

## MEMORANDUM

TO: Committee on the Uniform Commercial Code and Emerging Technologies

FROM: Steven Harris, Reporter

RE: Controllable Electronic Records (to be discussed on April 27th, 2 p.m. CT)

DATE: April 18, 2021

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This document includes a draft of a new UCC article, Article 12, as well as a draft of amendments to Articles 1 and 9 that would implement new Article 12.

### **Prefatory Note**

*Introduction to Article 12.* Article 12 and the accompanying amendments to Article 1 and 9 are but one part of the effort to adapt the UCC to emerging technologies as they might affect electronic commerce.

The adoption of distributed ledger technology (DLT) has underscored two important trends in electronic commerce. First, 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 interests in personal and real property. Second, 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 binding agreement, people around the world have agreed to treat Bitcoin (or, more precisely “transaction outputs” generated by the Bitcoin protocol) as a medium of exchange and store of value.

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, draft Article 12 is meant 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*). The rules would 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 is unable to verify the identity of the transferor or the source of the transferor’s title. Accordingly, controllable electronic records would be negotiable, in the sense that a 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” that one person can enjoy to the exclusion of all others, *e.g.*, the power to “spend” a Bitcoin (or, more precisely, the power to include an unspent transaction output in a message that the Bitcoin protocol will record to its blockchain).
- A person must be able to transfer to another person this exclusive power to use the electronic record. To remain exclusive, the transfer must divest the transferor of the power to use the electronic record.
- A third party must be able to demonstrate to a third party that the person has the power to “use” the electronic record.

As discussed in the Reporter’s Note to draft § 12-105, these functions form the basis of the Article 12 concept of *control*. To receive the benefits of negotiability under the draft, a person must have *control* of the controllable electronic record. In addition, control would serve as a method of perfection of a security interest in a controllable electronic record. In this context, it may be useful to think of control as the rough functional equivalent of possession of tangible property, such as goods.

Like the UCC in general, Article 12 would not be a regulatory statute. It would govern the rights of transacting parties and the rights of persons that might be affected by the transactions. With the exception of certain rights to payment evidenced by a controllable electronic record, Article 12 would not govern assets other than controllable electronic records.

#### *What is the scope of draft Article 12?*

Article 12 would apply to *controllable electronic records*. Controllable electronic records would be defined as a subset of what often are referred to as digital assets. Article 12 is designed to work for both technologies that are known and those that may be developed in the future. Whether an asset is a controllable electronic record (and therefore within the scope of Article 12) would depend on whether the characteristics of the asset and the protocols of any system on which the asset is recorded would make it suitable for the application of Article 12’s substantive rules. Inasmuch as the nature of electronic commerce is constantly changing, the technology on which an asset depends, the type of asset, and the prevailing use of the asset would all be irrelevant to whether the asset is a controllable electronic record.

To determine whether Article 12 would apply to a particular asset, *e.g.*, Bitcoin, one must determine whether the asset would fall within the definition of *controllable electronic record*. A controllable electronic record is a *record*, as the UCC defines the term. A *record* is information that is retrievable in perceivable form.<sup>1</sup> *Electronic* means “relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.” A *controllable electronic record* is an electronic record that can be subjected to *control*, as defined in draft § 12-105. An electronic record that cannot be subjected to control under draft § 12-105 would be outside the scope of Article 12.

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<sup>1</sup> See UCC § 1-201(b)(31).

The meaning of *control* in the UCC depends on the type of property involved.<sup>2</sup> The Reporter's Note accompanying draft § 12-105 explains the requirements for obtaining control of a controllable electronic record. For present purposes, it is sufficient to think of Bitcoin as the prototypical controllable electronic record.

The existing law governing certain types of electronic records that can be subjected to Article 12 control is sufficient. These electronic records, which include electronic chattel paper, electronic documents, investment property, and transferable records under UETA, would be excluded from Article 12.

*What are the substantive provisions of Article 12?*

The principal function of Article 12 would be to specify the rights of a *purchaser* of a controllable electronic record.<sup>3</sup> A purchaser is a person that acquires an interest in property by a voluntary transaction, such as a sale.<sup>4</sup> Law other than Article 12 would determine whether a person acquires any rights in a controllable electronic record and so would be eligible to be a purchaser.

Draft § 12-104 adopts the “shelter” principle, under which a purchaser of a controllable electronic record would acquire whatever rights the transferor had or had power to transfer. This rule appears in Article 2 with respect to goods and Article 8 with respect to securities.<sup>5</sup>

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

Consider the case in which *B* contracts to buy Bitcoin from *S*. Assume that *S* is the owner of the Bitcoin.

- Law other than Article 12 generally would determine whether *S* is the owner of the Bitcoin.

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<sup>2</sup> E.g., UCC § 7-106 (electronic documents of title); § 8-106 (containing four definitions of “control,” one for each of four different types of investment property); § 9-104 (deposit accounts); § 9-105 (electronic chattel paper).

<sup>3</sup> These provisions appear in draft § 12-104.

<sup>4</sup> “‘Purchase’ means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property.” UCC § 1-201(b)(29).

<sup>5</sup> UCC § 2-403(1) provides, “A purchaser of goods acquires all title which his transferor had or had power to transfer . . . .” UCC § 8-302(a) provides, “a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer.” Other UCC provisions also reflect the shelter principle. *See, e.g.*, UCC § 3-203(b) (concerning negotiable instruments); UCC § 7-504(a) (concerning documents of title).

<sup>6</sup> Article 8 also provides for certain purchasers for value to take greater rights. *See* UCC § 8-303.

- Law other than Article 12 would resolve issues concerning the formation of the contract of sale between *B* and *S* and the obligations of the parties under the contract.
- Law other than Article 12 would determine what steps are necessary for *B* to acquire rights in the Bitcoin.<sup>7</sup>
- By acquiring rights in the Bitcoin, *B* would become a *purchaser* of the Bitcoin within the meaning of UCC Article 1.
- Article 12 would provide that if *B* becomes a purchaser, *B* would acquire whatever rights *S* had or had power to transfer. As a general matter, law other than Article 12 would define these rights. *B* would acquire these rights regardless of whether *B* obtained control of the Bitcoin.

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

- Just as a buyer of goods can obtain possession from a seller that has no rights in the goods, *B* can obtain control of the Bitcoin, even if *S* “stole” it from the owner.
- If *B* obtains control of the Bitcoin for value, in good faith, and without notice of any claim of a property interest, *B* would be a *qualifying purchaser*.
- Even if *B* would not have acquired any rights in the Bitcoin under non-Article 12 law, as an Article 12 qualifying purchaser, *B* would acquire the Bitcoin free of all claims of a property interest in the Bitcoin. 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.)

*How would Article 12 deal with rights or property that is linked to a controllable electronic record?*

*The general rules.*

Recall that a controllable electronic record is a record, *i.e.*, information. Some records have what one might call “inherent 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 could hold the Bitcoin as an investment.

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<sup>7</sup> Law other than Article 12 would include Article 9. Thus, Article 9 would determine whether a security interest attaches to a controllable electronic record. If there is a conflict between Article 12 and Article 9, Article 9 would govern. Draft § 12-102(b).

The value of many (if not most) records, however, is as evidence of the rights of the parties to a transaction. 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 *S* is to deliver the goods, and *B* is to pay for them, at a future date. *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* 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 and that *B* sells to *P* the controllable electronic record. Under draft § 12-104(c), *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* would become a *qualifying purchaser* and, as such, would acquire its rights *in the controllable electronic record* free of any claim of a property right.

But the controllable electronic record may not be of itself a valuable asset. It would have value to *P* only if by virtue of acquiring rights in the controllable electronic record, *P* would also acquire the right to receive delivery of the goods from *S*.

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

Suppose, however, that other law does provide that, by acquiring the controllable electronic record, *P* would acquire the right to receive delivery of the goods from *S*. Suppose also that *P* becomes a qualifying purchaser of the controllable electronic record. As we have seen, as a qualifying purchaser, *P* would take its rights *in the controllable electronic record* free of property claims. But *P* would not acquire *the right to receive delivery* of the goods free of property claims unless non-Article 12 law provides otherwise.

*The exceptions: controllable electronic records and controllable payment intangibles.*

As a general rule, draft Article 12 would apply to records and not to rights evidenced by

records (or to rights that records purport to evidence). Law other than Article 12 would determine what steps must be taken for a person to acquire an interest in a controllable electronic record and the rights, if any, that the person acquires. This “other” law would include UCC Article 9.

The draft would provide that the attachment and perfection of a security interest in a controllable electronic record would also be attachment of a security interest in “controllable accounts” and “controllable payment intangibles.”<sup>8</sup> These are accounts and payment intangibles that are evidenced by a controllable electronic record that provides that the account debtor undertakes to pay the person that has control of the controllable electronic record.<sup>9</sup> The draft would provide a similar rule with regard to perfection of a security interest in a controllable account or controllable payment intangible.<sup>10</sup> A qualifying purchaser of the controllable electronic record would acquire its rights in the controllable account or controllable payment intangible free of any claim of a property interest.<sup>11</sup>

The draft would amend several other sections of Article 9 to deal with other aspects of security interests in controllable accounts and controllable payment intangibles. The Reporter’s Notes to these sections discuss the amendments.

## **ARTICLE 12**

### **CONTROLLABLE ELECTRONIC RECORDS**

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

**Section 12-102. Definitions.**

(a) In this article, “controllable electronic record” means an electronic record that can be subjected to control (Section 12-105). The term does not include electronic chattel paper, electronic documents, electronic money, investment property, “transferable records” as defined in the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7021(a)(1), and “transferable records” as defined in the Uniform Electronic Transactions Act Section 16(a).

(b) The definitions of “account debtor,” “authenticate,” “controllable account,”

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<sup>8</sup> Draft § 9-203(j).

<sup>9</sup> See draft § 9-102(b) (defining “controllable account” and “controllable payment intangible”).

<sup>10</sup> Draft § 9-310(h).

<sup>11</sup> Draft § 12-104.

“controllable payment intangible,” “electronic chattel paper,” “electronic money,” and “investment property” in Article 9 apply to this article.

### **Reporter’s Note**

1. “*Controllable electronic record.*” A “controllable electronic record” is an “electronic record,” *i.e.*, information that is stored in an electronic or other medium and is retrievable in perceivable form. To be within the scope of Article 12, the record must be susceptible of control under Section 12-105.

The provisions of Article 12 are likely to be unsuitable for certain types of electronic records, and the definition will need to be limited accordingly. The Drafting Committee may wish to consider whether the exclusions in the draft are appropriate and any whether additional exclusions would be needed.

#### **Section 12-103. Scope.**

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

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

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

### **Reporter’s Note**

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

Subsection (c) is copied from Section 9-102.

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

#### **Section 12-104. Rights in Controllable Electronic Records, Controllable Accounts, and Controllable Payment Intangibles.**

(a) In this section, “qualifying purchaser” means a purchaser of a controllable electronic record or an interest therein, which 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 or any controllable account or controllable payment intangible that is evidenced by the controllable electronic record.

(b) Subject to subsections (c) through (h), law other than this article determines whether a person acquires rights in a controllable electronic record and the rights, if any, that the person acquires.

(c) A purchaser of a controllable electronic record acquires all rights in the controllable electronic record that the transferor had or had power to transfer.

(d) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

(e) In addition to acquiring the rights of a purchaser, a qualifying purchaser acquires its rights in the controllable electronic record and any controllable account or controllable payment intangible that is evidenced by the controllable electronic record free of a claim of a property right in the controllable electronic record, controllable account, or controllable payment intangible.

(f) Except as otherwise provided by subsection (e) or law other than the [Uniform Commercial Code], a qualifying purchaser takes any right to payment, right to performance, or interest in property that is evidenced by the controllable electronic record subject to a claim of a property right in the right to payment, right to performance, or interest in property.

(g) This subsection applies to a purchaser of a controllable electronic record that is traceable to another controllable electronic record. An action based on a claim of a property right in the other controllable electronic record or a controllable account or controllable payment intangible



that is evidenced by the other controllable record, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against the purchaser if the purchaser acquires its interest in the traceable controllable electronic record for value, in good faith, and without notice of a claim of a property right in the traceable controllable electronic record or any controllable account or controllable payment intangible that is evidenced by the traceable controllable electronic record.

(2) A purchaser of the traceable controllable electronic record takes free of a security interest in the traceable controllable electronic record and any controllable account or controllable payment intangible that is evidenced by the traceable controllable electronic record if:

(A) the purchaser acquires its interest in the traceable controllable electronic record for value, in good faith, and without notice of a claim of a property right in the traceable controllable electronic record or any controllable account or controllable payment intangible that is evidenced by the traceable controllable electronic record; and

(B) the traceable controllable electronic record constitutes the proceeds of the other controllable electronic record.

(h) Filing of a financing statement under Article 9 is not notice of a claim of a property right in a controllable electronic record.

### **Reporter's Note**

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

Subsections (c) and (d) derive from UCC §§ 2-403(1) (concerning the rights of a purchaser).

Subsection (e) derives from UCC § 3-306 (concerning the rights of a holder in due course).

Subsection (g) derives from UCC § 8-502 (protecting entitlement holders).

Subsection (h) derives from UCC § 3-302(b) (concerning notice of a claim).

2. *Applicability of other law.* As a general matter, this section would leave to other law the resolution of questions concerning the transfer of rights in a controllable electronic record, such as the acts that must be taken to effectuate a transfer of rights and the scope of the rights that a transferee acquires. *See* subsection (b). Subsections (c) through (h) contain important exceptions to this subsection.

**Example:** A creates a controllable electronic record. Other law would determine what rights A has in the controllable electronic record. A and B agree to the sale of the controllable electronic record to B. Other law would determine what steps need to be taken for B to acquire rights in the controllable electronic record. Once B acquires those rights, B would be a purchaser (as defined in Section 1-201), whose rights would be determined by either subsection (c) or (h), depending on whether B was a qualifying purchaser.

The “law other than this article” that may apply to the transfer of rights in a controllable electronic record includes UCC Article 9. UCC § 9-203 would apply, for example, to determine whether a purported secured party acquired an enforceable security interest in a controllable electronic record.

3. *Nonpurchaser having control.* Section 12-105 would not condition control of a controllable electronic record on a person’s having an interest in the controllable electronic record. A person that has control of, but no interest in, a controllable electronic record would not be a purchaser of the controllable electronic record and so would not be eligible to be a qualifying purchaser under this section.

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

Because Debtor’s security agreement does not cover controllable electronic records, Secured Party would have no interest in the controllable electronic record. Accordingly, Secured Party would not be a purchaser of the controllable electronic record and would not benefit from the take-free rule in draft § 12-104(e). Secured Party’s security interest would, however, have priority over a conflicting security interest that was perfected by a method other than control. *See* draft § 9-326A.

4. *Conditions for, and consequences of, becoming a qualifying purchaser.* The conditions for, and consequences of, becoming a qualifying purchaser were drawn from Article 3. More specifically, the conditions for becoming a qualifying purchaser were drawn from UCC § 3-302(a)(2), which defines “holder in due course.” The definition of “qualifying purchaser” would, however, omit some of the conditions for becoming a holder in due course. For example, to qualify as a holder in due course, a holder must take “without notice that any party has a defense or claim in recoupment . . . .” UCC § 3-302(a)(2)(vi). A controllable electronic record is

information; there are no parties to a controllable electronic record. (There are parties to a controllable account or controllable payment intangible. Sections 9-404 and 9-403 would determine whether a purchaser of the controllable account or controllable payment intangible takes free of a defense.)

Subsection (e) derives from UCC § 3-306, under which a holder in due course takes a negotiable instrument free of a claim of a property right in the instrument. A qualifying purchaser of a controllable electronic record would take free of all claims of a property right in the controllable electronic record and any related controllable account or controllable payment intangible.

In earlier drafts, the conditions for, and consequences of, becoming a qualifying purchaser were drawn from Article 8. The specified conditions for becoming a protected purchaser under Section 8-303(a) do not include a good-faith requirement, and a person that has notice of property claims that are not “adverse claims” can become a protected purchaser.

5. *The take-free rule.* Subsection (e) would make controllable electronic records highly negotiable. It would protect a qualified purchaser of a controllable electronic record against claims of a property interest in the controllable electronic record as well as in any related controllable account or controllable payment intangible.

As a general matter, law other than Article 12 would determine whether any particular transaction creates a property interest in a controllable electronic record. See subsection (b). The applicable law may provide that a hacker, who is essentially a thief, acquires no rights in a “stolen” controllable electronic record. If that is the case, a person that acquires the controllable electronic record from the hacker would acquire no rights, would not qualify as a “purchaser” of the controllable electronic record, would not be a “qualified purchaser,” and would not enjoy the protection of the take-free rule.

Subsections (c) and (e) would change that outcome. They would enable a purchaser that obtains control from a hacker and that otherwise meets the definition of “qualified purchaser” (for value, in good faith, and without notice of property claims) to take the controllable electronic record and any related controllable account or controllable payment intangible free of property claims.

6. *The no-action rule.* The take-free rule in subsection (e) would apply when both the person having control and a third person claim a property interest in the same controllable electronic record. The no-action rule in subsection (g) is meant to provide analogous protection when a purchaser obtains control of a controllable electronic record that is not the same controllable electronic record in which a third person claims a property interest but is traceable to that controllable electronic record. To qualify for protection under subsection (g), a purchaser would need to obtain control for value, in good faith, and without notice of a claim of a property interest in the traceable controllable electronic record or any related controllable account or controllable payment intangible.

**Example:** Secured Party holds a perfected security interest in Debtor's Bitcoin unspent transaction output. Debtor contracts to sell Bitcoin to Buyer. To fulfill its obligation under the contract of sale, Debtor uses the transaction output as a transaction input to transfer Bitcoin to Buyer. Subsection (e) would protect Buyer from Secured Party's claim that the Bitcoin recorded in the transaction input are the same as the Bitcoin recorded in the transaction output. Subsection (g) would protect Buyer if the Bitcoin were recorded in a transaction output that is not the same as the claimed transaction input.

7. *"Tethered" assets.* Certain controllable electronic records may carry with them rights to other assets, e.g., goods or rights to payment. By its terms, the take-free rule in subsection (e) would apply to controllable electronic records, controllable accounts, and controllable payment intangibles. One might argue that the reference to controllable accounts and controllable payment intangibles is unnecessary. By taking a controllable electronic record free of property claims, wouldn't a person take not only the controllable electronic record itself but also all rights that are "carried" in the controllable electronic record free and clear?

Subsection (f) would defeat that argument and limit the application of the take-free rule in subsection (e) to controllable electronic records, controllable accounts, and controllable payment intangibles. Under subsection (f), a qualifying purchaser of a controllable electronic record would take other rights to payment, rights to performance, and interests in property that are evidenced by a controllable electronic record subject to third-party property claims, unless law other than the UCC provides to the contrary.

**Example:** *O* is the owner of a controllable electronic record. The controllable electronic record is a nonfungible token (NFT) that provides access to an electronic image file depicting LeBron James. The image file is not a controllable electronic record, and *O* does not own the copyright in the image of LeBron James. *O* granted to *SP* a security interest in all of *O*'s existing and after-acquired property. *SP* perfected the security interest.

Because the NFT is a controllable electronic record, a purchaser (*P*) of the NFT ordinarily would acquire only those rights that the seller had or had power to convey. Thus, *P* would acquire its interest subject to *SP*'s perfected security interest. See draft § 12-104(c); UCC § 9-315(a)(1).

However, if *P* is a qualifying purchaser, *P* would acquire its interest in the NFT free of any claim of a property right in the NFT, including *SP*'s security interest. See draft § 12-104(e); § 9-331. Article 9 would determine whether *SP*'s security interest attached to the image file depicting LeBron James. If it did attach, law other than Article 12 would determine whether *P* would acquire the image file free and clear of *SP*'s security interest.

8. *Creating the functional equivalent of a negotiable instrument.* Two defining characteristics of an Article 3 negotiable instrument are that a holder in due course (1) takes free of claims of a property or possessory right to the instrument (UCC § 3-306) and (2) takes free of most

defenses and claims in recoupment (UCC § 3-305). Article 3 applies only to written instruments. This draft would provide a method for reaching a similar result with respect to controllable accounts and controllable payment intangibles. As regards the first characteristic, a qualified purchaser of the controllable electronic record would acquire the controllable account or controllable payment intangible free of any claim of a property interest. As regards the second, UCC § 9-403 ordinarily would give effect to the account debtor's agreement not to assert claims or defenses.

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

(a) A person has “control” of a controllable electronic record if the following conditions are met:

(1) the controllable electronic record or the system in which it is recorded, if any, gives the person:

(A) the power to avail itself of substantially all the benefit from the controllable electronic record;

(B) subject to subsection (b), the exclusive power to prevent others from availing themselves of substantially all the benefit from the controllable electronic record; and

(C) subject to subsection (b), the exclusive power to transfer control of the controllable electronic record to another person or cause another person to obtain control of a controllable electronic record that is traceable to the controllable electronic record; and

(2) the controllable electronic record, a record attached to or logically associated with the controllable electronic record, or the system in which the controllable electronic record is recorded, if any, enables the person to readily identify itself as having the powers specified in subsection (a)(1).

(b) A power specified in subsection (a) is “exclusive,” even if:

(1) the controllable electronic record or the system in which it is recorded, if any, limits the use to which the controllable electronic record may be put or has protocols that are programmed to result in a transfer of control; or

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

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

### **Reporter's Notes**

1. *Why "control" matters.* Control would serve two major functions Article 12. An electronic record would be a "controllable electronic record" and would be subject to the provisions of this article only if it can be subjected to control under this section. *See* draft §§ 12-102; 12-103. And a person having control of a controllable electronic record would be eligible to become a qualified purchaser and so take free of claims of a property interest in the controllable electronic record. *See* draft § 12-104.

In addition, under draft amendments to Article 9, perfection of a security interest in a controllable electronic record would be achieved by obtaining control of the controllable electronic record. Perfection of a security interest in controllable accounts and controllable payment intangibles would be achieved by obtaining control of the related controllable electronic record.

2. *Powers; inability to exercise a power.* This section would condition control on a person's having the three powers specified in paragraph (a)(1). A person would have a "power" described in this paragraph if the controllable electronic record or any system in which it is recorded gives the purchaser that power, even if the characteristics of the particular purchaser disable the person from exercising the power (as would be the case, *e.g.*, if the purchaser holds the private key required to access the benefit of the controllable electronic record but lacks the hardware required to use it).

3. *"Benefit."* Subparagraphs (a)(1)(A) and (a)(1)(B) would condition control of a controllable electronic record on a person's relationship to the benefit of the controllable electronic record.

As used in the section, the "benefit" of a controllable electronic record refers to the rights that are afforded by the controllable electronic record and the uses to which the controllable electronic record can be put. These, in turn, depend on the characteristics of the controllable electronic record in question. For example, Bitcoin can be held or disposed of (sold). A controllable electronic record evidencing a controllable account or controllable payment intangible affords the right to collect from the account debtor (obligor).

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

4. *Power to retrieve information.* By definition, the information constituting an electronic record must be “retrievable in perceivable form.” UCC § 1-201. The power to retrieve the record in perceivable form is included in the benefit that of a controllable electronic record. “Perceivable form” means that the contents of the record are intelligible; the ability to perceive the indecipherable jumble of an encrypted record does not give a person the power to retrieve the record in perceivable form. To have control of a controllable electronic record under subparagraph (a)(1)(A), a person must have at least the nonexclusive power to avail itself of this benefit. If a person also has the exclusive power to decrypt the encrypted record, the person would have the exclusive power to prevent others from availing themselves of substantially all the benefit from the controllable electronic record and thereby satisfy the condition in subparagraph (a)(1)(B).

5. *Exclusive powers.* Unlike the power in subparagraph (a)(1)(A), the powers in subparagraphs (a)(1)(B) and (a)(1)(C) must be held exclusively by the person claiming control in order to establish control.

Subsection (b) contains two limitations on the term “exclusive” as used in subsection (a). Under subsection (b), a power can be “exclusive,” even if one or both of these limitations apply.

Paragraph (b)(1) takes account of the fact that the powers of a purchaser of a controllable electronic record necessarily are subject to the attributes of the controllable electronic record and the protocols of any system in which the controllable electronic record is recorded.

One effect of paragraph (b)(2) is that, under a multi-signature (multi-sig) agreement, any person that is readily identifiable under paragraph (a)(2) and shares the relevant power would be eligible to have control, even if the action of another person is a condition for the exercise of the power.

6. *Readily identify.* Paragraph (a)(2) provides that a person does not have control of a controllable electronic record unless the controllable electronic record, a record attached to or logically associated with the controllable electronic record, or any system in which the controllable electronic record is recorded enables the person to readily identify itself as the person having the requisite powers. This paragraph does not obligate a person to identify itself as having control. However, to prove that it has control, a person would need to prove that the relevant records or any system in which the controllable electronic record is recorded readily identifies the person as such.

Subsection (c) derives from UCC § 3-110(c). It adds “cryptographic key” as an example of a way in which a person may be identified for purposes of paragraph (a)(2).

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

(a) Subject to subsections (b) through (g), the account debtor on a controllable account or controllable payment intangible may discharge its obligation:

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

(2) by paying a person that formerly had control of the controllable electronic record.

(b) Subject to subsection (g), an account debtor may not discharge its obligation by paying a person that formerly had control if the account debtor receives a notification, authenticated by a person that formerly had control or the person to which control was transferred, that reasonably identifies the controllable account or controllable payment intangible, notifies the account debtor that control of the controllable electronic record that evidences the controllable account or controllable payment intangible was transferred, identifies the transferee, and provides a reasonable method by which the account debtor is to make payments to the transferee. The transferee may be identified in any way, including by name, identifying number, cryptographic key, office, or account number. After receipt of the notification, the account debtor may discharge its obligation by paying in accordance with the notification and may not discharge the obligation by paying a person that formerly had control.

(c) **[When notification ineffective.]** Subject to subsection (g), notification is ineffective under subsection (b):



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

(2) at the option of the account debtor, if the notification notifies the account debtor to divide a payment and send portions by more than one method.

(d) **[Request for proof of transfer.]** Subject to subsection (g), if requested by the account debtor, the person giving the notification shall seasonably furnish reasonable proof that control of the controllable electronic record has been transferred. Unless the person complies, 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).

(e) **[Proof of transfer.]** A person furnishes reasonable proof that control has been transferred if the person demonstrates that the transferee has the power to avail itself of substantially all the benefit from the controllable electronic record, to prevent others from availing themselves of substantially all the benefit from the controllable electronic record, and to transfer these powers to another person.

(f) **[Subsection (c)(2) not waivable.]** Subject to subsection (g), an account debtor may not waive or vary its option under subsection (c)(2).

(g) **[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.

### **Reporter's Note**

1. *Source of these provisions.* These provisions derive from UCC § 3-602, which governs the discharge of a person obligated on a negotiable instrument, and UCC § 9-406, which governs the discharge of a person obligated on an account or payment intangible or other account debtor.

2. *The basic rules.* This section would apply only to an account debtor that has undertaken to pay the person that has control of the controllable electronic record that evidences the obligation to pay. See the definitions of “controllable account” and “controllable payment intangible” in draft § 9-102. Section 9-406 would apply to all other account debtors.

Under subsection (a)(1), an account debtor may discharge its obligation on the controllable account or controllable payment intangible by paying the person that has control of the related controllable electronic record at the time of payment. Subsections (a)(2) and (b) would remove from an account debtor the burden of determining who has control of the related controllable electronic record at any given time—a burden that, with respect to some controllable electronic records, an account debtor may be unable to satisfy. Under paragraph (a)(2), an account debtor may discharge its obligation by paying a person that formerly had control of the related controllable electronic record, which presumably would include the initial obligee.

Subsection (b) reflects the fact that a person to which control has been transferred may not wish to take the risk that the account debtor will discharge its obligation by paying the transferor. Subsection (b) would protect the transferee by providing that if the account debtor receives a notification that control has been transferred, the account debtor may discharge its obligation by paying in accordance with the notification and not by paying a person that formerly had control. The notification must be authenticated by a person formerly having control or by the transferee.

To be effective under subsection (b), a notification must reasonably identify the controllable account or controllable payment intangible, notify the account debtor that control of the controllable electronic record that evidences the controllable account or controllable payment intangible was transferred, identify the transferee in any way, and provide a reasonable method by which the account debtor is to make payments to the transferee. A change in the identity of the person to which the account debtor must pay should not, and typically will not, impose a significant burden on the account debtor. However, one can imagine a method of making payment that would be burdensome, *e.g.*, making a payment through a trading platform or payment service with which the account debtor does not have an account. For this reason, the designated method of making payment must be “reasonable.”

Reasonable proof that is seasonably furnished by person other than the person that gave the notification would constitute compliance with the account debtor’s request.

3. *“Reasonable proof.”* As noted above, this section derives in large part from Section 9-406, which provides for notification that an account or payment intangible has been assigned. Account debtors that have received notification of an assignment under Section 9-406 almost always make payments in accordance with the notice. Recognizing that an account debtor may be uncertain whether a notification is legitimate, Section 9-406 affords to an account debtor the right to request proof that the account or payment intangible was assigned.

Subsection (d) contains a similar provision. Upon the account debtor's request, the person giving the notification must seasonably furnish reasonable proof that control of the controllable electronic record has been transferred. If the person does not comply with the request, the account debtor may ignore the notification and discharge its obligation by a paying a person formerly in control.

"Reasonable proof" would require evidence that would be understood by a typical account debtor to whom it is proffered as demonstrating to a reasonably high probability that control of the controllable electronic record has been transferred to the transferee. Subsection (e) would provide a safe harbor for providing reasonable proof. It would enable a person to satisfy the account debtor's request by demonstrating that the transferee has the power to avail itself of substantially all the benefit from the controllable electronic record, to prevent others from availing themselves of substantially all the benefit from the controllable electronic record, and to transfer these powers to another person. This demonstration would not necessarily prove that a person actually has control of a controllable electronic record because it need not show that the transferee held the latter two powers exclusively. Nevertheless, such a demonstration would constitute "reasonable proof" under subsection (e). A person that has control should have little difficulty providing this proof, as a person cannot have control unless it can readily identify itself as having the requisite powers. See draft § 12-105(a)(2).

4. *Relationship to UCC § 9-406.* UCC § 9-406 governs the discharge of the obligation of an account debtor. It would be amended to carve out transactions covered by this section. See draft § 9-406.

#### **Section 12-107. Governing Law.**

[to come]

#### **Reporter's Note**

1. The Drafting Committee has yet to consider this section.

### **ARTICLE 9**

### **SECURED TRANSACTIONS**

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

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

\* \* \*

(2) “Account”, except as used in “account for”, 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. \* \* \*

\* \* \*

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

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

\* \* \*

(61) “Payment intangible” means a general intangible under which the account debtor’s principal obligation is a monetary obligation. The term includes controllable payment intangibles.

\* \* \*

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

\* \* \*

“Controllable electronic record” Section 12-102.

\* \* \*

### **Reporter’s Note**

1. “*Controllable account*”; “*controllable payment intangible*.” This draft would afford special treatment to security interests in controllable accounts and controllable payment intangibles, *i.e.*, those accounts and payment intangibles that are evidenced by a controllable electronic record that provides that the account debtor (obligor) undertakes to pay the person having control of the controllable electronic record. This special treatment includes the following:

- Attachment of a security interest in a controllable electronic record would be attachment of a security interest in a related controllable account and controllable payment intangible. Draft § 9-203(i).
- Perfection of a security interest in a controllable electronic record would be perfection of a security interest in a related controllable account and controllable payment intangible. Draft § 9-308(h).
- Perfection of a security interest in a controllable account or controllable payment intangible would be achieved by filing a financing statement or obtaining control of the controllable electronic record that evidences the controllable account or controllable payment intangible. Draft § 9-314(a); § 9-107A(b).
- A person that would enjoy the benefit of the take-free and no-action rules respect to a controllable electronic record would also enjoy those benefits with respect to a controllable account or controllable payment intangible that is evidenced by the controllable electronic record. Draft § 12-104(e), (g).

2. “*Person that has control*.” An undertaking to pay the “person that has control” means an undertaking to pay the person that, from time to time, has control. An undertaking to pay Smith, who has control of the relevant controllable electronic record at the time the undertaking was made, is not an undertaking to pay the person that has control.

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

(a) A secured party has control of a controllable electronic record as provided in Section 12-105.

(b) 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 would provide for perfection by filing and perfection by control as alternative methods of perfection with respect to a controllable electronic record. See draft §§ 9-313, 9-314. Under draft § 9-107A(a), a secured party would have control of a controllable electronic record as provided in draft § 12-105. Under draft § 9-326A, a security interest perfected by control would have priority over a security interest perfected by another method.

2. *Consequences of control of controllable account or controllable payment intangible.* This draft would provide for perfection by filing and perfection by control as alternative methods of perfection with respect to a controllable account or controllable payment intangible. See draft §§ 9-313, 9-314. Under draft § 9-107A(a), a secured party would have control of a controllable account or controllable payment intangible by obtaining control of the related controllable electronic record. Under draft § 9-326A, a security interest perfected by control would have priority over a security interest perfected by another method.

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

**Section 9-203. Attachment and Enforceability of Security Interest; Proceeds;  
Supporting Obligations; Formal Requisites.**

\* \* \*

(b) **[Enforceability.]** Except as otherwise provided in subsections (c) through ~~(i)~~ (j), 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:

\* \* \*

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

\* \* \*

(j) **[Controllable account or payment intangible.]** The attachment of a security interest in a controllable electronic record that evidences a controllable account or controllable payment intangible is also attachment of a security interest in the controllable account or controllable payment intangible.

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

\* \* \*

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

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

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

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

\* \* \*

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

[to come]

1. The Drafting Committee has yet to consider this section.

**Reporter's Note**

**Section 9-308. When Security Interest or Agricultural Lien Is Perfected; Continuity of Perfection.**

\* \* \*

(h) [Controllable account or payment intangible.] Perfection of a controllable electronic record that evidences a controllable account or controllable payment intangible also perfects a security interest in the controllable account or controllable payment intangible.

\* \* \*

**Section 9-312. Perfection of Security Interests in Controllable Electronic Records, Controllable Accounts, Controllable Payment Intangibles, Chattel Paper, Deposit Accounts, 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 controllable electronic records, controllable accounts, controllable payment intangibles, chattel paper, negotiable documents, instruments, or investment property may be perfected by filing.

\* \* \*

#### **Section 9-314. Perfection by Control.**

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

(b) **[Specified collateral: time of perfection by control; continuation of perfection.]** A security interest in controllable electronic records, controllable accounts, controllable payment intangibles, deposit accounts, electronic chattel paper, or letter-of-credit rights is perfected by control under Section 9-104, 9-105, ~~or 9-107~~, or 9-107A when the secured party obtains control and remains perfected by control only while the secured party retains control.

\* \* \*

#### **Section 9-317. Interests That Take Priority Over or Take Free of Security Interest or Agricultural Lien.**

\* \* \*

(d) **[Licensees and buyers of certain collateral.]** A licensee of a general intangible or a buyer, other than a secured party, of accounts, electronic chattel paper, electronic documents, general intangibles, or investment property other than 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.

\* \* \*

### **Reporter's Note**

1. No change to this section is needed, as controllable electronic records and controllable payment intangibles would be “general intangibles” and controllable accounts would be “accounts.”

**Section 9-326A. Priority of Security Interests in Controllable Electronic Records, Controllable Accounts, and Controllable Payment Intangibles.** A security interest held by a secured party having control of a controllable electronic record, controllable account, or controllable payment intangible has priority over a conflicting security interest held by a secured party that does not have control.

### **Reporter's Note**

1. This section adopts an approach to priority in controllable electronic records, controllable accounts, and controllable payment intangibles that is similar to the approach of Sections 9-327 and 9-328: A security interest perfected by control has priority over conflicting security interests that are not perfected by control. The approach taken in Section 9-330 would be likely to yield the same outcomes that would obtain under draft §§ 12-104 and 9-331 in the vast majority of cases.

**Section 9-331. Priority of Rights of Purchasers of Instruments, Documents, And Securities, Controllable Electronic Records, Controllable Accounts, and Controllable Payment Intangibles Under Other Articles; Priority of Interests in Financial Assets and Security Entitlements Under Article 8 and Controllable Electronic Records Under Article 12.**

(a) **[Rights under Articles 3, 7, and 8, and 12 not limited.]** This article does not limit the rights of a holder in due course of a negotiable instrument, a holder to which a negotiable document of title has been duly negotiated, ~~or~~ a protected purchaser of a security, or a qualifying purchaser of a controllable electronic record. These holders or purchasers take priority over an earlier security interest, even if perfected, to the extent provided in Articles 3, 7, ~~and 8,~~ and 12.

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

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

### **Reporter's Note**

1. *Purpose of this section.* This section would insure that Article 9 does not interfere with the protections that Article 12 would afford to a good faith purchaser for value under the take-free and no-action rules in draft § 12-105(e) and (g).

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

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

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

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

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

(3) at the option of an account debtor, if the notification notifies the account debtor to make less than the full amount of any installment or other periodic payment to the assignee, even if:

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

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

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

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

(d) **[Term restricting assignment generally ineffective.]** \* \* \*

(e) **[Inapplicability of subsection (d) to certain sales.]** \* \* \*

(f) **[Legal restrictions on assignment generally ineffective.]** \* \* \*

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

(h) **[Rule for individual under other law.]** \* \* \*

(i) **[Inapplicability to health-care-insurance receivable.]** \* \* \*

(j) **[Section prevails over specified inconsistent law.]** \* \* \*

(k) **[Inapplicability to interests in certain entities.]** \* \* \*

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

### **Reporter's Note**

Subsections (a) through (c) and (g) would be replaced by analogous provisions in draft § 12-106.

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

\* \* \*

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

\* \* \*

### **Section 9-605. Unknown Debtor or Secondary Obligor.**

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

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

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

(B) the identity of the person; and

(C) how to communicate with the person; or

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

(A) that the person is a debtor; and

(B) the identity of the person.

(b) Subsection (a) does not apply to a secured party that, at the time its security interest attaches to a controllable electronic record, controllable account, or controllable payment intangible, knows or should know that the nature of the collateral or any system in which the collateral is recorded would prevent the secured party from acquiring the knowledge specified in that subsection.

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

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

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

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

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

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

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

(B) the identity of the person; and

(C) how to communicate with the person; or

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

(A) that the person is a debtor; and

(B) the identity of the person.

(c) Subsection (b) does not apply to a secured party that, at the time its security interest attaches to a controllable electronic record, controllable account, or controllable payment intangible, knows or should know that the nature of the collateral or any system in which the collateral is recorded would prevent the secured party from acquiring the knowledge specified in that subsection.

### **Reporter's Note**

1. Practices are developing under which lenders extend secured credit without knowing, or having the ability to discover, the identity of their borrowers. Existing Sections 9-605 and 9-628 would excuse these secured parties from having duties to their debtors, including, *e.g.*, the duty to notify the debtor before disposing of the collateral and the duty to account to the debtor for any surplus arising from a disposition.

Comment 2 to Section 9-628 observes, “Without this group of provisions [in Sections 9-605 and 9-628], a secured party could incur liability to unknown persons and under circumstances that would not allow the secured party to protect itself.” The draft amendments to this section reflect the policy that a secured party should not be free to avoid statutory duties or absolve itself from liability by entering into a transaction when it knows or should know that the nature of the collateral or any system in which the collateral is recorded would prevent it from acquiring the knowledge necessary to fulfill its statutory duties.

## **ARTICLE 11**

### **EFFECTIVE DATE AND TRANSITION PROVISIONS**

**Section 11-901. Effective Date.** This [Act] takes effect [to come].

**Section 11-902. Savings Clause/Transition.**

[to come]

### **Reporter's Note**

1. The Drafting Committee has yet to consider these sections.