (describe collateral) privately
sometime after (day and date) .⁴

You are entitled to an accounting of the unpaid indebtedness secured by the property that we intend to sell (or lease or license, as applicable) (include, if applicable: for a charge of \$ (specify amount)). You may request an accounting by calling us at (telephone number).

[End of Form]

³ The sender must include this paragraph for a public disposition of the collateral.

⁴ The sender must include this paragraph for a private disposition of the collateral.

1 **Section 9-614. Contents and Form of Notification Before Disposition of**
2 **Collateral: Consumer-Goods Transaction.**

3
4 In a consumer-goods transaction, the following rules apply:

5 (1) A notification of disposition must provide the following information:

6 (A) the information specified in Section 9-613(1);

7 (B) a description of any liability for a deficiency of the person to which
8 the notification is sent;

9 (C) a telephone number from which the amount that must be paid to the
10 secured party to redeem the collateral under Section 9-623 is available; and

11 (D) a telephone number or mailing address from which additional
12 information concerning the disposition and the obligation secured is available.

13 (2) A particular phrasing of the notification is not required.

14 (3) The following form of notification, when completed, provides sufficient
15 information:

16 ~~==[Name and address of secured party]==~~

17 ~~==[Date]==~~

18 **NOTICE OF OUR PLAN TO SELL PROPERTY**

19 ~~==[Name and address of any obligor who is also a debtor]==~~

20 Subject: ~~==[Identification of Transaction]==~~

21
22 We have your ~~==[describe collateral]==~~, because you broke promises in our agreement.

23
24 ~~[For a public disposition:]~~

1 We will sell [describe collateral] at public sale. A sale could include a lease or license.

2 The sale will be held as follows:

3 Date: _____

4 Time: _____

5 Place: _____

6 You may attend the sale and bring bidders if you want.

7
8 *[For a private disposition:]*

9 We will sell [describe collateral] at private sale sometime after [date]. A sale could
10 include a lease or license.

11
12 The money that we get from the sale (after paying our costs) will reduce the amount you owe. If
13 we get less money than you owe, you [will or will not, as applicable] still owe us the
14 difference. If we get more money than you owe, you will get the extra money, unless we must
15 pay it to someone else.

16 You can get the property back at any time before we sell it by paying us the full amount you owe
17 (not just the past due payments), including our expenses. To learn the exact amount you must
18 pay, call us at [telephone number].

19
20 If you want us to explain to you in writing how we have figured the amount that you owe us, you
21 may call us at [telephone number] [or write us at [secured party's address]] and
22 request a written explanation. [We will charge you \$ _____ for the explanation if we sent you
23 another written explanation of the amount you owe us within the last six months.]

If you need more information about the sale call us at [telephone number] [or write us at [secured party's address]].

We are sending this notice to the following other people who have an interest in [describe collateral] or who owe money under your agreement:

[Names of all other debtors and obligors, if any]

{End of Form}

NOTICE OF OUR PLAN TO SELL PROPERTY

(Name and address of any obligor who is also a debtor)

Subject: (Identification of Transaction)

We have your (describe collateral) , because you broke promises in our agreement.

We will sell (describe collateral) at public sale. A sale could include a lease or license. The sale will be held as follows:

Date: (date)

Time: (time)

Place: (place)

You may attend the sale and bring bidders if you want.⁵

We will sell (describe collateral) at private sale sometime after (date). A sale could include a

⁵ The sender must include this paragraph for a public disposition of the collateral.

1 lease or license.⁶

2 The money that we get from the sale (after paying our costs) will reduce the amount you owe. If
3 we get less money than you owe, you (will or will not, as applicable) still owe us the difference.
4 If we get more money than you owe, you will get the extra money, unless we must pay it to
5 someone else.

6
7 You can get the property back at any time before we sell it by paying us the full amount you owe
8 (not just the past due payments), including our expenses. To learn the exact amount you must
9 pay, call us at (telephone number).

10
11 If you want us to explain to you⁷ (in writing) (in writing or in an electronic document) (in an
12 electronic document) how we have figured the amount that you owe us, you may call us
13 at (telephone number) (or⁸ (write us at (secured party's address)) (description of electronic
14 communication method)) and request⁹ (a written explanation) (or) (a written explanation or an
15 explanation in an electronic document) (or) (an explanation in an electronic document). (We
16 will charge you \$ (specify amount) for the explanation if we sent you another written
17 explanation of the amount you owe us within the last six months.¹⁰)

⁶ The sender must include this paragraph for a private disposition of the collateral.

⁷ The sender of the form must insert *any one* of the three alternative modes for the explanation (writing, writing and electronic document, or electronic document)

⁸ The sender of the form may include *either, both, or neither* of the two alternative methods (writing or electronic communication) in addition to telephone for the recipient of the Notice to communicate with the sender.

⁹ The sender of the form must refer to the mode or modes for the explanation inserted pursuant to the first set of alternatives for this form mentioned above

¹⁰ If a written explanation is one of the alternative methods inserted pursuant to the first set of alternatives mentioned above, the sender may include this sentence and specify the amount of the charge.

1
2 If you need more information about the sale call us at (telephone number) (or¹¹ (write us at
3 (secured party's address)) (description of electronic communication method)).

4
5 We are sending this notice to the following other people who have an interest in (describe
6 collateral) or who owe money under your agreement:
7 (Names of all other debtors and obligors, if any)

8 **[End of Form]**

9 * * *

10 **Reporter's Note**

11 In furtherance of medium neutrality, references to "electronic document" and "electronic
12 communication method" have been added to the form.

13
14 * * *

15 **Section 9-616. Explanation of Calculation of Surplus or Deficiency.**

16 (a) **[Definitions.]** In this section:

17 (1) "Explanation" means a ~~writing~~ record that:

18 (A) states the amount of the surplus or deficiency;

19 (B) provides an explanation in accordance with subsection (c) of how the
20 secured party calculated the surplus or deficiency;

21 (C) states, if applicable, that future debits, credits, charges, including
22 additional credit service charges or interest, rebates, and expenses may affect the amount of the

¹¹ The sender of the form may include *either, both, or neither* of the two alternative methods (writing or electronic communication) in addition to telephone for the recipient of the Notice to communicate with the sender.

1 surplus or deficiency; and

2 (D) provides a telephone number or mailing address from which additional
3 information concerning the transaction is available.

4 (2) "Request" means a record:

5 (A) ~~authenticated~~ signed by a debtor or consumer obligor;

6 (B) requesting that the recipient provide an explanation; and

7 (C) sent after disposition of the collateral under Section 9-610.

8 (b) **[Explanation of calculation.]** In a consumer-goods transaction in which the debtor is
9 entitled to a surplus or a consumer obligor is liable for a deficiency under Section 9-615, the
10 secured party shall:

11 (1) send an explanation to the debtor or consumer obligor, as applicable, after the
12 disposition and:

13 (A) before or when the secured party accounts to the debtor and pays any
14 surplus or first makes ~~written~~ demand in a record on the consumer obligor after the disposition
15 for payment of the deficiency; and

16 (B) within 14 days after receipt of a request; or

17 (2) in the case of a consumer obligor who is liable for a deficiency, within 14 days
18 after receipt of a request, send to the consumer obligor a record waiving the secured party's right
19 to a deficiency.

20 (c) **[Required information.]** To comply with subsection (a)(1)(B), ~~a writing~~ an
21 explanation must provide the following information in the following order:

22 (1) the aggregate amount of obligations secured by the security interest under
23 which the disposition was made, and, if the amount reflects a rebate of unearned interest or credit

1 service charge, an indication of that fact, calculated as of a specified date:

2 (A) if the secured party takes or receives possession of the collateral after
3 default, not more than 35 days before the secured party takes or receives possession; or

4 (B) if the secured party takes or receives possession of the collateral
5 before default or does not take possession of the collateral, not more than 35 days before the
6 disposition;

7 (2) the amount of proceeds of the disposition;

8 (3) the aggregate amount of the obligations after deducting the amount of
9 proceeds;

10 (4) the amount, in the aggregate or by type, and types of expenses, including
11 expenses of retaking, holding, preparing for disposition, processing, and disposing of the
12 collateral, and attorney's fees secured by the collateral which are known to the secured party and
13 relate to the current disposition;

14 (5) the amount, in the aggregate or by type, and types of credits, including rebates
15 of interest or credit service charges, to which the obligor is known to be entitled and which are
16 not reflected in the amount in paragraph (1); and

17 (6) the amount of the surplus or deficiency.

18 * * *

19 **Reporter's Note**

20 In furtherance of medium neutrality, references to "writing" and "written" have been
21 changed to refer to a "record."

22 * * *

24 **Section 9-627. Determination of Whether Conduct Was Commercially**
25 **Reasonable.**

* * *

(b) **[Dispositions that are commercially reasonable.]** A disposition of collateral is made

in a commercially reasonable manner if the disposition is made:

(1) in the usual manner on any recognized market;

(2) at the price current in any recognized market at the time of the disposition; or

(3) otherwise in conformity with reasonable commercial practices among dealers

in the type of property that was the subject of the disposition.

* * *

Official Comment

* * *

4. **“Recognized Market.”** As in Sections 9-610(c) and 9-611(d), the concept of a “recognized market” in subsections (b)(1) and (2) is quite limited; it applies only to markets in which there are standardized price quotations for property that is essentially fungible, such as (but not limited to) stock securities and commodities exchanges. See Section 9-610, Comment 9 (discussing standards for a “recognized market”).

* * *

Reporter's Note

No change. No change is proposed to Section 9-627, which is provided for convenience.

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~~

Subject to subsection (f), 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

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

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

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

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

7 (B) the identity of the person; and

8 (C) how to communicate with the person; or

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

11 (A) that the person is a debtor; and

12 (B) the identity of the person.

13 * * *

14 **(f) [When secured party owes duty to debtor notwithstanding subsection (b).]** A
15 secured party owes a duty based on its status as a secured party to a person that is a debtor if, at
16 the time the secured party obtains control of collateral that is a controllable account, controllable
17 electronic record, or controllable payment intangible, the secured party knows that the
18 information specified in subsection (b)(1)(A), (B), or (C) is not provided by the collateral, a
19 record attached to or logically associated with the collateral, or the system in which the collateral
20 is recorded.

21 **Reporter's Note**

22 See the Reporter's Note to Section 9-605.

23 * * *

ARTICLE 12

CONTROLLABLE ELECTRONIC RECORDS

Prefatory Note to Article 12

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

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

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

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

As explained in more detail below, Article 12 is designed to reduce these risks by providing the legal rules governing the transfer—both outright and for security—of interests in some, but not all, electronic records (*controllable electronic records*). These rules specify the rights in a controllable electronic record that a purchaser would acquire. Many systems for transferring controllable electronic records are pseudonymous, so that the transferee of a controllable electronic record may be unable to verify the identity of the transferor or the source of the transferor’s title. Accordingly, the Article 12 rules would make controllable electronic records negotiable, in the sense that a qualifying good faith purchaser for value would take a controllable electronic record free of third-party claims of a property interest in the controllable electronic record.

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

- The electronic record must have some “use” or benefit that one person can enjoy

1 and can exclude all others from enjoying, *e.g.*, the power to “spend” a bitcoin (or,
2 more precisely, the power to include an unspent transaction output (a UTXO) in a
3 message that the Bitcoin protocol will record to its blockchain).
4

- 5 • A person must be able to transfer to another person this exclusive power to use
6 and the exclusive power to transfer the electronic record. To remain exclusive, the
7 transfer must divest the transferor of the power to use the electronic record.
8
- 9 • A person must be able to demonstrate to others that the person has the power to
10 use and transfer control of the electronic record.
11

12 As discussed in the Comments to Section 12-105, these functions form the basis of the
13 Article 12 concept of *control*. To receive the benefits of negotiability and take free of third-party
14 claims of a property interest in a controllable electronic record, a person must have control of the
15 controllable electronic record. In addition, control serves as a method of perfection of a security
16 interest in a controllable electronic record and as a condition for achieving a non-temporal
17 priority of a security interest. In this context, it may be useful to think of control as the functional
18 analogue of possession of tangible personal property such as goods. Note that the concept of
19 control allows for certain exceptions to the exclusivity of powers.
20

21 Article 12 governs certain rights (primarily property rights) of transacting parties and
22 other persons that might be affected by the transactions. With the important exception of certain
23 rights to payment evidenced by a controllable electronic record (discussed below), Article 12
24 does not govern assets other than controllable electronic records and, in coordination with Article
25 9, controllable accounts and controllable payment intangibles. Like the UCC in general, Article
26 12 is not a regulatory statute. The fact that an asset is or is not a controllable electronic record
27 under the UCC would not necessarily affect the application of laws regulating, for example,
28 securities, commodities, money transmission, and taxation.
29

30 2. *What is the scope of Article 12?* 31

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

42 To determine whether Article 12 applies to a particular asset, *e.g.*, bitcoin, one must
43 determine whether the asset falls within the definition of *controllable electronic record*. A
44 controllable electronic record is a *record*, as the UCC defines the term. A *record* is information

1 that is retrievable in perceivable form.¹² A *controllable electronic record* is a record that is
2 stored in an electronic medium¹³ and that can be subjected to *control*, as defined in Section 12-
3 105. An electronic record that cannot be subjected to control under Section 12-105 is outside the
4 scope of Article 12.¹⁴ As already mentioned, Article 12 addresses primarily certain property
5 rights in controllable electronic records.

6
7 The meaning of *control* in the UCC depends on the type of property involved.¹⁵ The
8 Comments to Section 12-105 explain the requirements for obtaining control of a controllable
9 electronic record. For present purposes, it is sufficient to think of bitcoin as the prototypical
10 controllable electronic record.

11
12 The existing law that governs control for some types of electronic records (including
13 provisions on control for some types that are proposed to be modified in this draft) is sufficient.
14 These electronic records are excluded from Article 12.¹⁶

15 16 3. *What are the substantive provisions of Article 12?*

17
18 The principal function of Article 12 is to specify the rights of a *purchaser* of a
19 controllable electronic record. A purchaser is a person that acquires an interest in property by a
20 voluntary transaction, such as a sale.¹⁷ Purchasers include both buyers and secured parties. Law
21 other than Article 12 would determine whether a person acquires any rights in a controllable
22 electronic record and so would be eligible to be a purchaser.

23
24 Section 12-104 adopts the “shelter” principle, under which a purchaser of a controllable
25 electronic record acquires whatever rights the transferor had or had power to transfer. This rule
26 appears in Article 2 with respect to goods and Article 8 with respect to securities.¹⁸

27
¹² See Section 1-201(b)(31).

¹³ See Section 12-102(a)(2) (defining “electronic record”).

¹⁴ That an electronic record is not subject to control does not imply that it does not have commercial utility. Businesses generate and sell or license large quantities of electronic records that do not require the attributes of negotiability that Article 12 affords to controllable electronic records.

¹⁵ E.g., Sections 7-106 (electronic documents of title); 8-106 (four different types of investment property, each with a different definition of “control”); 9-104 (deposit accounts); 9-105 (electronic chattel paper). See also Section 9-105A (control of electronic money).

¹⁶ See Section 12-102(a)(1) (defining “controllable electronic record”).

¹⁷ “‘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.” Section 1-201(b)(29).

¹⁸ Section 2-403(1) provides, “A purchaser of goods acquires all title which his transferor had or had power to transfer” Section 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., Section 3-203(b) (concerning negotiable instruments); Section 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
5 transfer.¹⁹ Article 12 refers to these purchasers as *qualifying purchasers*. Qualifying purchasers
6 are 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*.

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

30
31 Now assume that *O* is the owner of the bitcoin and that *S* is a hacker, who acquired
32 control of the bitcoin illegally from *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 *O*.
- 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

¹⁹ Article 8 also provides for certain purchasers for value to take greater rights but does not contain a good-faith requirement. See Section 8-303.

²⁰ Law other than Article 12 includes UCC Article 9. Although in general law other than Article 12 determines whether a person has rights in collateral, Article 9 would determine the steps necessary for a security interest to attach to a controllable electronic record. More generally, Article 9 governs any conflict between Article 9 and Article 12. Section 12-102(b).

- Even if *B* would not have acquired any rights in the bitcoin under non-Article 12 law (for example, because *S*, a “thief, had no rights to give), as an Article 12 qualifying purchaser, *B* would acquire the bitcoin free of all claims of a property interest in the bitcoin. *S*’s control of the bitcoin gave *S* the power to transfer rights to a qualifying purchaser, such as *B*. In the unlikely event that *O* could locate *B*, *B* would defeat *O*’s claim of ownership and own the bitcoin free and clear. (The same result would obtain if *B* bought a negotiable instrument from a thief under circumstances where *B* became a holder in due course.)

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

a. The general rules.

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

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

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

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

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

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

But the controllable electronic record itself may or may not be a valuable asset. In this

1 example, unlike bitcoin, the record would have value to *P* only if by virtue of acquiring rights in
2 the controllable electronic record, *P* would also acquire the right to receive delivery of the goods
3 from *S*.

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

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

19
20 b. *The exceptions: controllable accounts and controllable payment intangibles.*

21
22 As a general rule, Article 12 applies to records and not to rights evidenced by records (or
23 to rights that records purport to evidence). And, in general, law other than Article 12 would
24 govern what steps must be taken for a person to acquire an interest in a controllable electronic
25 record and the rights, if any, that the person acquires in other property as a result of acquiring an
26 interest in the record. This "other" law includes UCC Article 9.

27
28 The draft provides an important exception to this general rule. The exception concerns
29 rights to payment (specifically, accounts and payment intangibles) that are evidenced by a
30 controllable electronic record that provides that the obligor (account debtor) undertakes to pay
31 the person that has control of the controllable electronic record. These rights to payment are
32 referred to as "controllable accounts" and "controllable payment intangibles."²¹ A qualifying
33 purchaser of a controllable account or controllable payment intangible takes free of property
34 claims.

35
36 The draft amends several sections of Article 9 to deal with various aspects of security
37 interests in controllable accounts and controllable payment intangibles. The Prefatory Note to
38 Article 9 Amendments and the Reporter's Notes to those sections discuss those amendments.

²¹ See Section 9-102(a) (defining "controllable account" and "controllable payment intangible"). Both controllable accounts and controllable payment intangibles are "monetary obligations," *i.e.*, obligations to pay "money." Because cryptocurrencies such as bitcoin are not "money" as defined in Section 1-201 (unless they were not in existence and used before adoption by a government), obligations to pay in cryptocurrency would not be included in controllable accounts and controllable payment intangibles.

1 Finally, Section 12-107 provides rules on governing law. The general rule under
2 subsection (a) is that the local law of a “controllable record’s jurisdiction” governs matters
3 covered by Article 12. The controllable record’s jurisdiction is determined by an express
4 provision in the record or in the system in which the record is recorded. If not so designated, it is
5 determined based on the designation of the law governing the record or the system generally.
6 Absent such designations, at the bottom of this “waterfall” of alternatives, the governing law will
7 be that of the District of Columbia. Subsection (b) provides an exception for the rights and duties
8 of account debtors under Section 12-106 if an agreement between the account debtor and an
9 assignor of the record provides for the law of another jurisdiction to govern those rights and
10 duties.

11 **Section 12-101. Title.**

13 This article may be cited as Uniform Commercial Code—Controllable Electronic
14 Records.

15 **Official Comment**

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

18 **Section 12-102. Definitions.**

19 **(a) [Article 12 definitions.]**

21 In this article:

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

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

(3) “Transferable record” has the meaning provided for that term in either:

(A) the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7021(a)(1) [as amended]; or

(B) [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”, “controllable account”, “controllable payment intangible”, “chattel paper”, “deposit account”, “electronic money”, and “investment property” apply to this article.

(c) [Article 1 definitions and principles.] Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.

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

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

Official Comment

1. **Source.** Subsection (a)(1), defining “qualifying purchaser,” derives from Section 3-302(a)(2), which defines “holder in due course” of a negotiable instrument.

2. **“Controllable electronic record.”** To be a “controllable electronic record” within the scope of Article 12, an electronic record must be susceptible of control under Section 12-105. Unlike “transferable records” under the Electronic Signatures in Global and National Commerce Act or a “transferable record” under the Uniform Electronic Transactions Act, a record can be a controllable electronic record under Article 12 in the absence of an agreement to that effect.

The provisions of Article 12 do not apply to certain types of electronic records, and the definition has been limited accordingly. For example, under the applicable law and terms of issuance, a platform for the transfer of control of electronic records may constitute the books and records of an issuer for the registration of transfer of uncertificated securities. Even if such an electronic record would otherwise fall within the definition of a controllable electronic record, as

1 an uncertificated security (“investment property,” as defined in Section 9-102), it would be
2 excluded from that definition. Moreover, Article 12 does not limit the extent to which property,
3 including a controllable electronic record, may be a financial asset under Article 8, including as a
4 result of an express agreement between a securities intermediary and another person to treat such
5 property held by the securities intermediary as a “financial asset” credited to a securities account
6 pursuant to Section 8-102(a)(9)(iii).

7
8 This definition uses the term “record,” defined in Section 1-201 to include
9 “information . . . that is stored in an electronic or other medium and is retrievable in perceivable
10 form,” and the term “electronic,” also defined in Section 1-201.

11
12 3. **“Qualifying purchaser.”** The conditions for becoming a qualifying purchaser
13 were drawn from Article 3. More specifically, the conditions for becoming a qualifying
14 purchaser were drawn from Section 3-302(a)(2), which defines “holder in due course” of a
15 negotiable instrument. Among these conditions is that a person take the instrument “for value.”
16 As Comment 10 to Section 12-104 explains, the concept of value in Article 3 differs from the
17 concept of value that is generally applicable in the UCC. Article 12 adopts the Article 3 concept.

18
19 Under Section 12-104(a), not only a purchaser of a controllable electronic record but also
20 a purchaser of a controllable account or controllable payment intangible may be a qualifying
21 purchaser. Moreover, a purchaser of a controllable account or a controllable payment intangible
22 may be a qualified purchaser even if the purchaser does not also purchase the controllable
23 electronic record that evidences the account or payment intangible. For example, a secured party
24 having a security interest in all of a debtor’s accounts and payment intangibles would be a
25 purchaser of those rights to payment, which would include the debtor’s controllable accounts and
26 payment intangibles. If the secured party were to obtain control of the debtor’s controllable
27 account or payment intangible, it would become a qualifying purchaser if it also met the other
28 conditions for that status. However, to obtain control of the controllable account or controllable
29 payment intangible, a requirement for qualifying purchaser status, the purchaser must obtain
30 control of that controllable electronic record. Section 9-107A.

31
32 4. **“Transferable record.”** This definition facilitates the exclusion of transferable
33 records from the definition of controllable electronic record.

34
35 5. **“Value.”** The concept of value in Section 3-303 is narrower than the generally
36 applicable concept in Section 1-201. Comment 9 to Section 12-104 explains the difference
37 between the two concepts and that the Article 12 adopts the Article 3 approach.

38 39 **Section 12-103. Relation to Article 9 and Consumer Laws.**

40 (a) **[Article 9 governs in case of conflict.]** If there is conflict between this article and
41 Article 9, Article 9 governs.

42 (b) **[Applicable consumer law and other laws.]** A transaction subject to this article is

1 subject to any applicable rule of law that establishes a different rule for consumers and [insert
2 reference to (i) any other statute or regulation that regulates the rates, charges, agreements, and
3 practices for loans, credit sales, or other extensions of credit and (ii) any consumer-protection
4 statute or regulation].

5 **Official Comment**

6 **Source.** Subsection (a) follows Section 3-102(b). As is the case with respect to Article 3,
7 Article 9 would defer to Article 12 in some instances. *See, e.g.,* Section 9-331. Subsection (b) is
8 copied from Section 9-102.
9

10 **Section 12-104. Rights in Controllable Account, Controllable Electronic Record,** 11 **and Controllable Payment Intangible.**

12 (a) **[Applicability of section to controllable account and controllable payment**
13 **intangible.]** This section applies to the acquisition and purchase of rights in a controllable
14 account or controllable payment intangible, including the rights and benefits under subsections
15 (c), (d), (e), (g), and (h) of a purchaser and qualifying purchaser, in the same manner this section
16 applies to a controllable electronic record.

17 (b) **[Control of controllable account and controllable payment intangible.]** For the
18 purpose of determining whether a purchaser of a controllable account or a controllable payment
19 intangible is a qualifying purchaser, the purchaser obtains control of the account or payment
20 intangible if it obtains control of the controllable electronic record that evidences the account or
21 payment intangible.

22 (c) **[Applicability of other law to acquisition of rights.]** Except as provided in this
23 section, law other than this article determines whether a person acquires a right in a controllable
24 electronic record and the right the person acquires.

25 (d) **[Shelter principle and purchase of limited interest.]** A purchaser of a controllable

1 electronic record acquires all rights in the controllable electronic record that the transferor had or
2 had power to transfer, except that a purchaser of a limited interest in a controllable electronic
3 record acquires rights only to the extent of the interest purchased.

4 (e) **[Rights of qualifying purchaser.]** A qualifying purchaser acquires [its] rights in the
5 controllable electronic record free of a claim of a property right in the controllable electronic
6 record.

7 (f) **[Limitation of rights of qualifying purchaser in other property.]** Except as
8 provided in subsections (a) and (e) for controllable accounts and controllable payment
9 intangibles or law other than this article, a qualifying purchaser takes a right to payment, right to
10 performance, or other interest in property evidenced by the controllable electronic record subject
11 to a claim of a property right in the right to payment, right to performance, or other interest in
12 property.

13 (g) **[No-action protection for qualifying purchaser.]** An action may not be asserted
14 against a qualifying purchaser based on both a purchase by the qualifying purchaser of a
15 controllable electronic record and a claim of a property right in another controllable electronic
16 record, whether [the action is] framed in conversion, replevin, constructive trust, equitable lien,
17 or other theory.

18 (h) **[Filing not notice.]** Filing of a financing statement under Article 9 is not notice of a
19 claim of a property right in a controllable electronic record.

20 **Official Comment**

21
22 1. **Source.** Subsection (d) derives from Section 2-403(1) (concerning the rights of a
23 purchaser).

24
25 Subsection (e) derives from Sections 3-306 (concerning the rights of a holder in due
26 course of an instrument) and 8-303 (concerning rights of a protected purchaser of a security).
27

1 Subsection (g) derives from Section 8-502 (protecting entitlement holders).

2
3 Subsection (h) derives from Section 9-331(c) (filing under Article 9 does not provide
4 notice for purposes of protections of purchasers under other articles).

5
6 **2. Applicability of section to controllable accounts and controllable payment**
7 **intangibles.** Under subsection (a), the provisions of this section apply to controllable accounts
8 and controllable payment intangibles in the same manner that they apply to controllable
9 electronic records. For example, a qualifying purchaser of a controllable account that obtains
10 control of the controllable electronic record that evidences the account (and who thereby obtains
11 control of the account under Section 9-107A) would take the account free of conflicting rights in
12 the account under subsection (e). Under subsection (b), for purposes of determining whether a
13 purchaser of a controllable account or controllable payment intangible obtains control, the
14 purchaser obtains control by obtaining control of the controllable electronic record that evidences
15 the account or payment intangible. Unless otherwise specified or the context otherwise requires,
16 references to a controllable electronic record in the official comments in this article also refer to
17 a controllable account or controllable payment intangible.

18
19 **3. Applicability of other law.** As a general matter, this section leaves to other law
20 the resolution of questions concerning the transfer of rights in a controllable electronic record,
21 such as the acts that must be taken to effectuate a transfer of rights and the scope of the rights
22 that a transferee acquires. *See* subsection (c). Subsections (d) through (h) contain important
23 exceptions to this subsection.

24
25 **Example:** *A* creates a controllable electronic record. Although the system in which the
26 electronic record is recorded may determine how the electronic record can be used and
27 control may be transferred, other law would determine what rights *A* has in the
28 controllable electronic record. If, for example, *A* created the electronic record in the
29 scope of its employment, *A*'s rights would be subject to the terms of *A*'s employment
30 contract.

31
32 *A* and *B* agree to the sale of the controllable electronic record to *B*. Other law would
33 determine what steps need to be taken for *B* to acquire rights in the controllable electronic
34 record. Once *B* acquires those rights under other law, *B* would be a purchaser (as defined
35 in Section 1-201), whose rights also would be determined by subsection (d) (i.e., the
36 shelter principle, discussed below in Comment 4. However, even if *B* did not acquire
37 rights under other law, if *B* met the requirements for a qualifying purchaser, its rights
38 would be determined by subsections (e) and (g). *See* Comments 7 and 8, below.

39
40 The "law other than this article" that may apply to the transfer of rights in a controllable
41 electronic record under subsection (c) includes UCC Article 9. Section 9-203 would apply, for
42 example, to determine whether a purported secured party acquired an enforceable security
43 interest in a controllable electronic record.

44
45 **4. Purchaser and transferor under subsection (d): shelter principle and**
46 **resulting controllable electronic records.** Subsection (d) sets forth the familiar "shelter"

1 principle, under which a purchaser of a controllable electronic record acquires whatever rights
2 the transferor had or had power to transfer. However, in some cases the controllable electronic
3 record that is acquired by the purchaser will not be the “same” controllable electronic record that
4 was transferred by the transferor. Such a transfer might involve the elimination of a “transferred”
5 controllable electronic record and the resulting and corresponding derivative creation and
6 acquisition of a new controllable electronic record. An example of such a resulting controllable
7 electronic record is the unspent transaction output (UTXO) generated by a transaction in bitcoin.
8 Bitcoin’s protocol operates by allowing users to “spend” their UTXOs to create one or more new
9 UTXOs for the same amount of bitcoin, so each transfer produces new UTXOs controlled by the
10 transferees (one of which may be the transferor—spender—of the bitcoin). Subsection (d) should
11 be construed broadly to encompass such transfers and resulting derivative controllable electronic
12 records acquired by a purchaser. Because subsection (d) addresses the rights of a purchaser in the
13 “purchased” asset and not the “transferred” asset, this construction is wholly consistent with the
14 statutory text.

15
16 Notwithstanding the broad subsection (d) shelter principle, which provides that a
17 purchaser acquires “all rights” of the transferor, those rights are subject to the reach of Section 1-
18 304. Under that section a contract or duty under the UCC imposes an overarching “obligation of
19 good faith in its performance and enforcement.” Section 1-304. In this context, “performance and
20 enforcement” include the exercise of rights under the UCC, such as the rights conferred on a
21 purchaser by the subsection (d) shelter principle. *See* Section 1-304, Comment 2. For example,
22 consider a qualifying purchaser of a controllable electronic record, controllable account, or
23 controllable payment intangible who then sells that asset to a person who is not a qualifying
24 purchaser. If the second purchaser had previously engaged in fraudulent or illegal activity in
25 connection with the purchased asset or an asset to which the purchased asset is attributable, the
26 purchaser’s exercise of rights under subsection (d) as to the purchased asset may be in breach of
27 its obligation of good faith. Section 3-203(b) states this result directly with respect to a transferee
28 of a negotiable instrument if the transferee previously engaged in fraud or illegality with respect
29 to the same instrument. Section 3-203(b). The same result would apply under subsection (d).
30 Subsection (d) relies on the application of the general obligation of good faith under Section 1-
31 304 to reach the appropriate result. However, unlike negotiable instruments, many controllable
32 electronic records are fungible. For this reason, in some cases it might not be possible to
33 establish that an acquired controllable electronic record has a sufficient nexus with a transferee’s
34 earlier fraud or illegality.

35
36 **5. Nonpurchaser having control.** Under Section 12-105, a person may have control
37 of a controllable electronic record even if the person has no property interest in the controllable
38 electronic record. A person that has control of, but no interest in, a controllable electronic record
39 would not be a purchaser of the controllable electronic record and so would not be eligible to be
40 a qualifying purchaser under this section.

41
42 **Example:** Debtor granted to Secured Party a security interest in all Debtor’s existing and
43 after-acquired accounts, chattel paper, and payment intangibles. Secured Party perfected
44 its security interest in a specific controllable account by obtaining control of the
45 controllable electronic record that evidences the controllable account. *See* Section 9-
46 107A.

1 Because Debtor's security agreement does not cover controllable electronic records,
2 Secured Party would have no interest in the controllable electronic record. Accordingly,
3 Secured Party would not be a purchaser of the controllable electronic record. However, as
4 a purchaser of the controllable accounts and controllable payment intangibles, Secured
5 Party could benefit from the take-free rule in subsection (e) (discussed in Comment 7).
6 Having taken control of the specific controllable account, Secured Party may be a
7 qualifying purchaser. Even if Secured Party were not a qualifying purchaser of the
8 controllable account, its security interest in the account over which it obtained control
9 would, however, have priority over a conflicting security interest that was perfected by a
10 method other than control. Section 9-326A.

11
12 **6. Distinction between controllable electronic record and controllable account**
13 **or controllable payment intangible evidenced by the controllable electronic record.** Even
14 though a controllable electronic record evidences a controllable account or controllable payment
15 intangible, the controllable electronic record is distinct from the account or payment intangible
16 that it evidences. The account or payment intangible is connected with (or "tethered" to) the
17 electronic record by virtue of the relevant account debtor's obligation to pay the person in
18 control of the controllable electronic record. Moreover, control of the controllable account or
19 payment intangible is achieved only by obtaining control of the controllable electronic record
20 that evidences the account or payment intangible. The Example in Comment 5 explains that a
21 purchaser may obtain a property interest in the controllable account or controllable payment
22 intangible even if it does not acquire any interest in the controllable electronic record that
23 evidences the account or payment intangible. This approach is intended to avoid a trap for the
24 unwary purchaser that obtains an interest in the account or payment intangible (which is the asset
25 that has stand-alone value) but might fail to acquire an interest in the related controllable
26 electronic record. However, good practice may encourage a purchaser to acquire an interest in
27 the controllable electronic record as well, which would eliminate any potential confusion
28

29 **7. The take-free rule.** Subsection (e) makes controllable electronic records and,
30 under subsection (a), controllable accounts and controllable payment intangibles, highly
31 negotiable. Subsection (e) derives from Section 3-306, under which a holder in due course takes
32 a negotiable instrument free of a claim of a property right in the instrument. A qualifying
33 purchaser of a controllable electronic record, controllable account, or controllable payment
34 intangible takes free of all claims of a property right in the purchased controllable electronic
35 record, account, or payment intangible.
36

37 As a general matter, law other than Article 12 would determine whether any particular
38 transaction creates a property interest in a controllable electronic record. Section 12-104(c). The
39 applicable law may provide that a hacker, who is essentially a thief, acquires no rights in a
40 "stolen" controllable electronic record. Even if this is the case, subsection (e) would enable a
41 purchaser that obtains control from a hacker and that otherwise meets the definition of
42 "qualifying purchaser" (for value, in good faith, and without notice of property claims) to take
43 the controllable electronic record (or any purchased controllable account or controllable payment
44 intangible) free of property claims. A person in control of a controllable electronic record
45 therefore has the power, even if not the right, to transfer rights in the record to a qualifying
46 purchaser. Of course, if the qualifying purchaser is a secured party whose security interest

1 secures an obligation, the purchaser would take free of the conflicting property right only to the
2 extent of the obligation secured. *See* Section 12-104(d) (purchaser of a limited interest); *cf.*
3 Section 3-302(e).
4

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

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

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

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

40 10. **Creating the functional equivalent of a negotiable instrument.** Two defining
41 characteristics of an Article 3 negotiable instrument are that a holder in due course (i) takes free
42 of claims of a property or possessory right to the instrument (Section 3-306) and (ii) takes free of
43 most defenses and claims in recoupment (Section 3-305). Article 3 applies only to written
44 instruments. This draft provides a method for reaching a similar result with respect to
45 controllable accounts and controllable payment intangibles.
46

1 As regards the first characteristic, a qualifying purchaser could acquire the controllable
2 account or controllable payment intangible free of any claim of a property interest. As regards
3 the second characteristic, the definition of “qualifying purchaser” omits some of the conditions
4 for becoming a holder in due course. For example, to qualify as a holder in due course, a holder
5 must take “without notice that any party has a defense or claim in recoupment” Section 3-
6 302(a)(2)(vi). A controllable electronic record is information; there are no parties to a
7 controllable electronic record. However, there are parties to a controllable account or
8 controllable payment intangible. Accordingly, Sections 9-404 and 9-403 would determine
9 whether a purchaser of the controllable account or controllable payment intangible takes free of a
10 defense. Section 9-403 ordinarily would give effect to the account debtor’s agreement not to
11 assert claims or defenses.

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

19
20 **Section 12-105. Control of Controllable Electronic Record.**

21 (a) [General rule: control of controllable electronic record.] A person has control of a
22 controllable electronic record if the electronic record, a record attached to or logically associated
23 with the electronic record, or a system in which the electronic record is recorded:

24 (1) gives the person:

25 (A) the power to avail itself of substantially all the benefit from the
26 electronic record; and

27 (B) exclusive power, subject to subsection (b), to:

28 (i) prevent others from availing themselves of substantially all the
29 benefit from the electronic record; and

30 (ii) transfer control of the electronic record to another person or
31 cause another person to obtain control of another controllable electronic record as a result of the
32 transfer of the electronic record; and

33 (2) enables the person readily to identify itself in any way, including by name,

identifying number, cryptographic key, office, or account number, as having the powers specified in paragraph (1).

(b) **[Meaning of exclusive.]** A power is exclusive under subsection (a)(1)(B)(i) and (ii), even if:

(1) the controllable electronic record, a record attached to or logically associated with the electronic record, or a system in which the electronic record is recorded limits the use of the electronic record or has a protocol programmed to cause a change, including a transfer or loss of control or a modification of benefits afforded by the electronic record; or

(2) the power is shared with another person.

(c) A person does not share a power with another person if:

(i) the person can exercise a power only if the power also is exercised by the other person; and

(ii) the other person either:

(A) can exercise the power without exercise of the power by the person; or

(B) is the transferor to the person of an interest in the controllable electronic record or a controllable account or controllable payment intangible evidenced by the controllable electronic record.

(d) **[Presumption of exclusivity of certain powers.]** If a person has the powers that are specified in subsection (a)(1)(B)(i) and (ii), the powers are presumed to be exclusive.

(e) **[Control through another person.]** A person has control of a controllable electronic record if another person, other than the transferor of an interest in the electronic record:

(1) has control of the electronic record and acknowledges that it has control on behalf of the person; or

1 (2) obtains control of the electronic record after having acknowledged that it will
2 obtain control of the electronic record on behalf of the person.

3 (f) **[No requirement to acknowledge.]** A person that has control under this section is not
4 required to acknowledge that it has control on behalf of another person.

5 (g) **[No duties or confirmation.]** If a person acknowledges that it has or will obtain
6 control on behalf of another person, unless the person otherwise agrees or law other than this
7 article otherwise provides, the person does not owe any duty to the other person and is not
8 required to confirm the acknowledgment to any other person.

9 **Official Comment**

10
11 1. **Why “control” matters.** Control serves two major functions in Article 12. An
12 electronic record is a “controllable electronic record” and is subject to the provisions of this
13 article only if it can be subjected to control under this section. *See* Section 12-102(a)(1) (defining
14 “controllable electronic record”). And only a person having control of a controllable electronic
15 record is eligible to become a qualifying purchaser and so to take free of claims of a property
16 interest in the controllable electronic record, or any controllable account or controllable payment
17 intangible evidenced by the controllable electronic record, and to receive protection from the
18 “no-action” rule. *See* Section 12-104(e) and (g).
19

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

29 2. **Powers and sources of powers; inability to exercise a power.** This section
30 conditions control on a person’s having the three powers specified in subsection (a)(1). A person
31 would have the powers described in that subsection if the controllable electronic record, a record
32 attached to or logically associated with the controllable electronic record, or any system in which
33 it is recorded gives the purchaser those powers. This description of the source of the relevant
34 powers should be construed broadly and functionally. For example, a person would have a power
35 even if the characteristics of the particular purchaser disable the person from exercising the
36 power. This would be the case, for example, when the purchaser holds the private key required to
37 access the benefit of the controllable electronic record but lacks the hardware required to use it.
38 In addition, a system in which the person in control is identified is a permissible source of a

1 power even if it is related to but not precisely the “same” system in which the controllable
2 electronic record is recorded.

3
4 3. **“Benefit.”** Subsection (a)(1)(A) and (a)(1)(B)(i) condition control of a
5 controllable electronic record on a person’s relationship to the benefit of the controllable
6 electronic record.

7
8 As used in this section, the “benefit” of a controllable electronic record refers to the rights
9 that are afforded by the controllable electronic record and the uses to which the controllable
10 electronic record can be put. These, in turn, depend on the characteristics of the controllable
11 electronic record in question. For example, the benefit afforded by control of a bitcoin is that it
12 can be held or disposed of (sold or spent). And control of a controllable electronic record
13 evidencing a controllable account or controllable payment intangible affords the benefit of the
14 right to collect from the account debtor (obligor).

15
16 The system in which a controllable electronic record is recorded may limit the benefit
17 from the controllable electronic record that is available to those who interact with the system. In
18 determining whether a person has the power to avail itself of substantially all the benefit from a
19 controllable electronic record under subsection (a)(1)(A), or to prevent others from availing
20 themselves of substantially all the benefit from a controllable electronic record under subsection
21 (a)(1)(B)(i), only the benefit that the system makes available should be considered.

22
23 4. **Power to retrieve information.** By definition, the information constituting an
24 electronic record must be “retrievable in perceivable form.” Section 1-201(b)(31) (defining
25 “record”). The power to retrieve the record in perceivable form is included in the benefit of a
26 controllable electronic record. “Perceivable form” means that the contents of the record are
27 intelligible; the ability to perceive the indecipherable jumble of an encrypted record does not
28 give a person the power to retrieve the record in perceivable form.

29
30 To have control of a controllable electronic record under subsection (a)(1)(A), a person
31 must have at least the nonexclusive power to avail itself of this benefit. If a person also has the
32 exclusive power to decrypt the encrypted record, the person will have the exclusive power to
33 prevent others from availing themselves of substantially all the benefit from the controllable
34 electronic record and thereby will satisfy the condition in subsection (a)(1)(B)(i).

35
36 5. **Exclusive powers.** Unlike the power in subsection (a)(1)(A), the powers in
37 subsection (a)(1)(B)(i) and (a)(1)(B)(ii) must be held exclusively by the person claiming control
38 in order to establish control. However, once it is established that a person has received those
39 powers, subsection (d) provides a presumption of exclusivity. Consequently, a person asserting
40 control need not prove exclusivity in order to make out a *prima facie* case. Application of the
41 presumption will be governed also by Section 1-206 (effects of a presumption under the UCC)
42 and applicable non-UCC law (including rules of procedure and evidence). In addition, subsection
43 (b) contains two qualifications of the term “exclusive” as used in subsection (a)(1)(B). A power
44 can be “exclusive” under subsection (a)(1)(B) even if one or both of these qualifications apply.

45
46 Subsection (b)(1) takes account of the fact that the powers of a purchaser of a

1 controllable electronic record necessarily are subject to the attributes of the controllable
2 electronic record, records associated with the controllable electronic record, and the protocols of
3 any system in which the controllable electronic record is recorded. For example, a transfer of
4 control resulting from a program that is a part of a system's protocol is inherent in the
5 controllable electronic record and does not impair the exclusivity of the power of the person in
6 control of the record. Subsection (b)(1) also contemplates that the potential for the system to
7 otherwise modify (or even destroy) controllable electronic records would not impair the
8 exclusivity.

9
10 **Example 1.** Pursuant to the governance apparatus of a system (Propofolium) for a
11 cryptocurrency (propofol), an upgrade to the system was made that modified the
12 consensus mechanism for determining the effectiveness of transfers of propofols within
13 the system. Although this change did not divest any holder of propofols of its control, it
14 prospectively modified the system for all propofols. The adoption of this change and the
15 potential for such a change (or any other change) are functions of the attributes of the
16 system and, consequently, of all propofols. Neither this change nor such potential
17 impaired the exclusivity, for purposes of subsection (a)(1)(B), of the powers of a person
18 in control of propofols.

19
20 Subsection (b)(2) allows for a power to be shared with another person without impairing
21 the exclusivity of the power. One effect of subsection (b)(2) is that, under a multi-signature
22 (multi-sig) agreement, any person that is readily identifiable under subsection (a)(2) and shares
23 the relevant power would be eligible to have control, even if the action of another person is a
24 condition for the exercise of the power. For example, a person in control may agree that another
25 person's action on the relevant system would be required to effect a transfer of control without
26 impairing the requisite exclusivity.

27
28 **Example 2.** Pursuant to a multi-sig arrangement, control of propofols (in the system
29 described in Example 1) is shared by Campbell, Elizabeth, Mia, and Natasha. Under the
30 multi-sig arrangement, the exercise of powers over the propofols requires action by three
31 of the four persons having control. None of the participants acting alone has the power to
32 exercise the relevant powers. Subsection (b)(2) makes clear that all four participants have
33 control over the propofols and exclusivity is not impaired by the shared control under the
34 multi-sig arrangement.

35
36 Although all four persons in Example 2 have control, that may leave many questions as to the
37 rights of the four as among themselves. For example, if more than one of the four were secured
38 parties, it would be important for them to settle by agreement issues such as relative priorities
39 and enforcement rights. Similar situations can arise in other contexts and with respect to other
40 types of collateral.

41
42 A multi-sig arrangement for a controllable electronic record, such as that described in
43 Example 2, may provide enhanced security. For example, if the power of one participant is
44 compromised by a "hacker," the required actions by the other participants would prevent the
45 hacker from exercising unauthorized power over the record. Although the hacker might possess
46 the power along with the remaining multi-sig participants, those participants would continue to

1 have control. A multi-sig structure also may protect against the misuse of a record by ensuring
2 that actions by multiple persons are required for exercising power over the record.
3

4 Subsection (c) provides that in certain circumstances a power is not shared within the
5 meaning of subsection (b)(2) and, consequently, the relaxation of the exclusivity requirement
6 provided by subsection (b)(2) does not apply. Subsection (c) provides that a person does not
7 share an exclusive power with another person if the person can exercise the power only with the
8 other person's cooperation but the other person either (i) can exercise of the power unilaterally
9 without the person's cooperation (subsection (c)(ii)(A)) or (ii) is the transferor to the person of
10 an interest in the controllable electronic record or a controllable account or controllable payment
11 intangible evidenced by the controllable electronic record (subsection (c)(ii)(B)). It follows that a
12 transferee in that situation does not have control because it does not have the requisite exclusive
13 powers. The rationale for disqualifying a transferee (which includes a secured party in a secured
14 transaction) from the benefit of shared control is premised on the transferor's retention of a
15 blocking power over the transferee's exercise of the exclusive power. Such a transferee would
16 not have divested the transferor of power over the asset sufficiently to warrant treatment as a
17 secured party having a security interest perfected by control or as a qualifying purchaser.
18

19 *[Examples of the application of subsection (c) are forthcoming.]*
20

21 6. **Transfer of control.** The power to transfer control of a controllable electronic
22 record under subsection (a)(1)(B)(ii) includes the power to cause another person to obtain control
23 of another derivative and resulting controllable electronic record that results from the transfer of
24 the controllable electronic record. *See* Section 12-104, Comment 4.
25

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

39 8. **Control through another person.** Neither Article 12 nor any other provision of
40 the UCC (or other law that has been brought to the attention of the Drafting Committee) would
41 restrict or render ineffective any agreement of a person in control of a controllable electronic
42 record to hold control on behalf of another person. This result is implicit from subsection (b)(2)
43 dealing with sharing of control. It also would follow under principles of agency. But such an
44 arrangement should be effective regardless of any agency or fiduciary relationship.
45

46 This concept is expressly addressed in Section 8-106(d)(3), on control of a security

entitlement, which achieves perfection of a security interest under Sections 9-106(a) and 9-314(a). It also applies to perfection by possession under Section 9-313(c) if a person other than the debtor or the secured party is in possession of collateral. Under those provisions, however, effectiveness is conditioned in some circumstances on an “acknowledgment” by the person in control or possession. Under Section 9-313(c) the acknowledgment must be in a signed record. These provisions appear to derive from practices involving bailees of tangible property, such as goods, chattel paper, and certificated securities. See Section 9-313, Comment 4.

Subsection (e) likewise provides for control by a person through another person’s control on behalf of the person. Subsection (e) is patterned on Section 9-313(c), but like Section 8-103(d)(3), subsection (e) omits the requirement in Section 9-313(c) that an acknowledgment be made in a signed record. Although best practices would suggest the wisdom of relying on a signed record to evidence such an acknowledgment, subsection (e) would permit proof by other means.

Subsection (e) qualifies this method of obtaining control by providing that the acknowledging person must be one “other than the transferor of an interest in the electronic record.” Section 9-313(c) expressly provides in this context that an acknowledging person having possession of goods must be a person “other than the debtor.” The official comments to Section 8-106 are to the same effect in the context of control of a security entitlement. Section 8-106(d)(3), Comment 4. The same policy that underpins the inapplicability of this method of control to an acknowledgment by a debtor applies as well to a transferor that is not an Article 9 debtor. Control is intended to be a proxy for and a functional equivalent of the transfer of physical possession of goods. In general, a person can obtain control through control by an agent, as noted above. However, an acknowledgment by a *debtor or transferor* that acts as an agent of a secured party or other transferee would be ineffective. This corresponds to the policy underlying Section 9-313 that “the debtor cannot qualify as an agent for the secured party for purposes of the secured party’s taking possession.” Section 9-313, Comment 3.

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

Provisions substantially similar to subsection (e) are proposed to be included in Section 7-106 (control of electronic documents of title), 9-104 (control of deposit accounts), 9-105 (control of authoritative electronic copies of records evidencing chattel paper), and 9-105A (control of electronic money) and in a proposed conforming modification to Section 8-106(d)(3) (control of security entitlement).

9. **No requirement to acknowledge, no duties, and no requirement to confirm acknowledgment.** Subsections (f) and (g) derive from Section 9-313(f) and (g). Subsection (f) makes clear that a person that has control under this section has no duty to acknowledge that it

1 has or will obtain control on behalf of another person. Arrangements for a person to
2 acknowledge that it has or will obtain control on behalf of another person are not standardized.
3 Accordingly, subsection (g) leaves to the agreement of the parties and to any other applicable
4 law any duties of a person that does acknowledge that it has or will obtain control on behalf of
5 another person and provides that a person making an acknowledgment is not required to confirm
6 the acknowledgment to another person.

7
8 For example, subsection (e) would apply to give control to a person, Alpha, when another
9 person, Beta, has control of a controllable electronic record and acknowledges that it has control
10 on behalf of Alpha. However, under subsection (f), Beta is not required to so acknowledge. And
11 under subsection (g), even if Beta does so acknowledge, Beta owes no duty to Alpha unless Beta
12 agrees or other law so provides, and Beta is not required to confirm its acknowledgment to any
13 other person.

14
15 **Section 12-106. Discharge of Account Debtor on Controllable Account or**
16 **Controllable Payment Intangible.**

17 (a) **[Discharge of account debtor.]** An account debtor on a controllable account or
18 controllable payment intangible may discharge its obligation by paying:

19 (1) the person having control of the controllable electronic record that evidences
20 the controllable account or controllable payment intangible; or

21 (2) except as provided in subsection (b), a person that formerly had control of the
22 controllable electronic record.

23 (b) **[Content and effect of notification.]** Subject to subsection (d), an account debtor
24 may not discharge its obligation by paying a person that formerly had control of the controllable
25 electronic record if the account debtor receives a notification that:

26 (1) is signed by a person that formerly had control or the person to which control
27 was transferred;

28 (2) reasonably identifies the controllable account or controllable payment
29 intangible;

30 (3) notifies the account debtor that control of the controllable electronic record

1 that evidences the controllable account or controllable payment intangible was transferred;

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

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

6 (c) **[Discharge following effective notification.]** After receipt of a notification that
7 complies with subsection (b), the account debtor may discharge its obligation by paying in
8 accordance with the notification and may not discharge the obligation by paying a person that
9 formerly had control.

10 (d) **[When notification ineffective.]** Subject to subsection (h), notification is ineffective
11 under subsection (b):

12 (1) unless, before the notification is sent, an account debtor and the person that, at
13 that time, had control of the controllable electronic record that evidences the controllable account
14 or controllable payment intangible agree in a signed record to a commercially reasonable method
15 by which a person may furnish reasonable proof that control has been transferred;

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

19 (3) at the option of an account debtor, if the notification notifies the account
20 debtor to:

21 (A) divide a payment;

22 (B) make less than the full amount of an installment or other periodic
23 payment; or

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

(e) **[Proof of transfer of control.]** Subject to subsection (h), if requested by the account debtor, the person giving the notification under subsection (b) seasonably shall furnish reasonable proof, using the agreed method, that control of the controllable electronic record has been transferred. Unless the person complies with the request, the account debtor may discharge its obligation by paying a person that formerly had control, even if the account debtor has received a notification under subsection (b).

(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

(3) transfer the powers under 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) **[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.

Official Comment

1. **Source.** 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

1 of an account debtor, including a person obligated on an account or payment intangible.

2
3 2. **The basic rules.** This section applies only to an account debtor that has
4 undertaken to pay the person that has control of the controllable electronic record that evidences
5 the obligation to pay. *See* Section 9-102 (defining “controllable account” and “controllable
6 payment intangible”). Section 9-406 would continue to apply in other respects and to all other
7 account debtors. As to the relationship between this section and Section 9-406, see Comment 5.

8
9 Under subsection (a)(1), an account debtor may discharge its obligation on the
10 controllable account or controllable payment intangible by paying the person that has control of
11 the related controllable electronic record at the time of payment. Subsections (a)(2) and (b)
12 would remove from an account debtor the burden of determining who has control of the related
13 controllable electronic record at any given time—a burden that, with respect to some controllable
14 electronic records, an account debtor may be unable to satisfy. Under subsection (a)(2), subject
15 to subsection (b), an account debtor may discharge its obligation by paying a person that
16 formerly had control of the related controllable electronic record, which presumably would
17 include the initial obligee.

18
19 Subsection (b) reflects the fact that a person to which control has been transferred may
20 not wish to take the risk that the account debtor will discharge its obligation by paying the
21 transferor. Subsection (b) would protect the transferee by providing that if the account debtor
22 receives an effective notification that control has been transferred, the account debtor may
23 discharge its obligation by paying in accordance with the notification and may not discharge its
24 obligation by paying a person that formerly had control. The notification must be signed by a
25 person formerly having control or by the transferee.

26
27 To be effective under subsection (b), a notification must reasonably identify the
28 controllable account or controllable payment intangible, notify the account debtor that control of
29 the controllable electronic record that evidences the controllable account or controllable payment
30 intangible was transferred, identify the transferee in any reasonable way, and provide a
31 commercially reasonable method by which the account debtor is to make payments to the
32 transferee. A change in the identity of the person to which the account debtor must make
33 payment should not, and typically will not, impose a significant burden on the account debtor.
34 However, one can imagine a method of making payment that would be burdensome, *e.g.*, making
35 a payment through a trading platform or payment service with which the account debtor does not
36 have an account. For this reason, the designated method of making payment must be
37 “commercially reasonable.”

38
39 3. **“Reasonable proof.”** As noted above, this section derives in large part from
40 Section 9-406, which provides for notification that an account or payment intangible has been
41 assigned. Account debtors that have received notification of an assignment under Section 9-406
42 almost always make payments in accordance with the notice. Recognizing that an account debtor
43 may be uncertain whether a notification is legitimate, Section 9-406 affords to an account debtor
44 the right to request proof that the account or payment intangible was assigned.

45
46 Subsection (e) contains a similar provision. On the account debtor’s request, the person

1 giving the notification must seasonably furnish reasonable proof that control of the controllable
2 electronic record has been transferred. If the person does not comply with the request, the
3 account debtor may ignore the notification and discharge its obligation by a paying a person
4 formerly in control.

5
6 “Reasonable proof” requires evidence that would be understood by a typical account
7 debtor to whom it is proffered as demonstrating to a reasonably high probability that control of
8 the controllable electronic record has been transferred to the transferee. Subsection (f) provides a
9 safe harbor for providing reasonable proof. It enables a person to satisfy the account debtor’s
10 request by demonstrating that the transferee has the power to avail itself of substantially all the
11 benefit from the controllable electronic record, to prevent others from availing themselves of
12 substantially all the benefit from the controllable electronic record, and to transfer these powers
13 to another person. This demonstration would not necessarily prove that a person actually has
14 control of a controllable electronic record because it need not show that the transferee held the
15 last two powers exclusively. Nevertheless, such a demonstration would constitute “reasonable
16 proof” under subsection (f). A person that has control should have little difficulty providing this
17 proof, as a person cannot have control unless it can readily identify itself as having the requisite
18 powers. *See* Section 12-105(a)(2).

19
20 Reasonable proof that is seasonably furnished by a person other than the person that gave
21 the notification would constitute compliance with the account debtor’s request.

22
23 Subsection (e) requires that reasonable proof be provided “using the agreed method.”
24 Subsection (f) requires that a person use “the agreed method” to demonstrate that the transferee
25 has the specified powers. “Agreed method” refers to the commercially reasonable method to
26 which the parties agreed, in a signed record, before the notification was sent. If parties did not so
27 agree, the notification is ineffective under subsection (d)(1).

28
29 An account debtor may agree to participate in a system providing for the control of
30 controllable accounts or controllable payment intangibles. If the system is programmed to
31 provide for notification to the account debtor upon the transfer of control, the account debtor’s
32 agreement and the operation of the system may satisfy the requirements of subsections (d)(1),
33 (e), and (f).

34
35 **4. Additional considerations for account debtors.** The requirement in subsection
36 (e) that reasonable proof be furnished using the “agreed method” provides considerable
37 protection for account debtors upon receipt of a notification of assignment and making a request
38 for proof. There are, however, other considerations that are of importance to account debtors but
39 are beyond the scope of the frameworks provided by Articles 9 and 12. One such consideration is
40 the potential involvement of pseudonymous payees, which may raise issues such as compliance
41 with anti-money laundering regulations and sanctions compliance. These are examples of issues
42 that a well-structured program for controllable accounts and controllable payment intangibles
43 might address.

44
45 **5. Relationship to Section 9-406.** Section 9-406 governs the discharge of the
46 obligation of an account debtor. Section 9-406 carves out of its scope transactions to the extent

covered by this section. *See* Section 9-406.

Section 12-107. Governing Law.

(a) **[Governing law: general rule.]** Except as provided in subsection (b), the local law of a controllable electronic record's jurisdiction governs a matter covered by this article.

(b) **[Governing law: Section 12-106.]** For a controllable electronic record that evidences a controllable account or controllable payment intangible, the local law of the controllable electronic record's jurisdiction governs a matter covered by Section 12-106 unless an effective agreement determines that the local law of another jurisdiction governs.

(c) **[Controllable electronic record's jurisdiction.]** The following rules determine a controllable electronic record's jurisdiction under this section:

(1) If the controllable electronic record, or a record attached to or logically associated with the controllable electronic record and readily available for review, expressly provides that a particular jurisdiction is the controllable electronic record's jurisdiction for purposes of this article or [the Uniform Commercial Code], that jurisdiction is the controllable electronic record's jurisdiction.

(2) If paragraph (1) does not apply and the rules of the system in which the controllable electronic record is recorded are readily available for review and expressly provide that a particular jurisdiction is the controllable electronic record's jurisdiction for purposes of this article or [the Uniform Commercial Code], that jurisdiction is the controllable electronic record's jurisdiction.

(3) If paragraphs (1) and (2) do not apply and the controllable electronic record, or a record attached to or logically associated with the controllable electronic record and readily available for review, expressly provides that the controllable electronic record is governed by the

1 law of a particular jurisdiction, that jurisdiction is the controllable electronic record's
2 jurisdiction.

3 (4) If paragraphs (1) through (3) do not apply and the rules of the system in which
4 the controllable electronic record is recorded are readily available for review and expressly
5 provide that the controllable electronic record or the system is governed by the law of a
6 particular jurisdiction, that jurisdiction is the controllable electronic record's jurisdiction.

7 (5) If paragraphs (1) through (4) do not apply, the controllable electronic record's
8 jurisdiction is the District of Columbia.

9 (d) **[Applicability of Article 12.]** If subsection (c)(5) applies and Article 12 is not in
10 effect in the District of Columbia without material modification, the governing law for a matter
11 covered by this article is the law of the District of Columbia as though Article 12 were in effect
12 in the District of Columbia without material modification. In this subsection, "Article 12" means
13 [Uniform Commercial Code—Controllable Electronic Records (with Conforming Amendments
14 to Articles 1 and 9), 2022 Official Text], which is available at [indicate where and how the
15 official text may be found].

16 (e) **[Relation of transaction to controllable electronic record's jurisdiction not
17 necessary.]** To the extent subsections (a) and (b) provide that the local law of the controllable
18 electronic record's jurisdiction governs matters covered by this article, that law governs even if a
19 matter or transaction does not bear any relation to the controllable electronic record's
20 jurisdiction.

21 (f) **[Rights of purchasers determined at time of purchase.]** The rights acquired by a
22 purchaser or a qualifying purchaser under Section 12-104 are governed by the law applicable
23 under this section at the time of purchase.

1 **Legislative Note:** The definition of “Article 12” in subsection (d) should cite the official “title”
2 of the official text of Article 12 and should indicate where and how the official text is made
3 available to the public. See, e.g., TRADES Regulations, 31 CFR 357.2, defining “Revised Article
4 8.”

5 6 **Official Comment**

7
8 1. **Source.** The provisions of Section 12-107 (as well as Sections 9-306A and 9-
9 306B) derive from Sections 8-110 and 9-305 on law governing perfection and priority of security
10 interests in investment property and the relevance of a securities intermediary’s jurisdiction and a
11 commodity intermediary’s jurisdiction.

12
13 2. **The basic rule: Law governing matters covered by Article 12.** Subsection (a)
14 states the basic rule that the local law of the controllable electronic record’s jurisdiction governs
15 the matters covered by this article. The “matters covered by” this article are relatively narrow
16 and discrete, albeit enormously important. If the choice-of-law rule provided by this section
17 points to a jurisdiction that has adopted Article 12, those matters would include the interpretation
18 and application of Article 12, including its definitions. In general, issues that would be
19 determined by the provisions of this article are to be determined under the law that is applicable
20 as determined by this section. These would include the rights of purchasers and property
21 claimants more generally with respect to controllable electronic records, controllable accounts,
22 and controllable payment intangibles to the extent dealt with by this article—issues addressed by
23 section 12-104. The rights and obligations of account debtors, to the extent dealt with by section
24 12-106, also would be matters covered. Matters not covered by this article, including matters as
25 to which this article expressly provides are covered by other law, are not within the scope of this
26 section.

27
28 3. **Practical limitations on determination of governing law.** This section relating
29 to the law governing the matters covered by this article must confront substantial practical
30 limitations. These limitations arise primarily from two factors. First, as described below, this
31 section relies primarily on a “waterfall” of alternatives for determining a controllable electronic
32 record’s jurisdiction. The waterfall depends on express provisions of a controllable electronic
33 record or the system in which it is recorded. Many electronic records and systems that currently
34 exist do not contain these provisions. As explained in Comment 6, the expectation is that over
35 time electronic records and related systems will adopt these provisions in reliance on this section,
36 thereby creating certainty as to the governing law. Second, in the absence of these provisions, at
37 the bottom of the waterfall the controllable electronic record’s jurisdiction is the District of
38 Columbia (DC). See Comment 6.

39
40 4. **Governing law for Section 12-106.** Subsection (b) provides an exception to the
41 general rule of subsection (a) that “the local law of a controllable electronic record’s jurisdiction
42 governs the matters covered by this article.” The exception recognizes that an account debtor’s
43 rights and duties generally are governed by the law applicable to the underlying contract between
44 the account debtor and an assignor, and not by the law applicable to the agreement between the
45 assignor (debtor) and the assignee (secured party)—a security agreement. See Section 9-401,
46 Comment 3. Subsection (b) recognizes that an effective agreement (i.e., one effective under

1 Section 1-301(a)) between the account debtor and assignor may choose a different law to cover
2 the matters covered by Section 12-106 (i.e., the account debtor's rights and duties addressed in
3 that section).

4
5 **5. Determination of controllable electronic record's jurisdiction.** The basic rule
6 that the law of a controllable electronic record's jurisdiction governs the matters covered by
7 Article 12 might be viewed as a rough proxy for the traditional role of the location of tangible
8 asset (e.g., goods) in determining the applicable law (*lex rei sitae*). Drawing on the analogous
9 provisions in Sections 8-110 and 9-305 in the context of a security entitlement or securities
10 account or a commodity contract or commodity account, under subsection (c) it is the
11 controllable electronic record itself, records attached thereto or associated therewith, or the
12 system in which the controllable electronic record is recorded that determines the controllable
13 electronic record's jurisdiction and, thereby, the governing law. Subsection (c) provides a
14 "waterfall" of rules based on provisions that identify a particular jurisdiction as the controllable
15 electronic record's jurisdiction or alternatively that provide the governing law for a controllable
16 electronic record or the system in which the record is recorded. As to subsection (e), see Section
17 8-110, Comment 5A.

18
19 Paragraphs (1) through (4) of the subsection (c) waterfall each relies on information
20 available from a controllable electronic record, an attached or associated record, or rules of a
21 system in which the record is recorded. A controllable electronic record's jurisdiction is
22 determined by one of these sources that "expressly provide[s]" that a jurisdiction is the
23 controllable electronic record's jurisdiction or that a particular jurisdiction's law is the governing
24 law. These paragraphs refer to attached or associated records or system rules that are "readily
25 available." They also assume that the controllable electronic record is itself readily available to
26 anyone choosing to deal with the record. These provisions are based on the assumption that the
27 relevant express provision will be available to an interested person without the imposition of
28 unreasonable burdens.

29
30 **6. Bottom of the waterfall: District of Columbia.** Currently, many controllable
31 electronic records, associated records, and systems in which such records are recorded do not
32 identify the "controllable electronic record's jurisdiction" or the governing law (some
33 permitted systems being exceptions). (One hopes that once Article 12 and accompanying
34 amendments are widely adopted, systems will adapt and the waterfall will become more
35 generally viable for identifying a controllable electronic record's jurisdiction.) Consequently,
36 subsection (c)(5) addresses a problem that does not normally exist in the context of Sections 8-
37 110 and 9-305. The likely choice for the bottom of the waterfall ordinarily might be the location
38 of the debtor. That approach would follow the role of the location of a debtor under Sections 9-
39 301 and 9-307. However, that location may not readily be determined by parties to a transaction,
40 primarily because in many cases involving controllable electronic records the transferor is not
41 known to or easily discoverable by a purchaser. *See* Prefatory Note 1 to Article 12.
42 Consequently, Subsection (c)(5) resolves this dilemma by providing that the controllable
43 electronic record's jurisdiction is DC.

44
45 **7. District of Columbia as controllable electronic record's jurisdiction.** The
46 designation of DC as the controllable electronic record's jurisdiction assumes that DC will have

1 adopted Article 12 and the conforming amendments to Articles 1 and 9 in substantially the
2 uniform version. This is a plausible assumption based on the history of adoptions in that
3 jurisdiction. Subsection (d) addresses the unlikely situation that DC might not so adopt Article
4 12 or might later adopt materially non-uniform amendments. Subsection (d) is patterned loosely
5 (but as closely as feasible) on the TRADES Regulations, 31 CFR § 357.11(d), for U.S. Treasury
6 securities.

7
8 The term “Article 12” is defined in subsection (d) as the officially promulgated version of
9 Article 12 and conforming amendments. The official comments will explain that in determining
10 whether DC has enacted Article 12 without material modification a tribunal should consider the
11 materiality of any provision in the context of the issue or issues before it. A modification of a
12 provision that would be material in another context should be disregarded if it would have no
13 bearing on the issue or issues before the tribunal.

14
15 8. **Relevant time for determination of governing law.** Subsection (f) provides that
16 the rights of purchasers are governed by the applicable law as of the time of purchase. Note that
17 Sections 8-110 and 9-305 do not contain an analogous rule with respect to a securities
18 intermediary’s jurisdiction. However, Section 8-110(c) does provide a similar rule for the
19 delivery of a security certificate and adverse claims. As to the timing of the determination of the
20 governing law for other issues under Article 12, such as the rights and duties of account debtors
21 under Section 12-106, the section does not specify a time. As with most statutory provisions
22 relating to governing law, courts are free to determine the appropriate relevant time taking into
23 account the relevant facts and the nature of the issues involved.

1 ANNEX A

2
3 **TRANSITION PROVISIONS FOR 2022 AMENDMENTS**
4 **TO UNIFORM COMMERCIAL CODE—EMERGING TECHNOLOGIES**

5 **Prefatory Note to Annex A—Transition Provisions**

6 Unlike previous UCC revisions, the Emerging Technologies amendments pose special
7 challenges. The amendments add a new Article 12, covering new classes of property, and
8 provide extensive revisions to Article 9. They also include amendments to every other UCC
9 article (save Article 6). Consequently, earlier transition provisions do not provide an adequate
10 template for addressing such a broad set of amendments. However, this annex draws
11 substantially on Article 9, Part 7, the transition provisions applicable to the 1999 revisions to
12 Article 9. In particular, the substantial amendments to Article 9 and the new Article 12 require
13 special attention to post-effective date perfection and priority issues.

14
15 A uniform law as complex as these Emerging Technologies amendments necessarily
16 gives rise to difficult problems and uncertainties during the transition to the new law. As is
17 customary for uniform laws, these amendments are based on the general assumption that all
18 States will have enacted substantially identical versions. While always important, uniformity is
19 particularly important to the success of these amendments, especially those to Article 9 and the
20 new Article 12 and conforming amendments relating to each.

21
22 Article 9, Part 7, provided that several material changes in the law would be given effect
23 one year after a “uniform” effective date. (As it turned out, all but a few states enacted the 1999
24 amendments with the uniform effective date.). However, for practical reasons many states may
25 wish to provide an effective date for this act that is consistent with their usual timing for
26 effectiveness of legislation. Consequently, this annex does not provide for a uniform effective
27 date but does provide for a uniform adjustment date on which several material provisions (in
28 particular, new priority rules that would override pre-effective-date established priorities) would
29 apply. However, if the uniform adjustment date is less than one year after the effective date for a
30 state’s adoption of these amendments, then the state should adopt an adjustment date that is one
31 year after the state’s effective date. In these official comments to this annex, references to the
32 “adjustment date” mean the uniform adjustment date or such later date. The minimum of a one-
33 year period between the effective date and the adjustment date is important. It is intended
34 primarily to provide sufficient time for a person to achieve perfection or priority of a security
35 interest following the effective date or for a person with an established priority in property to
36 protect its priority before the priority may otherwise be lost on the adjustment date.

37
38 The law, other than the Uniform Commercial Code, of a state adopting this act
39 determines the time of day on the state’s effective date on which this act takes effect.

40
41 ***Legislative Note:***

42
43 *1. A state should insert in each place where “[the effective date of this act]” appears in the text*
44 *of this Annex, the actual date on which this act takes effect, as specified in Section 4-101.*

2. A state should insert in each place where “[the adjustment date]” appears in the text of the statute, either (i) “[January] [July] 1, 2025” or, (ii) if later, the date that is one year after the actual date on which this act takes effect.

3. A state should codify Parts 1 through 3 of this annex as a part of the state’s [Uniform Commercial Code].

4. A state (i) should insert in Part 4 (Section 4-101) of this Annex the actual date on which this act takes effect and (ii) should not codify Part 4.

PART 1

DEFINITIONS

Section A-101. Definitions.

(a) [Annex A Definitions.] In this annex:

(1) “Article 12” means Article 12 of [the Uniform Commercial Code].

(2) “Article 12 property” means a controllable account, a controllable electronic record, and a controllable payment intangible.

(b) [Definitions in other articles.] The following definitions in [the Uniform Commercial Code] apply to this annex.

“Controllable account”. Section 9-102

“Controllable electronic record”. Section 12-102

“Controllable payment intangible”. Section 9-102

“Electronic money”. Section 9-102.

“Financing statement”. Section 9-102.

(c) [Article 1 definitions and principles.] Article 1 contains general definitions and principles of construction and interpretation applicable throughout this annex.

Official Comment

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

1 **PART 2**

2 **GENERAL TRANSITION PROVISION**

3 **Section A-201. Saving Clause.**

4 Except as provided in Part 3, a transaction validly entered into before [the effective date
5 of this act] and the rights, duties, and interests flowing from the transaction remain valid
6 thereafter and may be terminated, completed, consummated, or enforced as required or permitted
7 by law other than [the Uniform Commercial Code] or, if applicable, [the Uniform Commercial
8 Code], as though this act had not taken effect.

9 **Official Comment**

10
11 1. **Source.** This Section is drawn from former Section 10-102(2) (now withdrawn).
12

13 2. **In general: Prospective application.** This section is a savings clause that
14 provides in general for the prospective application of the amendments to the Uniform
15 Commercial Code and the preservation of the validity of pre-effective-date transactions and the
16 rights, duties, and interests flowing from those transactions. Part 3 provides exceptions to this
17 prospective application for Articles 9 and new Article 12.
18

19 3. **Prospective application: Examples.**
20

21 “*Conspicuous.*” Section 1-201(b)(10) provides a revised definition of “conspicuous” and
22 extensive new official comments. The new definition applies to a record that becomes a part of
23 the relevant transaction after the effective date.
24

25 “*Hybrid transaction*” and “*hybrid lease.*” Revisions to Sections 2-102 and 2A-102
26 address a sale of goods that is a part of a “hybrid transaction” and a lease of goods that is part of
27 a “hybrid lease.” See Sections 2-106(5) (defining “hybrid transaction”) and 2A-103(1)(h.1)
28 (defining “hybrid lease”). These revisions apply to transactions entered into after the effective
29 date.
30

31 4. **Revisions reflecting continuation of pre-effective-date precedents.** Several
32 revisions are intended to clarify and reaffirm understandings of pre-effective-date interpretations
33 of the Uniform Commercial Code and are intended to modify some pre-effective-date judicial
34 interpretations. Examples include (i) the amendment to Section 3-104, which clarifies that
35 neither a choice-of-law nor a choice-of-forum clause prevents a promise from being a negotiable
36 instrument, (ii) the amendments to Section 4A-201, which indicate that a security procedure may
37 impose an obligation on both the receiving bank and the customer and may involve the use of
38 symbols, sounds, or biometrics, (iii) the clarifying revision of Section 5-116, (iv) the new

1 definitions of “assignee” and “assignor” in Section 9-102(a)(7A) and (7B), and (v) clarification
2 of the attachment of a security interest in consumer goods as proceeds or commingled goods and
3 in a commercial tort claim as proceeds in Section 9-204(c). However, this transition rule will be
4 important in situations in which the controlling pre-effective-date case law is not consistent with
5 the amended provisions.

6 7 **PART 3**

8 **TRANSITION PROVISIONS FOR ARTICLES 9 AND 12**

9 **Section A-301. Saving Clause.**

10 (a) **[Pre-effective-date transactions, liens, or interests.]** Except as provided in this part,
11 Article 9 as amended by this act and Article 12 apply to a transaction, lien, or other interest in
12 property, even if the transaction, lien, or interest was entered into, created, or acquired before
13 **[the effective date of this act]**.

14 (b) **[Continuing validity]** Except as provided in subsection (c) and Sections A-302
15 through A-306:

16 (1) a transaction, lien, or interest in property that was not governed by [the
17 Uniform Commercial Code], was validly entered into, created, or transferred before **[the**
18 **effective date of this act]**, and would be subject to Article 9 as amended by this act or Article 12
19 if it had been entered into, created, or transferred after **[the effective date of this act]**, including
20 the rights, duties, and interests flowing from the transaction, lien, or interest in property, remains
21 valid after **[the effective date of this act]**; and

22 (2) the transaction, lien, or interest in property may be terminated, completed,
23 consummated, and enforced as required or permitted by this act or by the law that would apply if
24 this act had not taken effect.

25 (c) **[Pre-effective-date proceedings.]** This act does not affect an action, case, or
26 proceeding commenced before **[the effective date of this act]**.

1 **Official Comment**

2
3 1. **Source.** This section derives from Section 9-702.

4
5 2. **Pre-effective-date transactions, liens, and interests.** Subsection (a) contains the
6 general rule that Article 9 as amended by this act (as used in these official comments to Annex
7 A, “revised Article 9”) and Article 12 generally apply to transactions, liens (including security
8 interests), and interests in property, even if entered into, created, or acquired before the effective
9 date. Thus, for example, secured transactions entered into under Article 9 before amendment by
10 this act (as used in these official comments to Annex A, “former Article 9”) must be terminated,
11 completed, consummated, and enforced under this act. However, other provisions in this part
12 provide exceptions to this general rule.

13
14 3. **Pre-effective-date transactions not governed by pre-effective-date Uniform**
15 **Commercial Code.** Subsection (b) is an exception to the general rule. It applies to valid, pre-
16 effective-date transactions, liens, and other interests in property that were not governed by the
17 former Uniform Commercial Code but would be governed by this act if they had been entered
18 into or created after this act takes effect. Under subsection (b), these valid transactions, such as
19 the sale of a controllable electronic record, retain their validity under this article and may be
20 terminated, completed, consummated, and enforced as required or permitted by the law that
21 would apply had this act not taken effect or, to the extent not inconsistent with that law, this act.

22
23 3. **Judicial proceedings commenced before effective date.** As is usual in transition
24 provisions, this subsection (c) provides that this this act, does not affect litigation pending on the
25 effective date.

26
27 **Section A-302. Security Interest Perfected Before Effective Date.**

28 (a) **[Continuing perfection: perfection requirements satisfied.]** A security interest that
29 is enforceable and perfected immediately before **[the effective date of this act]** is a perfected
30 security interest under this act if, on **[the effective date of this act]**, the applicable requirements
31 for enforceability and perfection under this act are satisfied without further action.

32 (b) **[Continuing perfection: perfection requirements not satisfied.]** If, immediately
33 before **[the effective date of this act]**, a security interest is enforceable and perfected, but the
34 applicable requirements for enforceability or perfection under this act, are not satisfied on **[the**
35 **effective date of this act]**, the security interest:

36 (1) is a perfected security interest until the earlier of the time perfection would

1 have ceased under the law in effect immediately before **[the effective date of this act]** or [the
2 adjustment date];

3 (2) remains enforceable thereafter only if the security interest satisfies the
4 requirements for enforceability under Section 9-203 before the [the adjustment date]; and

5 (3) remains perfected thereafter only if the applicable requirements for perfection
6 under this act are satisfied before the [the adjustment date].

7 **Official Comment**

8
9 1. **Source.** This section derives from Section 9-703.

10
11 2. **Perfected security interests under former Article 9 and revised Article 9.** This
12 section deals with security interests that are perfected under former Article 9 immediately before
13 this act takes effect. Subsection (a) provides, not surprisingly, that if the security interest would
14 be a perfected security interest under revised Article 9 (i.e., if the transaction satisfies revised
15 Article 9's requirements for enforceability (attachment) and perfection), no further action need
16 be taken for the security interest to be a perfected security interest.

17
18 **Example 1:** A pre-effective-date security agreement and financing statement covered "all
19 accounts and general intangibles now owned or hereafter acquired." After the effective
20 date the debtor acquired controllable accounts, controllable electronic records, and
21 controllable payment intangibles. The security interest in the after-acquired collateral is
22 enforceable and perfected under both former and revised Article 9. The controllable
23 accounts are accounts, the controllable electronic records and controllable payment
24 intangibles are general intangibles, and filing is an appropriate method of perfection for
25 that collateral under both versions of Article 9.

26
27 Other examples of methods of perfection under former Article 9 that also would achieve
28 perfection under revised Article 9 include perfection in electronic documents under former and
29 amended Section 7-106 and perfection in electronic chattel paper under former Section 9-105
30 and perfection in chattel paper evidenced by authoritative electronic records under amended
31 Section 9-105.

32
33 3. **Security interests enforceable and perfected under former Article 9 but**
34 **unenforceable or unperfected under revised Article 9.** Subsection (b) deals with security
35 interests that are enforceable and perfected under former Article 9 immediately before this act
36 takes effect but do not satisfy the requirements for enforceability (attachment) or perfection
37 under revised Article 9. These security interests are perfected security interests until the earlier of
38 the time perfection would have ceased under the law in effect immediately before this act takes
39 effect and the adjustment date. If the security interest satisfies the requirements for attachment
40 and perfection within that period, the security interest remains perfected thereafter. If the security

1 interest satisfies only the requirements for attachment within that period, the security interest
2 becomes unperfected on the adjustment date.

3
4 **Example 2:** A pre-effective-date security agreement signed by Debtor in favor of
5 Secured Party covers, among other things, “all money . . . and general intangibles now
6 owned or hereafter acquired.” Secured Party filed a proper financing statement in the
7 appropriate filing office covering “All personal property.” Debtor owns electronic
8 money, spitcoin, issued by the government of El Cuspidouro. Under former Article 9 the
9 electronic money might be characterized as a general intangible if “money” were to be
10 construed (at least for purposes of Article 9) to include only tangible money as to which
11 perfection is possible only by possession. See former Section 9-312(b)(3). Alternatively,
12 even if the spitcoin is money, perfection might be possible by filing under the baseline
13 rule of Section 9-310, inasmuch as the spitcoin (an intangible) cannot be possessed.
14 Assume, therefore, that under former Article 9 Secured Party’s security interest in the
15 spitcoin is perfected by filing. Assume also that spitcoin can be subjected to control under
16 Section 9-105A. As to the spitcoin owned by the debtor before the effective date, under
17 subsection (b) the security interest would remain perfected until the adjustment date but
18 would become unperfected under revised Article 9 on the adjustment date unless earlier
19 perfected by control. This is so because a security interest in electronic money that can be
20 subject to control under Section 9-105A, such as spitcoin, may be perfected only by
21 control under revised Article 9. Sections 9-312(b)(4); 9-314(a). The security interest in
22 any spitcoin acquired by the debtor after the effective date would be unperfected until the
23 secured party obtains control.

24
25 **Example 3:** Secured Party has a pre-effective-date security interest in a security
26 entitlement perfected by control pursuant to Sections 9-106 and 8-106(d)(3), based on
27 control held by Kontroal Phreeque LLC (KP) on behalf of Secured Party. Even in the
28 highly unlikely event that following the effective date the secured party could not prove
29 that KP acknowledged its control on behalf of the secured party in conformity with
30 revised Section 8-106(d)(3), its security interest would nevertheless remain perfected
31 beyond the adjustment date. Perfection by control for a security entitlement under Section
32 9-106 depends on control under 8-106 and, under Section A-301(a), Part 3 of this annex,
33 including subsection (b), does not apply to transactions under Article 8. The rules under
34 pre-effective date Article 8 continue to apply to the pre-effective date transaction. As to
35 financial assets acquired and becoming a part of the security entitlement after the
36 effective date, however, revised Articles 8 and 9 would apply. Secured Party could
37 perfect its security interest in those financial assets through a complying acknowledgment
38 by KP or by filing. This means for a securities account involving active trading, for
39 example, the secured party should ensure compliance with the revised Article 8 control
40 requirements at or before the effective date so as to ensure perfection in post-effective
41 date-acquired financial assets.

42
43 **4. Interpretation of pre-effective-date security agreements.** Section 9-102 defines
44 “security agreement” as “an agreement that creates or provides for a security interest.” Under
45 Section ~~1-201(3)~~ 1-201(b)(3), an “agreement” is a “bargain of the parties in fact.” If parties to a
46 pre-effective-date security agreement describe the collateral by using a term defined in former

Article 9 in one way and defined in revised Article 9 in another way, in most cases it should be presumed that the bargain of the parties contemplated the meaning of the term under former Article 9. Definitions of terms relating to collateral which have been amended in revised Article 9 are “account,” chattel paper,” “instrument,” “money,” and “general intangible.” A different result might be appropriate, for example, if a security agreement explicitly contemplated future changes in the Article 9 definitions of types of collateral—e.g., “‘Accounts’ means ‘accounts’ as defined in the Uniform Commercial Code Article 9 of [State X], *as that definition may be amended from time to time*.” Whether a different interpretive approach is appropriate in any given case depends on the bargain of the parties, as determined by applying ordinary principles of contract law.

Section A-303. Security Interest Unperfected Before Effective Date.

A security interest that is enforceable immediately before **[the effective date of this act]** but which was unperfected at that time:

(1) remains an enforceable security interest until the [the adjustment date];

(2) remains enforceable thereafter if the security interest becomes enforceable under Section 9-203 on **[the effective date of this act]** or before the [the adjustment date]; and

(3) becomes perfected:

(A) without further action, on **[the effective date of this act]** if the applicable requirements for perfection under this act are satisfied before or at that time; or

(B) when the applicable requirements for perfection are satisfied if the requirements are satisfied after that time.

Official Comment

1. **Source.** This Section derives from Section 9-704.

2. **Pre-effective-date enforceable but unperfected security interests.** This section deals with security interests that are enforceable but unperfected (i.e., subordinate to the rights of a person who becomes a lien creditor) under former Article 9 or other applicable law immediately before this act takes effect. These security interests remain enforceable until the adjustment date, and thereafter if the appropriate steps for attachment under revised Article 9 are taken before the adjustment date. (This section’s treatment of enforceability is the same as that of Section A-302.) The security interest becomes a perfected security interest on the effective date if, at that time, the security interest satisfies the requirements for perfection (which include the requirements for attachment) under revised Article 9. If the security interest does not satisfy the

requirements for perfection until sometime thereafter, it becomes a perfected security interest at that later time.

Example 1: Prior to the effective date Debtor obtained a loan from Secured Party and signed a security agreement covering “all cryptocurrencies now owned or hereafter acquired.” The security interest attached to various cryptocurrencies owned by Debtor, including 1,000 happicoins held by debtor on the happicoins blockchain platform. Debtor then transferred the 1,000 happicoins to Secured Party on the blockchain. Although the happicoins are general intangibles, Secured Party failed to file a financing statement necessary to perfect its security interest under former Article 9.

Under revised Article 9, the happicoins would be controllable electronic records and the transfer of the happicoins to Secured Party would give Secured Party “control” of the happicoins as provided in Section 12-105. Before revised Article 9 (i.e., including revised Sections 9-107A and 9-314) and Article 12 became effective, Secured Party’s security interest was unperfected as noted above. Upon the effective date, however, the security interest became perfected by control as a result of the pre-effective-date transfer of control to Secured Party.

Example 2. Prior to the effective date Debtor obtained a loan from Secured Party and signed a security agreement covering certain specified deposit accounts and “all documents and chattel paper now owned or hereafter acquired by Debtor.” The security interest attached to the deposit accounts and to various documents and chattel paper owned by Debtor. Persons in control of certain electronic chattel paper, electronic documents, and deposit accounts included in the collateral acknowledged that they had control of that collateral on behalf of Secured Party. Assuming that an agency relationship cannot be established between these acknowledging persons and Secured Party, it is perhaps arguable that Secured Party’s security interest in the relevant collateral was unperfected because Secured Party did not have control under former Sections 7-106, 9-104, and 9-105. However, because the pre-effective-date acknowledgments would give Secured Party control under the revised sections, its security interest, even if not perfected pre-effective date, became perfected by control on the effective date.

Section A-304. Effectiveness of Actions Taken Before Effective Date.

(a) **[Pre-effective-date action; attachment and perfection before adjustment date.]** If action, other than the filing of a financing statement, is taken before **[the effective date of this act]** and the action would have resulted in perfection of the security interest had the security interest become enforceable before **[the effective date of this act]**, the action is effective to perfect a security interest that attaches under this act before **[the adjustment date]**. An attached security interest becomes unperfected on **[the adjustment date]** unless the security interest

1 becomes a perfected security interest under this act before [the adjustment date].

2 (b) **[Pre-effective-date filing.]** The filing of a financing statement before **[the effective**
3 **date of this act]** is effective to perfect a security interest on **[the effective date of this act]** to the
4 extent the filing would satisfy the applicable requirements for perfection under this act.

5 (c) **[Pre-effective-date enforceability actions.]** The taking of an action before **[the**
6 **effective date of this act]** is sufficient for the enforceability of a security interest on **[the**
7 **effective date of this act]** if the action would satisfy the applicable requirements for
8 enforceability under this act.

9 Official Comment

10
11 1. **Source.** Subsections (a) and (b) of this Section derive from Section 9-705.
12 Subsection (c) is new.

13
14 2. **General.** This section addresses primarily the situation in which the perfection
15 step or requirement for enforceability is taken under former Article 9 or other applicable law
16 before the effective date of this act, but the security interest does not attach until after that date.

17
18 3. **Perfection other than by filing.** Subsection (a) applies when the perfection step
19 is a step other than the filing of a financing statement. If the step that would be a valid perfection
20 step under former Article 9 or other law is taken before this act takes effect, and if a security
21 interest attaches before the adjustment date, then the security interest becomes a perfected
22 security interest upon attachment. However, the security interest becomes unperfected on the
23 adjustment date unless the requirements for attachment and perfection under revised Article 9 are
24 satisfied within that period.

25
26 4. **Perfection by filing: ineffective filings made effective.** Subsection (b) deals
27 with financing statements that were filed under former Article 9 and which would not have
28 perfected a security interest under the former Article, but which would perfect a security interest
29 under revised Article 9. Under subsection (b), such a financing statement is effective to perfect a
30 security interest to the extent it complies with revised Article 9. Subsection (b) applies regardless
31 of the reason for the filing. When this act takes effect, the filing becomes effective to perfect a
32 security interest assuming the filing satisfies the perfection requirements under revised Article
33 9).

34
35 **Example 1.** Prior to the effective date Debtor obtained a loan from Secured Party and
36 signed a security agreement covering, among other collateral, “money,” “accounts,”
37 “chattel paper,” and “general intangibles.” Secured Party filed a financing statement
38 covering “all assets.” If, under the applicable former Article 9 as interpreted by the

1 courts, electronic currency was “money” as defined in former Section 1-201 even though
2 as an intangible it could not be possessed, then under the applicable former Section 9-
3 312(b)(3), filing a financing statement was not an effective method of perfection.
4 Assume, however, that under revised Articles 1 and 9, the electronic currency is not
5 “money,” and is instead a general intangible. Under revised Article 9, filing is an
6 effective method of perfection. Upon the effective date of revised Article 9, the security
7 interest became perfected by the pre-effective-date filed financing statement.
8

9 **Example 2.** Prior to the effective date Debtor obtained a loan from Secured Party and
10 signed a security agreement covering, among other collateral, “accounts,” “chattel
11 paper,” and “general intangibles.” Secured Party filed a financing statement covering
12 “accounts.” Under the applicable former Article 9, a certain right to payment was chattel
13 paper because it was a lease of specific goods, even though the transaction also covered,
14 and the lessee’s monetary obligation also related to, various other assets and various
15 services. Because the filed financing statement covered only accounts, the security
16 interest in the chattel paper was unperfected. Under revised Article 9, however, the right
17 to payment was an “account,” and not chattel paper, because the lessee’s right to
18 possession and use of the goods was not “the predominant purpose of the transaction.”
19 Section 9-102(a)(11)(B)(ii). Upon the effective date the security interest became
20 perfected by the pre-effective-date filed financing statement covering accounts.
21

22 **5. Enforceability of security interest: unenforceable security interest made**
23 **enforceable.**
24

25 **Example 3.** Under the facts of Example 1, Section A-303, Comment 2, instead of
26 authenticating a security agreement Debtor agreed orally to grant to Secured Party a
27 security interest in the happicoins. It follows that under former Article 9 Secured Party’s
28 security interest was unenforceable and did not attach to the happicoins for want of an
29 authenticated security agreement. Former Section 9-203(b)(3)(A). However, upon the
30 effective date of revised Article 9, Secured Party had control of the happicoins under
31 revised Article 9. Sections 12-105. At that time the security interest became enforceable
32 and attached under Sections 9-107A and 9-203(b)(3)(D) and also was perfected by
33 control.
34

35 **Section A-305. Priority.**

36 (a) **[Determination of priority.]** Subject to subsections (b) and (c), this act determines
37 the priority of conflicting claims to collateral.

38 (b) **[Established priorities.]** Subject to subsection (c), if the relative priorities of claims
39 to collateral were established before **[the effective date of this act]**, Article 9 as in effect prior to
40 **[the effective date of this act]** determines priority.

(c) **[Determination of certain priorities on adjustment date.]** On [the adjustment date], to the extent the relative priorities determined by Article 9 as amended by this act modify the relative priorities established before **[the effective date of this act]**, the relative priorities of claims to Article 12 property and electronic money which were established before **[the effective date of this act]** cease to apply.

Official Comment

1. **Source.** This section derives from Section 9-709.

2. **Law governing priority and established priorities.** Ordinarily, revised Article 9 determines the priority of conflicting claims to collateral under subsection (a). However, when the relative priorities of the claims were established before the effective date, former Article 9 governs under subsection (b). Subsection (c) provides an exception to subsection (b).

Example 1. In 2021, prior to the effective date, Debtor obtained a loan from Secured Party and signed a security agreement covering “all cryptocurrency and money now owned or hereafter acquired.” The security interest attached to various cryptocurrencies owned by Debtor, including 1,000 happicoins held by Debtor on the happicoins blockchain platform. Secured Party promptly filed a financing statement covering “all general intangibles, including cryptocurrencies, now owned or hereafter acquired by Debtor.” In 2022, also prior to the effective date, Debtor obtained a loan from Lender and signed a security agreement covering “all cryptocurrency now owned or hereafter acquired.” Although the happicoins are general intangibles, Lender failed to file a financing statement. Because the priorities of the claims were established before the effective date, former Article 9 governs. Secured Party’s perfected security interest has priority over Lender’s unperfected security interest under former Section 9-322(a)(2).

Example 2. The facts are the same as in Example 1, except that Debtor transferred control of the 1,000 happicoins to Lender on the blockchain in 2022 *before* the effective date. Because Lender failed to file a financing statement and control was not a method of perfection under former Article 9, Lender’s security interest was unperfected immediately prior to the effective date. However, because under revised Article 9 the happicoins are controllable electronic records and Lender has “control” of the happicoins under Section 12-105, Lender’s security interest became perfected on the effective date. Nevertheless, because the priorities of Secured Party’s and Lender’s security interests were established before the effective date, Secured Party’s security interest continues to have priority after the effective date. (However, see Example 4 for the shift of priority on the adjustment date.)

Example 3. The facts are the same as in Example 1, except that in 2023, *after* the effective date, Debtor transferred control of the 1,000 happicoins to Lender on the

1 blockchain. Under revised Article 9, the happicoins were controllable electronic records
2 and the transfer of control of the happicoins gave Lender “control” of the happicoins as
3 provided in Section 12-105. The affirmative step of transferring control established anew
4 the relative priority of the conflicting claims after the effective date. Revised Article 9
5 determines priority and Lender’s security interest has priority under Section 9-326A.
6 Moreover, Lender also may also have priority over other property claims as a qualifying
7 purchaser under Section 12-104(e).
8

9 One consequence of the rule on established priorities in subsection (b) is that the mere taking
10 effect of this act does not of itself adversely affect the priority of conflicting claims to collateral,
11 as Example 2 illustrates. However, as Example 3 illustrates, relative priorities that are
12 “established” before the effective date do not necessarily remain unchanged following the
13 effective date. Of course, unlike priority contests among security interests, some priorities are
14 established permanently, e.g., the rights of a buyer of property who took free of a security
15 interest under former Article 9.
16

17 3. Modification of established priorities on adjustment date. 18

19 Subsection (c) provides an exception to the respect that subsection (b) affords to pre-
20 effective-date established priorities, but only for security interests in Article 12 property—
21 controllable accounts, controllable electronic records, and controllable payment intangibles—and
22 electronic money.
23

24 **Example 4.** The facts are the same as in Example 2. Lender’s security interest became
25 perfected by control on the effective date, Secured Party’s established priority continued
26 to apply under subsection (b). Under subsection (c), however, on the adjustment date the
27 priorities shifted. Secured Party’s established priority ceased to apply and Lender’s
28 perfection by control gave Lender priority under revised Section 9-326A.
29

30 4. Transfers of collateral after the effective date. 31

32 **Example 5.** The facts are the same as in Example 2. In 2023, *after* the effective date,
33 Debtor acquired an additional 500 happicoins. The security interests of both Secured
34 Party and Lender attached to the happicoins pursuant to the after-acquired property
35 clauses in their respective security agreements. Secured Party’s security interest was
36 perfected by its earlier financing statement filing. Lender then perfected its security
37 interest by Debtor’s transfer of control of the happicoins to Lender. Lender’s security
38 interest perfected by control gave Lender priority under Section 9-326A. Unlike the
39 situation in Example 2, however, as to the newly acquired happicoins the priorities were
40 not established prior to the effective date. Before the effective date neither creditor could
41 have had a “perfected” security interest in happicoins in which Debtor had not yet
42 acquired rights.
43

44 **Example 6.** The facts are the same as in Example 1. In 2023, *after* the effective date,
45 Debtor transferred 750 spitcoins, an electronic money, to Beier. Beier then obtained
46 control of the spitcoins under Section 9-105A. Secured Party’s security interest in the

1 spitcoins, which were either money not capable of being possessed or general intangibles
2 under former Article 9, are assumed to be perfected by filing. See Section A-302,
3 Comment 3, Example 2. Because there was no wrongful collusion with Debtor (indeed,
4 Beier had no knowledge or notice of Secured Party's security interest), Beier took the
5 bitcoin free of Secured Party's security interest under Section 9-332(b).
6

7 **Section A-306. Priority of Claims When Priority Rules of Article 9 Do Not**

8 **Apply.**

9 (a) **[Determination of priority.]** Subject to subsections (b) and (c), Article 12 determines
10 the priority of conflicting claims to Article 12 property when the priority rules of Article 9 as
11 amended by this act do not apply.

12 (b) **[Established priorities.]** Subject to subsection (c), when the priority rules of Article 9
13 as amended by this act do not apply and the relative priorities of claims to Article 12 property
14 were established before **[the effective date of this act]**, law other than Article 12 determines
15 priority.

16 (c) **[Determination of certain priorities on adjustment date]** When the priority rules of
17 Article 9 as amended by this act do not apply, to the extent the relative priorities determined by
18 this act modify the relative priorities established before **[the effective date of this act]**, the
19 relative priorities of claims to Article 12 property which were established before **[the effective**
20 **date of this act]** cease to apply on [the adjustment date].

21 **Official Comment**

22
23 1. **Source.** This section derives from Section 9-709 and, in part, from Section 8-510.
24

25 2. **Applicability of this section to Article 12 property.** Although this section
26 applies to Article 12 property (controllable accounts, controllable electronic records, and
27 controllable payment intangibles) when the priority rules of Article 9 do not apply, it applies
28 primarily to controllable electronic records. Its application to controllable accounts and
29 controllable payment intangibles is quite limited because Article 9 applies to most sales of
30 accounts and payment intangibles (as well as to security interests in that property that secure an
31 obligation). Section 9-109(a)(3). There is a very limited exclusion from the scope of Article 9 for
32 sales of accounts and payment intangibles in connection with sales of the business out of which

1 they arose. Section 9-109(d)(4).

2
3 **3. Law governing priority and established priorities.** Ordinarily, when the
4 priority rules of Article 9 do not apply, Article 12 determines the priority of conflicting claims to
5 Article 12 property under subsection (a). However, when the relative priorities of the claims
6 were established before the effective date, under subsection (b) law other than Article 12
7 governs. Subsection (c) provides an exception to subsection (b).
8

9 **4. Law governing priority and established priorities.**

10
11 **Example 1.** In 2021, prior to the effective date, Aiko owned 500 happicoins (a
12 cryptocurrency consisting of controllable electronic records) over which Aiko had control
13 (within the meaning of Section 12-105) on the happicoins blockchain. In December 2021
14 Aiko sold the 500 happicoins to Barbara for \$10,000 cash. Aiko provided Barbara with a
15 signed memorandum acknowledging the sale and Aiko's receipt of the purchase price and
16 agreeing to hold the happicoins for Barbara pending Barbara's further instructions.
17

18 In January 2022 (also prior to the effective date), Aiko sold the same 500 happicoins to
19 Molly for \$12,000 cash. Aiko provided Molly with a signed memorandum similar to the
20 one Aiko had provided to Barbara. Assume that, under the non-Uniform Commercial
21 Code applicable law, Barbara remained the owner of the happicoins and under that law
22 Molly obtained no interest in the happicoins pursuant to the purported sale because Aiko
23 had retained no interest and had nothing to transfer to Molly. Because the priorities of the
24 claims of Aiko, Barbara, and Molly were established before the effective date, under
25 subsection (a) those priorities remained in effect after the effective date.
26

27 **Example 2.** The facts are the same as in Example 1, except that *before* the effective date,
28 Aiko transferred control of the happicoins to Molly on the happicoins blockchain. Again,
29 assume that under the non-Uniform Commercial Code applicable law that transfer had no
30 legal effect. After the effective date the relative priorities are unchanged from those
31 described in Example 1 because the relative priorities were established before the
32 effective date and subsection (b) applies.
33

34 **Example 3.** The facts are the same as in Example 1, except that *after* the effective date,
35 Aiko transferred control of the happicoins to Molly on the happicoins blockchain. Under
36 Article 12, the happicoins were controllable electronic records and the transfer of control
37 of the happicoins gave Molly "control" of the happicoins as provided in Section 12-105.
38 Because (it is assumed) Molly met the requirements for a "qualifying purchaser" under
39 Section 12-104(e), Molly acquired the happicoins free of Barbara's property claim. The
40 affirmative step of transferring control after the effective date established anew the
41 relative priority of the conflicting claims after the effective date. Under Section A-301(a),
42 Article 12 applies to the pre-effective-date transactions and property interests and
43 subsection (a) of this section applies.
44

45 **5. Modification of established priorities on adjustment date.** Subsection (c)
46 provides an exception to the respect that subsection (b) affords to pre-effective-date established

1 priorities.

2
3 **Example 4.** The facts are the same as in Example 2. However, on the adjustment date the
4 established priorities change. Because (it is assumed) Molly met the requirements for a
5 “qualifying purchaser” under Section 12-104(e), on the adjustment date Molly acquired
6 the happicoins free of Barbara’s property claim. Under Section A-301(a), Article 12
7 applies to the pre-effective-date transactions and property interests and subsection (a) of
8 this section applies.

9
10 **6. Transfers after the effective date.**

11
12 **Example 5.** The facts are the same as in Example 1, except that *after* the effective date
13 Aiko sold and transferred control of the happicoins to Jacob on the happicoins
14 blockchain. Because (it is assumed) Jacob met the requirements for a “qualifying
15 purchaser” under Section 12-104(e), Jacob acquired the happicoins free of Barbara’s and
16 Molly’s property claims. Note that Jacob took the happicoins free of conflicting claims in
17 the post-effective date acquisition immediately upon acquisition as a qualifying
18 purchaser. Jacob’s priority was established after the effective date and was not deferred
19 until the adjustment date, as was the case for Molly’s rights in Example 4.

20
21 **PART 4**

22 **GENERAL PROVISIONS**

23 **Section A-401. Effective Date.**

24 This act takes effect on **[the effective date of this act]**.

25 **Legislative Note:** *This [part] [section] is not to be codified as a part of [the Uniform*
26 *Commercial Code.*