

D R A F T
FOR DISCUSSION ONLY

Uniform Commercial Code and Emerging Technologies

Uniform Law Commission

November 5–6, 2021 Committee Meeting



Copyright © 2021
National Conference of Commissioners on Uniform State Laws

This draft, including the proposed statutory language and any comments or reporter's notes, has not been reviewed or approved by the Uniform Law Commission or the drafting committee. It does not necessarily reflect the views of the Uniform Law Commission, its commissioners, the drafting committee, or the committee's members or reporter.

October 26, 2021

Uniform Commercial Code and Emerging Technologies

The committee appointed by and representing the National Conference of Commissioners on Uniform State Laws in preparing this act consists of the following individuals:

Edwin E. Smith	Massachusetts, <i>Chair</i>
Juliet M. Moringiello	Pennsylvania, <i>Vice Chair</i>
Carl S. Bjerre	Oregon
Thomas J. Buiteweg	Michigan
Henry Deeb Gabriel	North Carolina
Larry T. Garvin	Ohio
Thomas S. Hemmendinger	Rhode Island
William H. Henning	Alabama
Philip A. Nicholas	Wyoming
Harvey S. Perlman	Nebraska
Sandra S. Stern	New York
Frank Sullivan Jr.	Indiana
William W. Barrett	Indiana, <i>Division Chair</i>
Carl H. Lisman	Vermont, <i>President</i>

American Law Institute Members

The committee appointed by and representing The American Law Institute in preparing this act consists of the following individuals:

Amelia H. Boss	Pennsylvania
Neil B. Cohen	New York
Marek Dubovec	Arizona
Walter Effross	District of Columbia
Teresa Wilton Harmon	Illinois
Tarik J. Haskins	Delaware
Stephanie A. Heller	New York
Charles W. Mooney Jr.	Pennsylvania (2019-21)
Norman M. Powell	Delaware
Sandra M. Rocks	New York
Steven O. Weise	California

Other Participants

Steven L. Harris	Illinois, <i>Reporter (2019-21)</i>
Charles W. Mooney, Jr.	Pennsylvania, <i>Reporter (2021-)</i>
Stephen L. Sepinuck	Washington, <i>Associate Reporter</i>
Stephen Y. Chow	Massachusetts, <i>American Bar Association Advisor</i>
Candace M. Zierdt	North Dakota, <i>American Bar Association Advisor</i>
Guido Carducci	France, <i>American Bar Association Section Advisor</i>
Stephen J. Curley	Connecticut, <i>American Bar Association Section Advisor</i>

Mark J. Cutrona
Tim Schnabel

Delaware, *Style Liaison*
Illinois, *Executive Director*

Copies of this act may be obtained from:

Uniform Law Commission
111 N. Wabash Ave., Suite 1010
Chicago, IL 60602
(312) 450-6600
www.uniformlaws.org

Uniform Commercial Code and Emerging Technologies

Table of Contents

Prefatory Note <u>to October 22, 2021 Draft</u>	1
---	---

A. Controllable Electronic Records

Prefatory Note.....	3
---------------------	---

ARTICLE 1

GENERAL PROVISIONS

Section 1-204. Value.	8
----------------------------	---

ARTICLE 12

CONTROLLABLE ELECTRONIC RECORDS

Section 12-101. Short Title.....	8
Section 12-102. Definitions.....	8
Section 12-103. Scope.	10
Section 12-104. Rights in Controllable Electronic Records, Controllable Accounts, and Controllable Payment Intangibles	10
Section 12-105. Control of Controllable Electronic Record.	17
Section 12-106. Discharge of Account Debtor on Controllable Account or Controllable Payment Intangible.	21
Section 12-107. Governing Law.....	25

ARTICLE 8

INVESTMENT SECURITIES

Section 8-102. Definitions and Index of Definitions.....	28
--	----

ARTICLE 9

SECURED TRANSACTIONS

Section 9-102. Definitions and Index of Definitions.....	31
--	----

Section 9-107A. Control of Controllable Electronic Record, Controllable Account, or Controllable Payment Intangible.	33
Section 9-203. Attachment and Enforceability of Security Interest; Proceeds; Supporting Obligations; Formal Requisites.	34
Section 9-207. Rights and Duties of Secured Party Having Possession or Control of Collateral....	35
Section 9-208. Additional Duties of Secured Party Having Control of Collateral.....	35
Section 9-301. Law Governing Perfection and Priority of Security Interests.	38
<u>Section 9-306A. Law Governing Perfection and Priority of Security Interests in Controllable Electronic Records.</u>	38
Section 9-308. When Security Interest or Agricultural Lien Is Perfected; Continuity of Perfection.	38
Section 9-310. When Filing Required to Perfect Security Interest or Agricultural Lien; Security Interests and Agricultural Liens to Which Filing Provisions Do Not Apply.	39
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.	39
Section 9-314. Perfection by Control.	40
Section 9-316. Continued Perfection of Security Interest Following Change in Governing Law. ..	40
Section 9-326A. Priority of Security Interests in Controllable Electronic Record, Controllable Account, and Controllable Payment Intangible	41
Section 9-331. Priority of Rights of Purchasers of Instruments, Documents, 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.	42
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.	43
Section 9-408. Restrictions On Assignment Of Promissory Notes, Health-Care-Insurance Receivables, And Certain General Intangibles Ineffective.	45
Section 9-601. Rights After Default; Judicial Enforcement; Consignor or Buyer of Accounts, Chattel Paper, Payment Intangibles, or Promissory Notes.	46
Section 9-605. Unknown Debtor or Secondary Obligor.	46
Section 9-628. Nonliability and Limitation on Liability of Secured Party; Liability of Secondary Obligor.	47

B. Money

Prefatory Note.....	48
---------------------	----

ARTICLE 1

GENERAL PROVISIONS

Section 1-201. General Definitions.	49
--	----

ARTICLE 9

SECURED TRANSACTIONS

Section 9-102. Definitions and Index of Definitions.....	51
Section 9-105A. Control of Intangible Money.....	52
Section 9-203. Attachment and Enforceability of Security Interest; Proceeds; Supporting Obligations; Formal Requisites.	53
Section 9-208. Additional Duties of Secured Party Having Control of Collateral.....	54
Section 9-301. Law Governing Perfection and Priority of Security Interests.....	54
Section 9-310. When Filing Required to Perfect Security Interest or Agricultural Lien; Security Interests and Agricultural Liens to Which Filing Provisions Do Not Apply.	55
Section 9-312. Perfection of Security Interests in 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.	55
Section 9-313. When Possession by or Delivery to Secured Party Perfects Security Interest Without Filing.....	56
Section 9-314. Perfection by Control.	56
Section 9-332. Transfer of Money; Transfer of Funds from Deposit Account.	57

C. Chattel Paper

Prefatory Note.....	58
---------------------	----

~~ARTICLE 1~~

~~GENERAL PROVISIONS~~

Section 1-201. General Definitions.	62
---	---------------

ARTICLE 2

SALES

Section 2-102. Scope; Certain Security and Other Transactions Excluded from this Article.....	63
---	----

ARTICLE 9

SECURED TRANSACTIONS

Section 9-102. Definitions and Index of Definitions.....	64
Section 9-105. Control of Electronic Copy of Record Evidencing Chattel Paper.	67
Section 9-203. Attachment and Enforceability of Security Interest; Proceeds; Supporting Obligations; Formal Requisites.	69
Section 9-208. Additional Duties of Secured Party Having Control of Collateral.....	70
Section 9-301. Law Governing Perfection and Priority of Security Interests.	71
Section 9-310. When Filing Required to Perfect Security Interest or Agricultural Lien; Security Interests and Agricultural Liens to Which Filing Provisions Do Not Apply.	72
Section 9-313. When Possession by or Delivery to Secured Party Perfects Security Interest Without Filing.....	73
Section 9-314. Perfection by Control.	73
Section 9-314A. Perfection by Possession and Control of Chattel Paper.	74
Section 9-317. Interests That Take Priority Over or Take Free of Security Interest or Agricultural Lien.	75
Section 9-330. Priority of Purchaser of Chattel Paper or Instrument.	76

NOTE: PART D IS NEW

D. Documents of Title

ARTICLE 1

GENERAL PROVISIONS

Section 1-201. General Definitions.	77
Section 7-106. Control of Electronic Document of Title.	78
<u>Section 7-106. Control of Electronic Copy of Document of Title.</u>	<u>79</u>

DE. Payments

ARTICLE 3

NEGOTIABLE INSTRUMENTS

Section 3–104. Negotiable Instrument.	81
Section 3–105. Issue of Instrument.	82
Section 3–309. Enforcement of Lost, Destroyed, or Stolen Instrument.....	83
Section 3–604. Discharge by Cancellation or Renunciation.	83

ARTICLE 4

BANK DEPOSITS AND COLLECTIONS

Section 4–207. Transfer Warranties.	84
--	----

Section 4–406. Customer’s Duty to Discover and Report Unauthorized Signature or Alteration...	84
---	----

ARTICLE 4A

FUNDS TRANSFERS

Section 4A–103. Payment Order - Definitions.....	86
Section 4A–104. Funds Transfer - Definitions.....	86
Section 4A–201. Security Procedure.....	88
Section 4A–202. Authorized and Verified Payment Orders.	89
Section 4A–203. Unenforceability of Certain Verified Payment Orders.....	90
Section 4A–206. Transmission of Payment Order Through Funds-Transfer or Other Communication System.....	94
Section 4A–207. Misdescription of Beneficiary.	95
Section 4A–208. Misdescription of Intermediary Bank or Beneficiary’s Bank.....	95
Section 4A–210. Rejection of Payment Order.	96
Section 4A–211. Cancellation and Amendment of Payment Order.....	97

EE. Miscellaneous Amendments

ARTICLE 1

GENERAL PROVISIONS

Section 1-201. General Definitions.	97
--	----

ARTICLE 5

LETTERS OF CREDIT

Section 5-102. Definitions.....	101
---------------------------------	-----

ARTICLE 9

SECURED TRANSACTIONS

Section 9-102. Definitions and Index of Definitions.....	101
--	-----

Uniform Commercial Code and Emerging Technologies

Prefatory Note to October 22, 2021 Draft

Note on formatting:

With the exception of the Payments amendments in Part E, the draft amendments to provisions of the UCC in this draft are NOT marked to show changes from the most recent UCC official text. Instead, those provisions are marked to reflect changes from the corresponding provisions in the 2021 ULC Annual Meeting Draft, June 30, 2021 (2021 AM Draft).

In Part E, Payments amendments, changes are marked to reflect changes from the UCC statutory text and official comments.

Part D, Documents of Title, is entirely new in this draft.

Because Article 12 is a completely new UCC article, its provisions are not underscored. However, changes to this Prefatory Note, to draft Article 12 and related changes to other provisions of the UCC, and to the Prefatory Notes and other Reporter's Notes throughout this draft are marked to reflect changes from the 2021 AM Draft.

At this time, we are uncertain whether new sections that appear in the draft will make their way into the final Act. Any necessary renumbering will occur before the final draft is presented to the 2022 ULC Annual Meeting. Accordingly, new sections, subsections, and paragraphs are numbered with an "A" at the end, e.g., Section 9-107A.

Background

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

In 2019, the Uniform Law Commission and The American Law Institute (the Sponsors) appointed a Joint Committee to consider whether changes to the UCC are advisable to accommodate emerging technologies, such as artificial intelligence, distributed ledger technology, and virtual currency. At the time when the Joint Committee was formed, invitations were sent to large groups of potential stakeholders including trade organizations, financial institutions, technology companies, government agencies, academicians, and consumer groups. The Joint Committee currently has over ~~250~~ 300 observers.

The Joint Committee was initially formed as a study committee. However, the Joint Committee subsequently received the permission of the Sponsors to act as a drafting committee for amendments to the UCC dealing with digital assets, bundled transactions (*i.e.*, transactions involving the sale or lease of goods together with the provision of services, the licensing of information, or both), and payments, as well as for certain discrete amendments to the UCC unrelated to emerging technologies.

1 The Drafting Committee has held the following meetings:

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

11
12 In addition, several small working groups met remotely to discuss specific topics and to hear the
13 views of various stakeholder groups. Since the 2021 ULC Annual Meeting the Chair, Reporters,
14 and several members of the Drafting Committee have presented educational programs addressing
15 the ongoing revision process to the Loan Syndication and Trading Association, the ABA Business
16 Law Section, and the American College of Commercial Finance Lawyers. Also, the Committee
17 held informal sessions with Commissioners on June 15 and 16, 2021, on the draft of proposed
18 amendments to the UCC. The next meeting of the Drafting Committee (remote) is scheduled for
19 November 5 and 6, 2021.

20
21 The work of the Drafting Committee is currently in the following areas concerning the
22 UCC: digital assets (controllable electronic records), intangible money, chattel paper, “bundled
23 transactions” (consisting of the sale or lease of goods together with licensing of software and the
24 provision of services as an integrated transaction), documents of title, payment systems,
25 miscellaneous UCC amendments, and consumer issues.

26
27 The Drafting Committee expects to hold ~~three~~ two full meetings, in-person with Zoom
28 meeting attendance available to those who do not attend in-person, in the ~~nine~~ six-month period
29 following the ~~annual~~ November 5-6, 2021 meeting, with a view to completing the draft of the
30 amendments, obtaining American Law Institute approval of the draft at its May 2022 annual
31 meeting, and final approval of the Commission at its July 2022 annual meeting. Members of the
32 Drafting Committee will continue to reach out to industry groups and other stakeholders and ~~are~~
33 already planning plan to continue participating in CLE presentations to educate members of the bar
34 and others.

35 36 **Organization of the draft**

37
38 The ~~Joint~~ Drafting Committee’s charge is broad, and the resulting draft is expansive. To
39 facilitate discussion, the draft is divided into five parts:

40
41 A. *Controllable electronic records.* The draft includes a new UCC Article 12 that
42 would govern the transfer of property rights in intangible assets (“controllable electronic records”)
43 that have been or may be created using new technologies. These assets include certain types of
44 virtual currency and nonfungible tokens (NFTs). The draft also includes amendments to UCC

Article 9 to govern security interests in controllable electronic records and in rights to payment that are embedded in (or tethered to) controllable electronic records.

B. *Money*. The draft includes amendments to accommodate intangible money when used to make payments and when used as collateral to secure a loan.¹

C. *Chattel paper*. UCC Article 9 affords special treatment to “chattel paper” (e.g., installment sale contracts and personal property leases). The draft redefines “chattel paper” and updates the Article 9 provisions applicable to this type of collateral. The new definition resolves uncertainty that has arisen under the current definition and more accurately reflects the distinction between the seller’s or lessor’s right to payment and the record (e.g., installment sale contract or lease) evidencing that right. The new definition also resolves uncertainty that has arisen when goods are leased as part of a bundled transaction. Moreover, this draft raises for discussion by the Drafting Committee additional issues relating to bundled transactions. Draft § 9-105 also provides an amended definition of “control” of an electronic copy of a record evidencing chattel paper, which reflects a more accurate and technologically flexible approach than the current definition.

D. *Documents of Title*. This draft includes a new draft § 7-106, dealing with control of electronic copy of document of title. It is patterned on draft § 9-105 for chattel paper, mentioned above.

E. *Payments*. These amendments primarily concern payments made by check and wire transfer. Many of the changes are to the official comments.

F. *Miscellaneous amendments*.

A. Controllable Electronic Records

Prefatory Note

Introduction to controllable electronic records. New UCC Article 12, which deals with controllable electronic records, and the accompanying amendments to Articles 1 and 9 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 not only to electronic (intangible) assets that are created using existing technologies such as distributed ledger technology (DLT), which powers transactions in ~~Bitcoin~~ bitcoin and other digital assets, but also to electronic assets that may be created using technologies that have yet to be developed, or even imagined.

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

¹ ~~This draft was written~~ The 2021 AM Draft was prepared before El Salvador adopted ~~Bitcoin~~ bitcoin as legal tender. However, the definition of “money” in Section 1-201, as proposed to be revised in this draft, would exclude bitcoin from the definition of money, notwithstanding the adoption by El Salvador (or any other sovereign state). See draft § 1-201(b)(24) (revised definition of “money” and Reporter’s Note discussing the proposed revision). The Drafting Committee has not yet had an opportunity to consider how this action may affect future drafts.

1 or delivery of goods), and interests in personal and real property. Second, people have begun to
2 assign economic value to some electronic records that bear no relationship to extrinsic rights and
3 interests. For example, without any law or binding agreement, people around the world have
4 agreed to treat ~~Bitcoin~~ bitcoin (or, more precisely “transaction outputs” generated by the Bitcoin
5 protocol) as a medium of exchange and store of value.

6
7 These trends will inevitably result in disputes among claimants to electronic records and
8 their related rights and other benefits. Uncertainty as to the criteria for resolving these claims
9 creates commercial risk. The magnitude of these risks will grow as these trends continue.

10
11 As explained in more detail below, draft Article 12 is designed to reduce these risks by
12 providing the legal rules governing the transfer—both outright and for security—of interests in
13 some, but not all, electronic records (*controllable electronic records*). These rules specify the
14 rights in a controllable electronic record that a purchaser would acquire. Many systems for
15 transferring controllable electronic records are pseudonymous, so that the transferee of a
16 controllable electronic record is unable to verify the identity of the transferor or the source of the
17 transferor’s title. Accordingly, controllable electronic records would be negotiable, in the sense
18 that a good faith purchaser for value would take a controllable electronic record free of third-party
19 claims of a property interest in the controllable electronic record.

20
21 Experience with DLT and other records-management systems has established some general
22 functions required for electronic records to serve as an effective and reliable means of transferring
23 economic value.

- 24
- 25 • The electronic record must have some “use” that one person can enjoy to the
26 exclusion of all others, *e.g.*, the power to “spend” a ~~Bitcoin~~ bitcoin (or, more
27 precisely, the power to include an unspent transaction output in a message that the
28 Bitcoin protocol will record to its blockchain).
 - 29
 - 30 • A person must be able to transfer to another person this exclusive power to use the
31 electronic record. To remain exclusive, the transfer must divest the transferor of the
32 power to use the electronic record.
 - 33
 - 34 • A person must be able to demonstrate to others that the person has the power to
35 “use” the electronic record.
 - 36

37 As discussed in the Reporter’s Note to draft § 12-105, these functions form the basis of the
38 Article 12 concept of *control*. To receive the benefits of negotiability and take free of third-party
39 claims of a property interest in a controllable electronic record, a person must have control of the
40 controllable electronic record. In addition, control serves as a method of perfection of a security
41 interest in a controllable electronic record. In this context, it may be useful to think of control as
42 the rough functional equivalent of possession of tangible personal property such as goods.

43
44 Article 12 governs the rights of transacting parties and the rights of persons that might be
45 affected by the transactions. With the important exception of certain rights to payment evidenced
46 by a controllable electronic record (discussed below), Article 12 does not govern assets other than
47 controllable electronic records. Like the UCC in general, Article 12 is not a regulatory statute.

1 The fact that an asset is or is not a controllable electronic record under the UCC would not
2 necessarily affect the application of laws regulating securities, commodities, or money
3 transmission.

4
5 *What is the scope of draft Article 12?*

6
7 Article 12 applies to *controllable electronic records*. Controllable electronic records are a
8 subset of what often are referred to as digital assets. Article 12 is designed to work for both
9 technologies that are known and those that may be developed in the future. Whether an asset is a
10 controllable electronic record (and therefore within the scope of Article 12) depends on whether the
11 characteristics of the asset and the protocols of any system on which the asset is recorded make it
12 suitable for the application of Article 12's substantive rules. The nature of electronic commerce is
13 constantly changing. For this reason, the technology on which an asset depends, the type of asset,
14 and the prevailing use of the asset are all irrelevant to whether the asset is a controllable electronic
15 record.

16
17 To determine whether Article 12 applies to a particular asset, *e.g.*, ~~Biteoin~~ bitcoin, one must
18 determine whether the asset falls within the definition of *controllable electronic record*. A
19 controllable electronic record is a *record*, as the UCC defines the term. A *record* is information
20 that is retrievable in perceivable form.² A *controllable electronic record* is a record that is stored
21 in an electronic or other intangible medium and can be subjected to *control*, as defined in draft §
22 12-105. An electronic record that cannot be subjected to control under draft § 12-105 is outside the
23 scope of Article 12.

24
25 The meaning of *control* in the UCC depends on the type of property involved.³ The
26 Reporter's Note accompanying draft § 12-105 explains the requirements for obtaining control of a
27 controllable electronic record. For present purposes, it is sufficient to think of ~~Biteoin~~ bitcoin as
28 the prototypical controllable electronic record.

29
30 The existing law governing some types of electronic records that can be subjected to Article
31 12 control is sufficient. These electronic records, which include electronic chattel paper, electronic
32 documents, investment property, and transferable records under UETA, are excluded from Article
33 12.

34
35 *What are the substantive provisions of Article 12?*

36
37 The principal function of Article 12 is to specify the rights of a *purchaser* of a controllable
38 electronic record. A purchaser is a person that acquires an interest in property by a voluntary
39 transaction, such as a sale.⁴ Law other than Article 12 would determine whether a person acquires
40 any rights in a controllable electronic record and so would be eligible to be a purchaser.

41
42 Draft § 12-104 adopts the "shelter" principle, under which a purchaser of a controllable

² See UCC § 1-201(b)(31).

³ *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).

⁴ "'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).

1 electronic record acquires whatever rights the transferor had or had power to transfer. This rule
2 appears in Article 2 with respect to goods and Article 8 with respect to securities.⁵
3

4 The ability to take a controllable electronic record free of third-party property claims
5 appears to be necessary for a controllable electronic record to have commercial utility. As is the
6 case with Articles 2, 3, 7, and 9, Article 12 would facilitate commerce by affording to certain good-
7 faith purchasers for value greater rights than their transferors had or had power to transfer.⁶ Draft
8 Article 12 refers to these purchasers as *qualifying purchasers*. Qualifying purchasers are
9 purchasers that obtain control of a controllable electronic record for value, in good faith, and
10 without notice of any claim of a property interest in the controllable electronic record. Like a
11 holder in due course of a negotiable instrument, a qualifying purchaser of a controllable electronic
12 record takes the controllable electronic record free of property claims.
13

14 Consider the case in which *B* contracts to buy ~~Biteoin~~ bitcoin from *S*. Assume that *S* is the
15 owner of the Bitcoin.
16

- 17 • Law other than Article 12 generally would determine whether *S* is the owner of the
18 ~~Biteoin~~ bitcoin.
19
- 20 • Law other than Article 12 would resolve issues concerning the formation of the
21 contract of sale between *B* and *S* and the obligations of the parties under the
22 contract.
23
- 24 • Law other than Article 12 would determine what steps are necessary for *B* to acquire
25 rights in the ~~Biteoin~~ bitcoin.⁷
26
- 27 • By acquiring rights in the ~~Biteoin~~ bitcoin by sale, *B* would become a *purchaser* of
28 the ~~Biteoin~~ bitcoin within the meaning of UCC Article 1.
29
- 30 • Article 12 provides that if *B* becomes a purchaser, *B* would acquire whatever rights
31 *S* had or had power to transfer. As a general matter, law other than Article 12 would
32 define these rights. *B* would acquire these rights regardless of whether *B* obtained
33 control of the ~~Biteoin~~ bitcoin.
34

35 Now assume that *S* is a hacker, who acquired the ~~Biteoin~~ bitcoin illegally from the owner,
36 *O*.

- 37 • Just as a buyer of goods can obtain possession from a seller that has no rights in the
38 goods, *B* can obtain control of the ~~Biteoin~~ bitcoin, even if *S* “stole” it from the
39 owner.

⁵ 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).

⁶ Article 8 also provides for certain purchasers for value to take greater rights but does not contain a good-faith requirement. *See* UCC § 8-303.

⁷ Law other than Article 12 includes UCC Article 9. Thus, Article 9 would determine whether a security interest attaches to a controllable electronic record. More generally, Article 9 governs any conflict between Article 9 and Article 12. Draft § 12-102(b).

- If *B* obtains control of the ~~Biteoin~~ 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 ~~Biteoin~~ bitcoin under non-Article 12 law, as an Article 12 qualifying purchaser, *B* would acquire the ~~Biteoin~~ bitcoin free of all claims of a property interest in the ~~Biteoin~~ bitcoin. In the unlikely event that *O* could locate *B*, *B* would defeat *O*'s claim of ownership and own the ~~Biteoin~~ 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 ~~Biteoin~~ bitcoin can hold the ~~Biteoin~~ 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. 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 draft § 12-104(e)(b), *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.

1 But the controllable electronic record itself may not be a valuable asset. It would have
2 value to *P* only if by virtue of acquiring rights in the controllable electronic record, *P* would also
3 acquire the right to receive delivery of the goods from *S*.
4

5 Article 12 leaves to other law the question whether *P*'s acquisition of rights in the
6 controllable electronic record gives *P* the right to receive delivery of the goods. We would
7 typically expect that under other law *P* would not acquire the right to receive the goods merely by
8 acquiring rights in the controllable electronic record, any more than *P* would have acquired the
9 right to receive the goods if the record were in paper form and physically delivered to *P*.
10

11 Suppose, however, that other law does provide that, by acquiring the controllable electronic
12 record, *P* would acquire the right to receive delivery of the goods from *S*. Suppose also that *P*
13 becomes a qualifying purchaser of the controllable electronic record. As we have seen, as a
14 qualifying purchaser, *P* would take its rights *in the controllable electronic record* free of property
15 claims. But *P* would not acquire *the right to receive delivery* of the goods free of property claims
16 unless non-Article 12 law provides otherwise.
17

18 *The exceptions: controllable electronic records and controllable payment intangibles.*
19

20 As a general rule, draft Article 12 applies to records and not to rights evidenced by records
21 (or to rights that records purport to evidence). Law other than Article 12 would determine what
22 steps must be taken for a person to acquire an interest in a controllable electronic record and the
23 rights, if any, that the person acquires. This "other" law includes UCC Article 9.
24

25 The draft provides an important exception to the general rule. The exception concerns
26 rights to payment (specifically, accounts and payment intangibles) that are evidenced by a
27 controllable electronic record that provides that the obligor (account debtor) undertakes to pay the
28 person that has control of the controllable electronic record. These rights to payment are referred
29 to as "controllable accounts" and "controllable payment intangibles."⁸ (which are included in the
30 definition of "controllable electronic record" in draft § 12-102). Under amendments to UCC
31 Article 9, the attachment and perfection of a security interest in a controllable electronic record
32 would also be attachment of a security interest in controllable accounts and controllable payment
33 intangibles that are evidenced by the controllable electronic record.⁹ The draft provides a similar
34 rule with regard to perfection of a security interest in a controllable account or controllable
35 payment intangible.¹⁰ Under Article 12, a qualifying purchaser of the controllable electronic
36 record would acquire its rights in the controllable account or controllable payment intangible free
37 of any claim of a property interest.¹¹
38

39 The draft amends several other sections of Article 9 to deal with other aspects of security
40 interests in controllable accounts and controllable payment intangibles. The Reporter's Notes to
41 these sections discuss the amendments.
42

43 *Note on formatting*

⁸ See draft § 9-102(b) (defining "controllable account" and "controllable payment intangible").

⁹ Draft § 9-203(j).

¹⁰ Draft § 9-310(h).

¹¹ Draft § 12-104.

1 The amendments to Articles 1 and 9 are marked to show changes from the most recent UCC
2 official text. At this time, we are uncertain whether new sections that appear in draft will make their
3 way into the final Act. Any necessary renumbering will occur before the final draft is presented to
4 the 2022 Annual Meeting. Accordingly, new sections, subsections, and paragraphs are numbered
5 with an “A” at the end, *e.g.*, Section 9-107A.

6
7 Because Article 12 is a completely new UCC article, its provisions are not underscored.

1 **Uniform Commercial Code and Emerging Technologies**

2 **ARTICLE 1**

3 **GENERAL PROVISIONS**

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

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

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

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

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

12 **Reporter's Note**

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

16 **ARTICLE 12**

17 **CONTROLLABLE ELECTRONIC RECORDS**

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

20 **Section 12-102. Definitions.**

21 (a) In this article:

22 (1) ~~"controllable~~ Controllable electronic record" means an electronic record that can
23 be subjected to control under Section 12-105. [Except as otherwise provided or the context
24 otherwise requires, the] [The] term includes a controllable account or a controllable payment
25 intangible evidenced by a controllable electronic record. The term does not include deposit
26

1 accounts, electronic chattel paper, electronic documents of title, intangible money, investment
2 property, or “transferable records”, as defined in the Electronic Signatures in Global and National
3 Commerce Act, 15 U.S.C. Section 7021(a)(1) or as defined in [cite to Uniform Electronic
4 Transaction Act Section 16(a)].

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

6 (b) The definitions of “account debtor,” “authenticate,” “controllable account,”
7 “controllable payment intangible,” “deposit account,” “electronic chattel paper,” “intangible
8 money,” “investment property,” and “proceeds” in Article 9 apply to this article.

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

10 **Legislative Note:** ~~In subsection~~ paragraph (a)(1), the state should cite to the state’s version of the
11 *Uniform Electronic Transactions Act Section 16(a) or comparable state law.*

12 **Reporter’s Note**

13
14 1. *“Controllable electronic record.”* ~~A “controllable electronic record” is an “electronic~~
15 ~~record,” i.e., information that is stored in an electronic or other intangible medium and is~~
16 ~~retrievable in perceivable form.~~ To be a “controllable electronic record” within the scope of
17 Article 12, ~~the~~ an electronic record must be susceptible of control under Section 12-105. Unlike a
18 “transferable record” under E-SIGN or UETA, a record can be a controllable electronic record
19 under Article 12 in the absence of an agreement to that effect.

20
21 The provisions of Article 12 are unsuitable for certain types of electronic records, and the
22 definition has been limited accordingly. Article 12 does not, however, limit the extent to which
23 property, including an electronic record, may be a financial asset under Article 8, including as a
24 result of an express agreement between a securities intermediary and another person to treat such
25 property held by the securities intermediary as a “financial asset” pursuant to Section 8-
26 102(a)(9)(iii) credited to a securities account.

27
28 This draft defines the term “controllable electronic record” to include a controllable account
29 or a controllable payment intangible evidenced by a controllable electronic record. Accordingly,
30 except where a specific reference to a controllable account or controllable payment is intended,
31 this draft deletes references to those terms in the text inasmuch as they are included by references
32 to a controllable electronic record. Although this definitional convention avoids excessive
33 repetition, the Drafting Committee should evaluate its wisdom—in particular, whether the
34 attendant brevity introduces undesirable ambiguity.

35
36 2. *“Electronic record.”* This definition uses the term “record,” defined in Section 1-201 to
37 include “information . . . that is stored in an electronic or other medium and is retrievable in

1 perceivable form,” and the ULC’s standard definition of “electronic,” which this draft proposes to
2 add to Section 1-201 (see Part F, *infra*).
3

4 23. “*Value*.” The concept of value in Section 3-303 is narrower than the generally
5 applicable concept in Section 1-201. Reporter’s Note 8 to draft § 12-104 explains the difference
6 between the two concepts and why the draft adopts the Article 3 approach.
7

8 **Section 12-103. Scope.**

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

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

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

16 **Reporter’s Note**

17 1. *Source of these provisions.* Subsection (b) follows Section 3-102(b). As is the case with
18 respect to Article 3, Article 9 would defer to Article 12 in some instances. See draft § 9-331.
19 Subsection (c) is copied from Section ~~9-102~~ 9-201.
20

21 2. *Controllable accounts and controllable payment intangibles.* As to controllable accounts
22 and controllable payment intangibles, see Reporter’s Note 1 to draft § 9-102. The Drafting
23 Committee should consider whether, notwithstanding the inclusion of controllable accounts and
24 controllable payment intangibles in the definition of controllable electronic record, reference
25 should be made to those terms in subsection (a) in the interest of clarity.
26

27 **Section 12-104. Rights in Controllable Electronic Records, ~~Controllable Accounts, and~~** 28 **~~Controllable Payment Intangibles.~~**

29 (a) In this section, “qualifying purchaser” means a purchaser of a controllable electronic
30 record or an interest in the controllable electronic record that obtains control of the controllable
31 electronic record for value, in good faith, and without notice of a claim of a property right in the
32 controllable electronic record ~~or a controllable account or controllable payment intangible~~

1 ~~evidenced by the controllable electronic record.~~

2 (b) Except as provided in this section, law other than this article determines whether a
3 person acquires a right in a controllable electronic record and the right, if any, the person acquires.

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

6 (d) A purchaser of a limited interest in a controllable electronic record acquires rights only
7 to the extent of the interest purchased.

8 (e) ~~In addition to acquiring the rights of a purchaser, a~~ A qualifying purchaser acquires its
9 rights in the controllable electronic record ~~and a controllable account or controllable payment~~
10 ~~intangible evidenced by the controllable electronic record~~ free of a claim of a property right in the
11 controllable electronic record, ~~controllable account, or controllable payment intangible.~~

12 (f) Except as provided in subsection (e) or law other than ~~[the Uniform Commercial Code]~~
13 [this article], a qualifying purchaser takes a right to payment, right to performance, or interest in
14 property evidenced by the controllable electronic record subject to a claim of a property right in the
15 right to payment, right to performance, or other interest in property.

16 (g) ~~The following rules apply to a purchaser of a controllable electronic record traceable to~~
17 ~~another controllable electronic record:~~

18 (1) An action based on a claim of a property right in ~~the other~~ a controllable
19 electronic record ~~or a controllable account or controllable payment intangible evidenced by the~~
20 ~~other controllable electronic record~~, whether framed in conversion, replevin, constructive trust,
21 equitable lien, or other theory, may not be asserted against ~~the~~ a qualifying purchaser of any
22 controllable electronic record ~~if the purchaser acquires its interest in and obtains control of the~~
23 ~~traceable controllable electronic record for value, in good faith, and without notice of a claim of a~~
24 ~~property right in the traceable controllable electronic record or a controllable account or~~

~~controllable payment intangible evidenced by the traceable controllable electronic record.~~

~~(2) The purchaser takes free of a security interest in the traceable-controllable electronic record and a controllable account or controllable payment intangible evidenced by the traceable-controllable electronic record if:~~

~~(A) the purchaser acquires its interest in and obtains control of 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 a controllable account or controllable payment intangible evidenced by the traceable controllable electronic record; and~~

~~(B) the traceable-controllable electronic record constitutes 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.

Legislative Note: In subsection (f), the state should insert the appropriate reference to the Uniform Commercial Code.

Reporter's Note

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

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

Subsection (e) derives from Section 3-306 (concerning the rights of a holder in due course of an instrument) and Section 8-303 (concerning rights of a protected purchaser of a security).

Subsection (g) (lead in) derives from Section 8-502 (protecting entitlement holders) and its applicability to a qualifying purchaser derives from Sections 3-302 and 3-306 (protecting holder in due course).

Subsection (g)

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

2. *Applicability of other law.* As a general matter, this section leaves to other law the resolution of questions concerning the transfer of rights in a controllable electronic record (which.

1 as defined in draft § 12-102, includes a controllable account or controllable payment intangible
2 evidenced by the controllable electronic record), such as the acts that must be taken to effectuate a
3 transfer of rights and the scope of the rights that a transferee acquires. *See* subsection (b).
4 Subsections (c) through (h) contain important exceptions to this subsection.
5

6 **Example:** *A* creates a controllable electronic record. Other law would determine
7 what rights *A* has in the controllable electronic record. *A* and *B* agree to the sale of
8 the controllable electronic record to *B*. Other law would determine what steps need
9 to be taken for *B* to acquire rights in the controllable electronic record. Once *B*
10 acquires those rights, *B* would be a purchaser (as defined in Section 1-201), whose
11 rights would be determined by either subsection (c) or by subsections (a) and (e),
12 depending on whether *B* was a qualifying purchaser.
13

14 The “law other than this article” that may apply to the transfer of rights in a controllable
15 electronic record under subsection (b) includes UCC Article 9. Section 9-203 would apply, for
16 example, to determine whether a purported secured party acquired an enforceable security interest
17 in a controllable electronic record.
18

19 3. *Purchaser and transferor under subsection (c): derivative controllable electronic*
20 *records.* Subsection (c) sets forth the familiar “shelter” principle, under which a purchaser of a
21 controllable electronic record acquires whatever rights the transferor had or had power to transfer.
22 However, in some cases the controllable electronic record that is acquired by the purchaser will not
23 be the “same” controllable electronic record that was transferred by the transferor. Such a transfer
24 could involve the elimination of a “transferred” controllable electronic record and the resulting and
25 corresponding derivative creation and acquisition of a new controllable electronic record. An
26 example of such a derivative controllable electronic record is the unspent transaction output
27 (UTXO) generated by a transaction in bitcoin. Subsection (c) should be construed broadly to
28 encompass such transfers and resulting derivative controllable electronic records.
29

30 34. *Nonpurchaser having control.* Under draft § 12-105, a person may have control of a
31 controllable electronic record even if the person has no property interest in the controllable
32 electronic record. A person that has control of, but no interest in, a controllable electronic record
33 would not be a purchaser of the controllable electronic record and so would not be eligible to be a
34 qualifying purchaser under this section.
35

36 **Example:** Debtor granted to Secured Party a security interest in all Debtor’s
37 existing and after-acquired accounts, chattel paper, and payment intangibles.
38 Secured Party perfected its security interest in a specific controllable account by
39 obtaining control of the controllable electronic record that evidences the controllable
40 account. *See* draft § 9-107A.
41

42 Because Debtor’s security agreement does not cover controllable electronic records,
43 Secured Party would have no interest in the controllable electronic record.
44 Accordingly, Secured Party would not be a purchaser of the controllable electronic
45 record and would not benefit from the take-free rule in subsection (e) (discussed in
46 Note 5). Secured Party’s security interest in Debtor’s controllable accounts and
47 controllable payment intangibles would, however, have priority over a conflicting

1 security interest that was perfected by a method other than control. See draft § 9-
2 326A.

3
4 45. Conditions for, and consequences of, becoming a qualifying purchaser. The conditions
5 for, and consequences of, becoming a qualifying purchaser pursuant to subsection (e) were drawn
6 from Article 3. More specifically, the conditions for becoming a qualifying purchaser were drawn
7 from Section 3-302(a)(2), which defines “holder in due course” of a negotiable instrument. Among
8 these conditions is that a person take the instrument “for value.” As Note 8 explains, the concept
9 of value in Article 3 differs from the concept of value that is generally applicable in the UCC.
10 Article 12 adopts the Article 3 concept.

11
12 The definition of “qualifying purchaser” omits some of the conditions for becoming a
13 holder in due course. For example, to qualify as a holder in due course, a holder must take
14 “without notice that any party has a defense or claim in recoupment” Section 3-302(a)(2)(vi).
15 A controllable electronic record is information; there are no parties to a controllable electronic
16 record. (There are parties to a controllable account or controllable payment intangible. Sections 9-
17 404 and 9-403 would determine whether a purchaser of the controllable account or controllable
18 payment intangible takes free of a defense.)

19
20 Subsection (e) derives from Section 3-306, under which a holder in due course takes a
21 negotiable instrument free of a claim of a property right in the instrument. A qualifying purchaser
22 of a controllable electronic record takes free of all claims of a property right in the controllable
23 electronic record (and any related controllable account or controllable payment intangible).

24
25 56. The take-free rule. Subsection (e) makes controllable electronic records highly
26 negotiable. It protects a ~~qualified~~ qualifying purchaser of a controllable electronic record against
27 claims of a property interest in the controllable electronic record (as well as in any related
28 controllable account or controllable payment intangible).

29
30 As a general matter, law other than Article 12 would determine whether any particular
31 transaction creates a property interest in a controllable electronic record. See subsection (b). The
32 applicable law may provide that a hacker, who is essentially a thief, acquires no rights in a “stolen”
33 controllable electronic record. Even if this is the case, subsections (c) and (e) would enable a
34 purchaser that obtains control from a hacker and that otherwise meets the definition of “~~qualified~~
35 qualifying purchaser” (for value, in good faith, and without notice of property claims) to take the
36 controllable electronic record and any related controllable account or controllable payment
37 intangible free of property claims. A person in control of a controllable electronic record therefore
38 has the power, even if not the right, to transfer rights in the record to a qualifying purchaser.

39
40 In this draft the phrase “In addition to acquiring the rights of a purchaser” has been deleted
41 from subsection (e). That phrase appears to be borrowed verbatim from Section 8-303(b), which
42 deals with the rights of a protected purchaser of a security. It is premised on the idea that the
43 security that was purchased was the same security that was transferred by the transferor, as
44 contemplated by Section 8-302(a). That paradigm does not always hold true, however, for security
45 entitlements and financial assets credited to securities accounts. It also does not always hold true
46 for controllable electronic records, as discussed in the following Notes.

1 67. Simplification: Proposed elimination of special treatment for “traceable controllable
2 records.”

3
4 Most of the revisions to Section 9-104 in this draft reflect an effort to simplify the section
5 and to make it more readable. The changes are not intended to make material changes in substance
6 or results.

7
8 As explained in the Reporter’s Note to the 2021 AM Draft and Note 3 above, in some cases
9 a purchaser will acquire and obtain control of a controllable electronic record that is not the same
10 controllable electronic record that was “transferred” and a third person may claim a property
11 interest in the “transferred” record from which the record that was purchased derives.

12
13 **Example:** Secured Party holds a perfected security interest in Debtor’s bitcoin
14 unspent transaction output. Debtor contracts to sell bitcoin to Buyer. To fulfill its
15 obligation under the contract of sale, Debtor uses the transaction output as a
16 transaction input to transfer bitcoin to Buyer. The transaction output is not the same
17 controllable electronic record as the transaction input.

18
19 As contemplated in the 2021 AM Draft, Subsection (e) would protect Buyer from Secured
20 Party’s claim that the bitcoin recorded in the transaction input are the same as the bitcoin
21 recorded in the transaction output. Subsection (g)(1), then, would protect Buyer if the
22 bitcoin were recorded in a transaction output that is not the same as the claimed transaction
23 input. But the text of subsection (e) was not so limited—except by implication from the
24 introductory phrase, which this draft proposes to delete as explained in Note 6. The
25 qualifying purchaser would take free of a claim of a property right in the purchased
26 controllable electronic record regardless of whether that claim results from a claim of a pre-
27 purchase right in the purchased controllable electronic record or a claim of a right in any
28 different, antecedent controllable electronic record. As revised, subsection (e) is intended
29 to protect Buyer in both circumstances. Moreover, in many (perhaps most) cases the
30 purchased controllable electronic record will be the “same” record as the pre-purchase
31 record. Thus, if the pre-purchase record were “traceable” to the purchased record, the
32 qualifying purchaser would be protected because the person asserting the claim would be
33 asserting a property interest in the purchased record based on a claim “traced” from the pre-
34 purchase record.

35
36 ~~6. The no-action rule. The take-free rule in subsection (e) applies when both the person~~
37 ~~having control and another person each claim a property interest in the same controllable electronic~~
38 ~~record. As explained above, the no-action rule in former subsection (g)(1) is was meant to provide~~
39 ~~analogous protection analogous to that of subsection (e) when a purchaser obtains control of a~~
40 ~~controllable electronic record that is not the same controllable electronic record in which a third~~
41 ~~person claims a property interest right but is traceable to that controllable electronic record. As~~
42 ~~revised in this draft, the “no-action rule” in subsection (g) eliminates the distinction based on a~~
43 ~~controllable electronic record being traceable to another controllable electronic record. Instead, it~~
44 ~~applies to the purchase of any controllable electronic record. This approach follows Section 8-502~~
45 ~~(from which subsection (g) derives), which does not involve traceability. Indeed, the no-action rule~~
46 ~~recognizes that tracing may be impossible. See Section 8-502, Comment 2.~~

1 The draft further simplifies subsection (g) by making the protection from actions based on
2 claims of property rights applicable to qualifying purchasers, thus avoiding repetition of the
3 necessary qualifying factors. Because a qualifying purchaser need only take without notice of
4 claims of property rights in the purchased controllable electronic record, a purchaser's notice of the
5 claim on which an action is based would not necessarily disqualify the purchaser from status as a
6 qualifying purchaser. This is so because the claimant's property right claim might not have carried
7 over to the purchased record. However, the purchaser's notice of the claim on which the action is
8 based would not suggest any culpability on the part of the purchaser unless the purchaser also had
9 notice of the connection between that claim and the purchased controllable electronic record. If the
10 purchaser were also to have notice of that connection, then, in an appropriate case, the purchaser
11 might be disqualified from qualifying purchaser status based on the absence of good faith.

12
13 **Example:** ~~Secured Party holds a perfected security interest in Debtor's Bitcoin~~
14 ~~unspent transaction output. Debtor contracts to sell Bitcoin to Buyer. To fulfill its~~
15 ~~obligation under the contract of sale, Debtor uses the transaction output as a~~
16 ~~transaction input to transfer Bitcoin to Buyer. Subsection (e) would protect Buyer~~
17 ~~from Secured Party's claim that the Bitcoin recorded in the transaction input are the~~
18 ~~same as the Bitcoin recorded in the transaction output. Subsection (g) would protect~~
19 ~~Buyer if the Bitcoin were recorded in a transaction output that is not the same as the~~
20 ~~claimed transaction input.~~

21
22 In a further effort to simplify, this draft proposes to delete subsection (g)(2). Paragraph (2)
23 would provide protection for a purchaser from a conflicting security interest in the purchased
24 "traceable" controllable electronic record as proceeds of another, antecedent controllable electronic
25 record. Inasmuch as a security interest would be a "claim of a property right," the application of
26 revised subsections (e) and (g) would provide protection for such a purchaser in the circumstances
27 contemplated by paragraph (2). Of course, if the purchaser is a secured party whose security
28 interest secures an obligation, the purchaser would take free of the conflicting property right only
29 to the extent of the obligation secured. Cf. Section 3-302(e).

30
31 7. "*Tethered*" assets. Certain controllable electronic records may carry with them rights to
32 other assets, e.g., goods or rights to payment. By its terms, the take-free rule in subsection (e)
33 applies to controllable electronic records; (which, as defined in draft § 12-102, includes
34 controllable accounts, and controllable payment intangibles evidenced by a controllable electronic
35 record). One might argue that the ~~reference to~~ inclusion of controllable accounts and controllable
36 payment intangibles in the definition of controllable electronic records is unnecessary. By taking a
37 controllable electronic record free of property claims, wouldn't a person take not only the
38 controllable electronic record itself but also all rights that are "carried" in the controllable
39 electronic record free and clear?

40
41 Subsection (f) defeats that argument and limits the application of the take-free rule in
42 subsection (e) to controllable electronic records (and related, controllable accounts, and
43 controllable payment intangibles). Under subsection (f), a qualifying purchaser of a controllable
44 electronic record takes other rights to payment, rights to performance, and interests in property that
45 are evidenced by a controllable electronic record subject to third-party property claims, unless law
46 other than Article 12 the UCC provides to the contrary. The reference in subsection (e) to "law
47 other than [the Uniform Commercial Code]" now refers to "law other than this article" because

1 another article of the UCC might provide a contrary rule for some types of property that might be
2 tethered to a controllable electronic record.

3
4 **Example:** *O* is the owner of a controllable electronic record. The controllable
5 electronic record is a nonfungible token (NFT) that provides access to an electronic
6 image file depicting ~~LeBron James~~ Cecil Celebrity. The image file is not a
7 controllable electronic record, and *O* does not own the copyright in the image of
8 ~~LeBron James~~ Cecil Celebrity. *O* granted to *SP* a security interest in all of *O*'s
9 existing and after-acquired property. *SP* perfected the security interest. Thereafter,
10 *O* sold the NFT to Buyer.

11
12 Because the NFT is a controllable electronic record, a purchaser (*P*) of the NFT
13 (here, Buyer) ordinarily would acquire only those rights that the seller had or had
14 power to convey. Thus, Buyer would acquire its interest subject to *SP*'s perfected
15 security interest. See draft § 12-104(c); UCC § 9-315(a)(1).

16
17 However, if Buyer is a qualifying purchaser, Buyer would acquire its interest in the
18 NFT free of any claim of a property right in the NFT, including *SP*'s security
19 interest. See draft § 12-104(e); UCC § 9-331. Article 9 would determine whether
20 *SP*'s security interest attached to *O*'s rights, if any in the image file depicting
21 ~~LeBron James~~ Cecil Celebrity. If it did attach, law other than Article 12 would
22 determine whether Buyer would acquire the image file free and clear of *SP*'s
23 security interest.

24
25 8. *Creating the functional equivalent of a negotiable instrument.* Two defining
26 characteristics of an Article 3 negotiable instrument are that a holder in due course (1) takes free of
27 claims of a property or possessory right to the instrument (Section 3-306) and (2) takes free of most
28 defenses and claims in recoupment (Section 3-305). Article 3 applies only to written instruments.
29 This draft provides a method for reaching a similar result with respect to controllable accounts and
30 controllable payment intangibles. As regards the first characteristic, a qualified qualifying
31 purchaser of the controllable electronic record would acquire the controllable account or
32 controllable payment intangible free of any claim of a property interest. As regards the second,
33 Section 9-403 ordinarily would give effect to the account debtor's agreement not to assert claims or
34 defenses.

35
36 Section 9-403 adopts the meaning of value in Section 3-303, as does Article 12. The
37 concept of value in Section 3-303 is narrower than the concept in Section 1-204, which applies
38 generally to UCC transactions. Under Section 1-204, a person gives value for rights if the person
39 acquires them in return for a promise. However, under Section 3-303, if a negotiable instrument is
40 issued or transferred for a promise of performance, the instrument is transferred for value only to
41 the extent that the promise has been performed.

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

43
44 (a) A person has control of a controllable electronic record if:

45 (1) the controllable electronic record, a record attached to or logically associated

1 with the controllable electronic record, or the system in which the controllable electronic record is
2 recorded, if any, gives the person:

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

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

6 (i) prevent others from availing themselves of substantially all the
7 benefit from the controllable electronic record; and

8 (ii) transfer control of the controllable electronic record to another
9 person or cause another person to obtain control of a controllable electronic record that is ~~traceable~~
10 ~~to~~ derived from the controllable electronic record; and

11 (2) the controllable electronic record, a record attached to or logically associated
12 with the controllable electronic record, or the system in which the controllable electronic record is
13 recorded, if any, enables the person to readily identify itself in any way as having the powers
14 specified in paragraph (1). ~~The person may be identified in any way,~~ including by name,
15 identifying number, cryptographic key, office, or account number.

16 (b) A power specified in subsection (a)(1) is exclusive, even if:

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

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

21 **Reporter's Note**

22 1. *Why “control” matters.* Control serves two major functions Article 12. An electronic
23 record is a “controllable electronic record” and is subject to the provisions of this article only if it
24 can be subjected to control under this section. *See* draft §§ 12-102; 12-103. And a person having
25 control of a controllable electronic record is eligible to become a ~~qualified~~ qualifying purchaser and
26 so take free of claims of a property interest in the controllable electronic record. *See* draft § 12-

1 104.

2
3 In addition, draft amendments to Article 9 provide that obtaining control of a controllable
4 electronic record is one method by which a security interest in the controllable electronic record
5 can be perfected. Under these amendments, perfection of a security interest in controllable
6 accounts and controllable payment intangibles can be achieved by obtaining control of the related
7 controllable electronic record.

8
9 2. *Powers and sources of powers; inability to exercise a power.* This section conditions
10 control on a person's having the three powers specified in paragraph (a)(1). A person would have a
11 power described in this paragraph if the controllable electronic record, a record attached to or
12 logically associated with the controllable electronic record, or any system in which it is recorded
13 gives the purchaser that power; This description of the source of the relevant powers should be
14 construed broadly and functionally. For example, a system in which the person in control is
15 identified is a permissible source of a power even if it is related to but not precisely the "same"
16 system in which the controllable electronic record is recorded. Moreover, a person would have a
17 power even if the characteristics of the particular purchaser disable the person from exercising the
18 power. This would be the case, for example, when the purchaser holds the private key required to
19 access the benefit of the controllable electronic record but lacks the hardware required to use it.

20
21 3. *"Benefit."* Subparagraphs (a)(1)(A) and (a)(1)(B)(i) condition control of a controllable
22 electronic record on a person's relationship to the benefit of the controllable electronic record.

23
24 As used in the section, the "benefit" of a controllable electronic record refers to the rights
25 that are afforded by the controllable electronic record and the uses to which the controllable
26 electronic record can be put. These, in turn, depend on the characteristics of the controllable
27 electronic record in question. For example, ~~Bitcoin~~ bitcoin can be held or disposed of (sold). A
28 controllable electronic record evidencing a controllable account or controllable payment intangible
29 affords the right to collect from the account debtor (obligor).

30
31 The system in which a controllable electronic record is recorded may limit the benefit from
32 the controllable electronic record that is available to those who interact with the system. In
33 determining whether a person has the power to avail itself of substantially all the benefit from a
34 controllable electronic record under subparagraph (a)(1)(A), or to prevent others from availing
35 themselves of substantially all the benefit from a controllable electronic record under subparagraph
36 (a)(1)(B)(i), only the benefit that the system makes available should be considered.

37
38 4. *Power to retrieve information.* By definition, the information constituting an electronic
39 record must be "retrievable in perceivable form." UCC § 1-201. The power to retrieve the record
40 in perceivable form is included in the benefit of a controllable electronic record. "Perceivable
41 form" means that the contents of the record are intelligible; the ability to perceive the
42 indecipherable jumble of an encrypted record does not give a person the power to retrieve the
43 record in perceivable form.

44
45 To have control of a controllable electronic record under subparagraph (a)(1)(A), a person
46 must have at least the nonexclusive power to avail itself of this benefit. If a person also has the
47 exclusive power to decrypt the encrypted record, the person would have the exclusive power to

1 prevent others from availing themselves of substantially all the benefit from the controllable
2 electronic record and thereby satisfy the condition in subparagraph (a)(1)(B)(i).

3
4 *5. Exclusive powers.* Unlike the power in subparagraph (a)(1)(A), the powers in
5 subparagraphs (a)(1)(B)(i) and (a)(1)(B)(ii) must be held exclusively by the person claiming
6 control in order to establish control.

7
8 Subsection (b) contains two limitations on the term “exclusive” as used in subsection (a).
9 Under subsection (b), a power can be “exclusive” if one or both of these limitations apply.

10
11 Paragraph (b)(1) takes account of the fact that the powers of a purchaser of a controllable
12 electronic record necessarily are subject to the attributes of the controllable electronic record and
13 the protocols of any system in which the controllable electronic record is recorded.

14
15 Paragraph (b)(2) allows for a person’s agreement to share a power with another person.
16 One effect of paragraph (b)(2) is that, under a multi-signature (multi-sig) agreement, any person
17 that is readily identifiable under paragraph (a)(2) and shares the relevant power would be eligible to
18 have control, even if the action of another person is a condition for the exercise of the power. For
19 example, a person in control may agree that another person’s action on the relevant system would
20 be required to effect a transfer of control without impairing the requisite exclusivity.

21
22 6. Transfer of control. The power to transfer control under subsection (a)(1)(B)(ii)
23 includes the power to cause another person to obtain control of a controllable electronic record that
24 derives from a controllable electronic record. See draft § 12-104, Reporter’s Note 3.

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

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

41
42 A similar provision (now placed in square brackets) on control by a person on behalf of
43 another person appears in draft § 9-105 on control of an electronic copy of a record evidencing
44 chattel paper and in draft § 7-106 on control of an electronic copy of a document of title. See draft
45 § 9-105(a)(2), Reporter’s Note 4.

46
47 The Drafting Committee is invited to consider whether a similar provision addressing

1 control by one person on behalf of another person should be added to draft § 12-105 for
2 controllable electronic records and, if so, whether it should apply generally or should be made
3 applicable only to control of controllable electronic records evidencing controllable accounts and
4 controllable payment intangibles. For example, a new subsection (c), along the following lines
5 might be added to draft § 12-105:

6
7 (c) A person also has control of a controllable electronic record if another person:
8 (1) has control of the controllable electronic record and acknowledges that it
9 has control on behalf of the person, or
10 (2) obtains control of the controllable electronic record after having
11 acknowledged that it will acquire control of the controllable electronic record on behalf of
12 the person.

13
14 This formulation follows the structure of Section 9-313(c), but without the requirement that the
15 acknowledgement be made in an authenticated record. The Drafting Committee may consider
16 whether such a provision should impose an authenticated record requirement. The Drafting
17 Committee also may consider whether it would be sufficient that these issues be addressed by
18 official comments only.

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

27
28 68. *Readily identify.* Paragraph (a)(2) provides that a person does not have control of a
29 controllable electronic record unless the controllable electronic record, a record attached to or
30 logically associated with the controllable electronic record, or any system in which the controllable
31 electronic record is recorded enables the person to readily identify itself as the person having the
32 requisite powers. This paragraph does not obligate a person to identify itself as having control.
33 However, to prove that it has control, a person would need to prove that the relevant records or any
34 system in which the controllable electronic record is recorded readily identifies the person as such.
35 The last sentence of paragraph (a)(2) derives from Section 3-110(c). It adds “cryptographic key”
36 as an example of a way in which a person may be identified.

37
38 **Section 12-106. Discharge of Account Debtor on Controllable Account or Controllable**
39 **Payment Intangible.**

40 (a) Except as provided in this section, an account debtor on a controllable account or
41 controllable payment intangible may discharge its obligation:

42 (1) by paying the person having control of the controllable electronic record that

1 evidences the controllable account or controllable payment intangible; or

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

4 (b) Subject to subsections ~~(e)~~(d) and ~~(g)~~(h), an account debtor may not discharge its
5 obligation by paying a person that formerly had control of the controllable electronic record if the
6 account debtor receives a notification that;

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

9 (2) ~~that~~ reasonably identifies the controllable account or controllable payment
10 intangible;

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

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

15 (5) provides a commercially reasonable method by which the account debtor is to
16 pay the transferee. ~~The transferee may be identified in any way, including by name, identifying~~
17 ~~number, cryptographic key, office, or account number.~~

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

21 ~~(e)~~(d) Subject to subsection ~~(g)~~(h), notification is ineffective under subsection (b):

22 (1) unless, before the notification is sent, the account debtor and the person that at
23 that time had control of the controllable electronic record that evidences the controllable account or
24 controllable payment intangible agree in an authenticated record to a commercially reasonable

1 method by which a person can furnish reasonable proof that control has been transferred;

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

5 (3) at the option of the account debtor, if the notification notifies the account debtor
6 to divide a payment, ~~and~~ make less than the full amount of any required payment, or pay any
7 portions of a payment by more than one method or to more than one person.

8 ~~(d)(e)~~ Subject to subsection ~~(g)(h)~~, if requested by the account debtor, the person giving the
9 notification shall seasonably furnish reasonable proof, using the agreed method, that control of the
10 controllable electronic record has been transferred. Unless the person complies with the request,
11 the account debtor may discharge its obligation by paying a person that formerly had control, even
12 if the account debtor has received a notification under subsection (b).

13 ~~(e)(f)~~ A person furnishes reasonable proof that control has been transferred if the person
14 demonstrates, using the agreed method, that the transferee has the power to avail itself of
15 substantially all the benefit from the controllable electronic record, prevent others from availing
16 themselves of substantially all the benefit from the controllable electronic record, and transfer these
17 powers to another person.

18 ~~(f)(g)~~ Subject to subsection ~~(g)(h)~~, an account debtor may not waive or vary its option under
19 subsection ~~(e)(d)~~(3).

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

23 **Reporter's Note**

24 1. *Source of these provisions.* These provisions derive from Section 3-602, which governs
25

1 the discharge of a person obligated on a negotiable instrument, and Section 9-406, which governs
2 the discharge of an account debtor (obligor), including a person obligated on an account or
3 payment intangible.
4

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

10 Under subsection (a)(1), an account debtor may discharge its obligation on the controllable
11 account or controllable payment intangible by paying the person that has control of the related
12 controllable electronic record at the time of payment. Subsections (a)(2) and (b) would remove
13 from an account debtor the burden of determining who has control of the related controllable
14 electronic record at any given time—a burden that, with respect to some controllable electronic
15 records, an account debtor may be unable to satisfy. Under paragraph (a)(2), an account debtor
16 may discharge its obligation by paying a person that formerly had control of the related
17 controllable electronic record, which presumably would include the initial obligee.
18

19 Subsection (b) reflects the fact that a person to which control has been transferred may not
20 wish to take the risk that the account debtor will discharge its obligation by paying the transferor.
21 Subsection (b) would protect the transferee by providing that if the account debtor receives a
22 notification that control has been transferred, the account debtor may discharge its obligation by
23 paying in accordance with the notification and may not discharge its obligation by paying a person
24 that formerly had control. The notification must be authenticated by a person formerly having
25 control or by the transferee.
26

27 To be effective under subsection (b), a notification must reasonably identify the controllable
28 account or controllable payment intangible, notify the account debtor that control of the
29 controllable electronic record that evidences the controllable account or controllable payment
30 intangible was transferred, identify the transferee in any way, and provide a commercially
31 reasonable method by which the account debtor is to make payments to the transferee. A change in
32 the identity of the person to which the account debtor must make payment should not, and typically
33 will not, impose a significant burden on the account debtor. However, one can imagine a method
34 of making payment that would be burdensome, e.g., making a payment through a trading platform
35 or payment service with which the account debtor does not have an account. For this reason, the
36 designated method of making payment must be “commercially reasonable.”
37

38 3. *“Reasonable proof.”* As noted above, this section derives in large part from Section 9-
39 406, which provides for notification that an account or payment intangible has been assigned.
40 Account debtors that have received notification of an assignment under Section 9-406 almost
41 always make payments in accordance with the notice. Recognizing that an account debtor may be
42 uncertain whether a notification is legitimate, Section 9-406 affords to an account debtor the right
43 to request proof that the account or payment intangible was assigned.
44

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

6
7 "Reasonable proof" requires evidence that would be understood by a typical account debtor
8 to whom it is proffered as demonstrating to a reasonably high probability that control of the
9 controllable electronic record has been transferred to the transferee. Subsection ~~(e)~~(f) provides a
10 safe harbor for providing reasonable proof. It enables a person to satisfy the account debtor's
11 request by demonstrating that the transferee has the power to avail itself of substantially all the
12 benefit from the controllable electronic record, to prevent others from availing themselves of
13 substantially all the benefit from the controllable electronic record, and to transfer these powers to
14 another person. This demonstration would not necessarily prove that a person actually has control
15 of a controllable electronic record because it need not show that the transferee held the last two
16 powers exclusively. Nevertheless, such a demonstration would constitute "reasonable proof" under
17 subsection (e). A person that has control should have little difficulty providing this proof, as a
18 person cannot have control unless it can readily identify itself as having the requisite powers. *See*
19 *draft § 12-105(a)(2)*.

20
21 Reasonable proof that is seasonably furnished by a person other than the person that gave
22 the notification would constitute compliance with the account debtor's request.

23
24 Subsection ~~(d)~~(e) requires that reasonable proof be provided "using the agreed method."
25 Subsection ~~(e)~~(f) requires that a person use "the agreed method" to demonstrate that the transferee
26 has the specified powers. "Agreed method" refers to the commercially reasonable method to which
27 the parties agreed, in an authenticated record, before the notification was sent. If parties did not so
28 agree, the notification is ineffective under subsection ~~(e)~~(1).

29
30 4. Subsection (d)(3) differs from the corresponding provision in Section 9-406(b)(3). The
31 Drafting Committee should consider whether this difference is appropriate.

32
33 45. Relationship to Section 9-406. Section 9-406 governs the discharge of the obligation of
34 an account debtor. It will be amended to carve out transactions covered by this section. *See draft §*
35 *9-406.*

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

37
38 ~~[The Drafting Committee will not consider this section until after the Annual Meeting]~~

39 (a) Except as provided in subsection[s (b) and] (d) [Alternative A], the local law of a
40 controllable electronic record's jurisdiction governs the matters covered by this article.

41 [(b) The local law of a controllable electronic record's jurisdiction governs the matters

1 covered by Section 12-106 unless an agreement effective under Section 1-301(a) determines that
2 the local law of another jurisdiction governs such matters.]

3 (c) The following rules determine a controllable electronic record's jurisdiction for
4 purposes of this section:

5 (1) If the controllable electronic record, or a record attached to or logically
6 associated with the controllable electronic record which is readily available for review, expressly
7 provides that a particular jurisdiction is the controllable electronic record's jurisdiction for
8 purposes of this article or [the UCC], that jurisdiction is the controllable electronic record's
9 jurisdiction.

10 (2) If paragraph 1 does not apply and the rules of the system in which the
11 controllable electronic record is recorded are readily available for review and expressly provide
12 that a particular jurisdiction is the controllable electronic record's jurisdiction for purposes of this
13 article or [the UCC], that jurisdiction is the controllable electronic record's jurisdiction.

14 (3) If none of the preceding paragraphs applies and the controllable electronic
15 record, or a record attached to or logically associated with the controllable electronic record which
16 is readily available for review, expressly provides that the controllable electronic record is
17 governed by the law of a particular jurisdiction, that jurisdiction is the controllable electronic
18 record's jurisdiction.

19 (4) If none of the preceding paragraphs applies and the rules of the system in which
20 the controllable electronic record is recorded are readily available for review and expressly provide
21 that the controllable electronic record or the system is governed by the law of a particular
22 jurisdiction, that jurisdiction is the controllable electronic record's jurisdiction.

23 **Alternative 1**

24 (5) If none of the preceding paragraphs applies, the controllable electronic record's

1 jurisdiction is the jurisdiction in which the transferor is located, unless the location of the transferor
2 cannot be readily determined.

3 (d) If none of paragraphs (1) - (5) of subsection (c) applies, [except as provided in
4 subsection (b)] the law that governs the matters covered by this article is determined under Section
5 1-301.

6 **Alternative 2**

7 (5) If none of the preceding paragraphs applies, the controllable electronic record's
8 jurisdiction is the jurisdiction in which the transferor is located.

9 (d) If paragraph (5) of subsection (c) applies and the location of the transferor cannot be
10 readily determined, the transferor is [deemed to be] located in [this state][the District of
11 Colombia][insert name of state that has adopted Article 12]].

12 (e) Subsection (c) applies even if a transaction does not bear any relation to the controllable
13 electronic record's jurisdiction determined under paragraphs (c)(1) - (4).

14 (f) [Except as provided in subsection (d) [Alternative B], the] [The] location of the
15 transferor for purposes of paragraph (c)(5) is determined under Section 9-307.

16 [(g) The rights acquired by a purchaser or a qualifying purchaser under Section 12-104 are
17 governed by the law applicable under this section as determined at the time of that person's
18 purchase.]

19 **Reporter's Note**

20
21 1. *Source of these provisions.* The provisions of draft § 12-107 derive from Sections 8-110
22 and 9-305 on law governing perfection and priority of security interests in investment property and
23 the relevance of a securities intermediary's jurisdiction and a commodity intermediary's
24 jurisdiction. This first draft is presented as a basis for an initial discussion of a choice-of-law rule
25 for controllable electronic records.

26
27 2. *The basic rule: Law of Controllable electronic record's jurisdiction.* Subsection (a)
28 states the basic rule that the law of a controllable electronic record's jurisdiction governs the
29 matters covered by Article 12. This might be viewed as a rough proxy for the traditional role of the

1 location of tangible asset (e.g., goods) in determining the applicable law (*lex rei sitae*). Drawing
2 on the analogous provisions in Sections 8-110 and 9-305 in the context of a security entitlement or
3 securities account or a commodity contract or commodity account, under this draft it is the
4 controllable electronic record itself, records attached thereto or associated therewith, or the system
5 in which the controllable electronic record is recorded that determines the governing law.
6 Subsection (c) provides a “waterfall” of rules based on provisions that identify a particular
7 jurisdiction as the controllable electronic record’s jurisdiction or alternatively that provide the
8 governing law of a controllable electronic record or the system in which the record is recorded.
9

10 3. Subsections (c)(5) and (d) (both alternatives) address a problem that does not normally
11 exist in the context of Sections 9-110 and 9-305. Currently it is generally the case that many
12 controllable electronic records, associated records, and systems in which such records are recorded
13 do not identify the “controllable electronic record’s jurisdiction” or the governing law (except in
14 some permissioned systems). (One hopes that once Article 12 and accompanying amendments are
15 widely adopted that systems will adapt and the waterfall will become more generally viable for
16 identifying the controllable electronic record’s jurisdiction.) This means that the waterfall
17 ultimately turns to the location of the “transferor” of a controllable electronic record. This
18 approach derives from the role of the location of a debtor under Sections 9-301 and 9-307. But in
19 many cases involving controllable electronic records the transferor is not known to or easily
20 discoverable by a purchaser. Subsection (d), Alternative 1, then points to the law applicable under
21 Section 1-301. That approach may be an acceptable (or at least feasible) fallback for purposes of
22 Article 12 in general. But it is unsatisfactory for purposes of the law applicable to perfection and
23 priority of security interests, addressed by draft § 9-306A. Consequently, when the controllable
24 electronic record’s jurisdiction is not resolved by the waterfall in draft § 12-107(c), draft § 9-306A
25 must rely on the location of the debtor, which may be unknown. The likely result is that this
26 uncertainty would discourage an extension of secured credit based on the controllable electronic
27 record as collateral. But in the usual case an extender of secured credit will know the identity and
28 location of its debtor, unlike the situation where a purchaser acquires a controllable electronic
29 record in a public blockchain platform and the transferor is anonymous. Subsection (d),
30 Alternative 2, offers another approach that provides more certainty, but may be problematic in
31 other respects.
32

33 4. Draft subsection (g) appears in square brackets. The Drafting Committee may consider
34 whether resolution of the timing issue that it addresses is implicit and therefore need not be
35 expressly stated in the text. Note that Sections 8-110 and 9-305 do not contain an analogous rule.
36 Alternatively, that subsection might be expanded to apply to the determination of other issues
37 under Article 12.
38

39 ARTICLE 8

40 INVESTMENT SECURITIES

41 See draft § 12-102, Reporter’s Note 2 (last paragraph).

42 Section 8-102. Definitions and Index of Definitions.

43 * * *

- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 0
- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 0
- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 0
- 1
- 2
- 3
- 4
- 5
- 6
- 7

* * *

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

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

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

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

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

1 * * *

2
3 14. “Securities intermediary.” A “securities intermediary” is a person that in the ordinary
4 course of its business maintains securities accounts for others and is acting in that capacity. The
5 most common examples of securities intermediaries would be clearing corporations holding
6 securities for their participants, banks acting as securities custodians, and brokers holding securities
7 on behalf of their customers. However, a person need not be such an entity in order to be a
8 securities intermediary. Because a “securities account” is an account to which a financial asset is or
9 may be credited in accordance with Section 8-501(a) and the definition of “financial asset” is not
10 limited to securities, a person may be a “securities intermediary” even if that person does not credit
11 “securities” (as defined in Article 8) to the account. Rather, the securities accounts that a securities
12 intermediary maintains may consist exclusively of financial assets described in clauses (ii) and (iii)
13 of Section 8-102(a)(9). Clearing corporations are listed separately as a category of securities
14 intermediary in subparagraph (i) even though in most circumstances they would fall within the
15 general definition in subparagraph (ii). The reason is to simplify the analysis of arrangements such
16 as the NSCC-DTC system in which NSCC performs the comparison, clearance, and netting
17 function, while DTC acts as the depository. Because NSCC is a registered clearing agency under
18 the federal securities laws, it is a clearing corporation and hence a securities intermediary under
19 Article 8, regardless of whether it is at any particular time or in any particular aspect of its
20 operations holding securities on behalf of its participants.

21
22 The terms securities intermediary and broker have different meanings. Broker means a
23 person engaged in the business of buying and selling securities, as agent for others or as principal.
24 Securities intermediary means a person maintaining securities accounts for others. A stockbroker,
25 in the colloquial sense, may or may not be acting as a securities intermediary.

26
27 The definition of securities intermediary includes the requirement that the person in
28 question is “acting in the capacity” of maintaining securities accounts for others. This is to take
29 account of the fact that a particular entity, such as a bank, may act in many different capacities in
30 securities transactions. A bank may act as a transfer agent for issuers, as a securities custodian for
31 institutional investors and private investors, as a dealer in government securities, as a lender taking
32 securities as collateral, and as a provider of general payment and collection services that might be
33 used in connection with securities transactions. A bank that maintains securities accounts for its
34 customers would be a securities intermediary with respect to those accounts; but if it takes a pledge
35 of securities from a borrower to secure a loan, it is not thereby acting as a securities intermediary
36 with respect to the pledged securities, since it holds them for its own account rather than for a
37 customer. In other circumstances, those two functions might be combined. For example, if the bank
38 is a government securities dealer it may maintain securities accounts for customers and also
39 provide the customers with margin credit to purchase or carry the securities, in much the same way
40 that brokers provide margin loans to their customers.

41
42 The definition of securities intermediary includes the requirement that the person in
43 question “in the ordinary course of its business maintain securities accounts for others”. This
44 “ordinary course” requirement does not have a fixed quantitative requirement and is determined by
45 the facts of each case. Thus, a person need not necessarily satisfy a specified threshold of activity
46 or necessarily have a minimum number of customers.

1 **Reporter's Note**

2
3 1. Relationship between Articles 8 and 12. These draft amendments to the Official
4 Comments to Article 8 are intended to make clear that a controllable electronic record may be a
5 financial asset credited to a securities account under Article 8 and to identify several significant
6 aspects of the relationship between Articles 8 and 12.

7
8 2. Financial assets held for a person other than an entitlement holder. The drafting
9 committee may wish to consider whether controllable electronic records might be held by a
10 securities intermediary pursuant to Section 8-501(d) for a person other than an entitlement holder.
11 Subsection (d) generally applies to “customer name securities” (see 15 U.S. Code § 78lll(3)) that
12 are held directly by a securities intermediary’s customer. That subsection uses terminology
13 applicable to conventional securities (e.g., “indorsed”) and would require amendment (unless very
14 “cheerfully” interpreted) for it to apply to financial assets such as controllable electronic records,
15 which would be held directly by the intermediary’s customer, perhaps subject to shared control.

16
17 **ARTICLE 9**

18 **SECURED TRANSACTIONS**

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

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

21 * * *

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

32 * * *

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

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

“Qualifying purchaser” Section 12-104.

* * *

Reporter’s Note

1. “*Controllable account*”; “*controllable payment intangible*.” The draft affords 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 is attachment of a security interest in a related controllable account and controllable payment intangible. Draft § 9-203(j).
- Perfection of a security interest in a controllable electronic record is perfection of a

1 security interest in a related controllable account and controllable payment intangible.
2 Draft § 9-308(h).
3

- 4 • Perfection of a security interest in a controllable account or controllable payment
5 intangible can be achieved by filing a financing statement or obtaining control of the
6 controllable electronic record that evidences the controllable account or controllable
7 payment intangible. Draft §§ 9-314(a); 9-107A(b).
8
- 9 • A security interest in a controllable electronic record, controllable account, or
10 controllable payment intangible that is perfected by control has priority over a
11 conflicting security interest that is perfected by another method. Draft § 9-326A.
12
- 13 • A person that enjoys the benefit of the take-free and no-action rules with respect to a
14 controllable electronic record would also enjoy those benefits with respect to a
15 controllable account or controllable payment intangible that is evidenced by the
16 controllable electronic record. Draft §§ 12-102(a)(1) (defining “controllable electronic
17 record” to include controllable accounts and controllable payment intangibles evidenced
18 by a controllable electronic record); 12-104(e), (g).
19

20 2. “*Person that has control.*” An undertaking to pay the “person that has control” means
21 an undertaking to pay the person that has control at the time payment is made. An undertaking to
22 pay Smith, who has control of the relevant controllable electronic record at the time the
23 undertaking was made, is not an undertaking to pay the person that has control.
24

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

27 (a) A secured party has control of a controllable electronic record as provided in Section 12-
28 105.

29 (b) A secured party has control of a controllable account or controllable payment intangible
30 if the secured party has control of the controllable electronic record that evidences the controllable
31 account or controllable payment intangible.

32 **Reporter’s Note**
33

34 1. *Control of controllable electronic records.* This draft provides for perfection by filing
35 and perfection by control as alternative methods of perfection with respect to a controllable
36 electronic record. See draft §§ 9-313; 9-314. Under draft § 9-107A(a), a secured party has control
37 of a controllable electronic record as provided in draft § 12-105. Under draft § 9-326A, a security
38 interest in a controllable electronic record that is perfected by control has priority over a security
39 interest perfected by another method.
40

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

By definition, a controllable account would be an Article 9 “account,” and a controllable payment intangible would be an Article 9 “payment intangible.” Draft § 9-102. The fact that an account or payment intangible is a controllable account or controllable payment intangible would afford to the secured party an alternative method of perfection, *i.e.*, filing. 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 (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, electronic documents, 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, 9-107, or 9-107A pursuant to the debtor’s security agreement.

1 ~~[The Drafting Committee will not consider this section until after the Annual Meeting]~~

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

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

7 (1) a secured party having control of a deposit account under Section 9-104(a)(2)
8 shall send to the bank with which the deposit account is maintained an authenticated statement that
9 releases the bank from any further obligation to comply with instructions originated by the secured
10 party;

11 (2) a secured party having control of a deposit account under Section 9-104(a)(3)
12 shall:

13 (A) pay the debtor the balance on deposit in the deposit account; or

14 (B) transfer the balance on deposit into a deposit account in the debtor's
15 name;

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

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

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

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

4 (4) a secured party having control of investment property under Section 8-106(d)(2)
5 or 9-106(b) shall send to the securities intermediary or commodity intermediary with which the
6 security entitlement or commodity contract is maintained an authenticated record that releases the
7 securities intermediary or commodity intermediary from any further obligation to comply with
8 entitlement orders or directions originated by the secured party; and

9 (5) a secured party having control of a letter-of-credit right under Section 9-107
10 shall send to each person having an unfulfilled obligation to pay or deliver proceeds of the letter of
11 credit to the secured party an authenticated release from any further obligation to pay or deliver
12 proceeds of the letter of credit to the secured party; ~~and~~

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

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

16 (B) if the debtor designates a custodian that is the designated custodian with
17 which the authoritative copy of the electronic document is maintained for the secured party,
18 communicate to the custodian an authenticated record releasing the designated custodian from any
19 further obligation to comply with instructions originated by the secured party and instructing the
20 custodian to comply with instructions originated by the debtor; and

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

24 (7) a secured party having control of a controllable electronic record shall transfer

1 control of the controllable electronic record to the debtor or to a person designated by the debtor.

2 * * *

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

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

7 * * *

8 **Section 9-306A. Law Governing Perfection and Priority of Security Interests in**
9 **Controllable Electronic Records.**

10 **(a) [Governing law: general rules.]** Except as provided in subsection (b), perfection, the
11 effect of perfection or nonperfection, and the priority of a security interest in a controllable
12 electronic record is governed by:

13 (1) the local law of the controllable electronic record's jurisdiction as specified in
14 Section 12-107(c)(1) through (4), or

15 (2) if none of those paragraphs applies, the local law of the jurisdiction in which the
16 debtor is located.

17 **(b) [Governing law: perfection by filing.]** The local law of the jurisdiction in which the
18 debtor is located governs perfection of a security interest in a controllable electronic record
19 intangibles by filing.

20 **(c) [Location of debtor.]** If the location of the debtor cannot readily be determined, the
21 debtor is [deemed to be] located in [the District of Colombia][insert name of state that has adopted
22 Article 12].

23 * * *

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

1 **Perfection.**

2 * * *

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

7 * * *

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

10 * * *

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

13 * * *

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

17 **Section 9-312. Perfection of Security Interests in Controllable Electronic Records,**
18 **~~Controllable Accounts, Controllable Payment Intangibles,~~ Chattel Paper, Deposit Accounts,**
19 **Documents, Goods Covered by Documents, Instruments, Investment Property, Letter-of-**
20 **Credit Rights, and Money; Perfection by Permissive Filing; Temporary Perfection Without**
21 **Filing or Transfer of Possession.**

22 (a) [**Perfection by filing permitted.**] A security interest in chattel paper, controllable
23 electronic records, ~~controllable accounts, controllable payment intangibles, chattel paper,~~
24 ~~negotiable documents,~~ instruments, ~~or investment property,~~ or negotiable documents 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, electronic chattel paper, or electronic documents~~ deposit accounts, electronic chattel paper, electronic documents, investment property, or letter-of-credit rights, may be perfected by control of the collateral under Section 7-106, 9-104, 9-105, 9-106, 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, letter-of-credit rights, or electronic documents~~ deposit accounts, electronic chattel paper, electronic documents, or letter-of-credit rights is perfected by control under Section 7-106, 9-104, 9-105, 9-107, or 9-107A when the secured party obtains control and remains perfected by control only while the secured party retains control.

* * *

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

(a) **[General rule: effect on perfection of change in governing law.]** A security interest perfected pursuant to the law of the jurisdiction designated in Section 9-301(1), ~~or 9-305(c)~~, or 9-306A(a)(2) or (b) remains perfected until the earliest of:

(1) the time perfection would have ceased under the law of that jurisdiction;

(2) the expiration of four months after a change of the debtor's location to another jurisdiction; or

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

* * *

(fA) [Change in jurisdiction of controllable accounts, controllable electronic records, or controllable payment intangibles.] A security interest that is perfected pursuant to the law designated in Section 9-306A(a)(1) remains perfected until the expiration of four months after a change of the applicable law to another jurisdiction.

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

* * *

Section 9-326A. Priority of Security Interests in Controllable Electronic Record, ~~Controllable Account, and Controllable Payment Intangible.~~

A security interest in a controllable electronic record, ~~controllable account, or controllable payment intangible~~ held by a secured party having control of the 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. *Control Priority priority.* This section adopts an approach to priority in controllable electronic records, (as defined, including controllable accounts, and controllable payment intangibles) that is similar to the approach of Sections 9-327 (deposit account) and 9-328 (investment property): 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, which applies to

chattel paper and instruments, would be likely to yield the same outcomes that would obtain under the provisions applicable to ~~qualifying~~ certain purchasers (draft §§ 12-104(e) and (g) and 9-331) in the vast majority of cases.

2. Alternative 9-330(d) approach. The “negotiability” attributes conferred by draft § 12-104(e) and (g) for controllable electronic records and attendant controllable accounts and controllable payment intangibles functionally mimic the treatment of negotiable instruments. As explained in Note 1, the control priority rule of this draft section is based on the similar rule for security interests in deposit accounts and investment property. An alternative approach would be to follow Section 9-330(d), which provides for purchasers of instruments (as defined in Section 9-102(a)(47) to include both negotiable and non-negotiable instruments) to obtain non-temporal priority over conflicting security interests. The 9-330(d) standard for priority is somewhat more generous than that provided in draft § 12-104(e) and (g) for qualifying purchasers—subsection (d) uses the Section 1-204 definition of “value” and requires that the purchaser act “without knowledge that the purchase violates the rights of the secured party.” However, the revisions to draft § 12-104 proposed in this draft along with draft § 9-326A opt for simplicity over a more granular allocation of priorities.

Section 9-331. Priority of Rights of Purchasers of Instruments, Documents, 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, 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 (as defined in Section 12-104) 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, 8 and 12.

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

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

1 **Reporter's Note**

2
3 1. *Purpose of this section.* This section ~~insures~~ ensures that Article 9 does not interfere
4 with the protections that Article 12 affords to a good faith purchaser for value under the take-free
5 and no-action rules in draft § 12-104(e) and (g).
6

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

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

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

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

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

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

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

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

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

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

7 * * *

8 (d) **[Term restricting assignment generally ineffective.]** Except as otherwise provided in
9 subsection (e) and Sections 2A-303 and 9-407, and subject to subsection (h), a term in an
10 agreement between an account debtor and an assignor or in a promissory note is ineffective to the
11 extent that it:

12 (1) prohibits, restricts, or requires the consent of the account debtor or person
13 obligated on the promissory note to the assignment or transfer of, or the creation, attachment,
14 perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible,
15 or promissory note; or

16 (2) provides that the assignment or transfer or the creation, attachment, perfection,
17 or enforcement of the security interest may give rise to a default, breach, right of recoupment,
18 claim, defense, termination, right of termination, or remedy under the account, chattel paper,
19 payment intangible, or promissory note.

20 (e) **[Inapplicability of subsection (d) to certain sales.]** Subsection (d) does not apply to
21 the sale of a payment intangible or promissory note, other than a sale [of a controllable payment
22 intangible and a sale] pursuant to a disposition under Section 9-610 or an acceptance of collateral
23 under Section 9-620.

24 * * *

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

3 **Reporter's Note**

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

7
8 2. *Sale of Controllable payment intangible.* The proposed amendment to subsection (e)
9 would carve out controllable payment intangibles from the general exception for payment
10 intangibles from the application of subsection (d). Providing that restrictions on assignments of
11 controllable payment intangibles are ineffective pursuant to subsection (d) is consistent with the
12 characteristics of negotiability generally conferred on controllable electronic records, controllable
13 accounts, and controllable payment intangibles. The proposed amendment appears in square
14 brackets pending discussion by the Drafting Committee.

15
16 * * *

17
18 **Section 9-408. Restrictions On Assignment Of Promissory Notes, Health-Care-**
19 **Insurance Receivables, And Certain General Intangibles Ineffective.**

20 (a) **[Term restricting assignment generally ineffective.]** Except as otherwise provided in
21 subsection (b), a term in a promissory note or in an agreement between an account debtor and a
22 debtor which relates to a health-care-insurance receivable or a general intangible, including a
23 contract, permit, license, or franchise, and which term prohibits, restricts, or requires the consent of
24 the person obligated on the promissory note or the account debtor to, the assignment or transfer of,
25 or creation, attachment, or perfection of a security interest in, the promissory note, health-care-
26 insurance receivable, or general intangible, is ineffective to the extent that the term:

27 (1) would impair the creation, attachment, or perfection of a security interest; or

28 (2) provides that the assignment or transfer or the creation, attachment, or perfection
29 of the security interest may give rise to a default, breach, right of recoupment, claim, defense,
30 termination, right of termination, or remedy under the promissory note, health-care-insurance
31 receivable, or general intangible.

(b) **[Applicability of subsection (a) to sales of certain rights to payment.]** Subsection (a) applies to a security interest in a payment intangible or promissory note only if the security interest arises out of a sale of the payment intangible or promissory note, other than a sale [of a controllable payment intangible and a sale] pursuant to a disposition under Section 9-610 or an acceptance of collateral under Section 9-620.

Reporter's Note

1. Sale of controllable payment intangibles. See draft § 9-406, Reporter's Note 2.

* * *

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, 9-107, or 9-107A has the rights and duties provided in Section 9-207.

* * *

Section 9-605. Unknown Debtor or Secondary Obligor.

(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:

1 (A) that the person is a debtor; and

2 (B) the identity of the person.

3 (b) Subsection (a) does not apply to a secured party that, at the time the secured party's
4 security interest attaches to a controllable electronic record,~~controllable account, or controllable~~
5 ~~payment intangible~~, has notice that the nature of the collateral or the system in which the collateral
6 is recorded, if any, would prevent the secured party from acquiring the knowledge specified in that
7 subsection.

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

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

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

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

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

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

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

21 (B) the identity of the person; and

22 (C) how to communicate with the person; or

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

1 (A) that the person is a debtor; and

2 (B) the identity of the person.

3 (c) Subsection (b) does not apply to a secured party that, at the time the secured party's
4 security interest attaches to a controllable electronic record, ~~controllable account, or controllable~~
5 ~~payment intangible~~, has notice that the nature of the collateral or the system in which the collateral
6 is recorded, if any, would prevent the secured party from acquiring the knowledge specified in that
7 subsection.

8 **Reporter's Note**

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

14
15 Comment 2 to Section 9-628 observes, "Without this group of provisions [in Sections 9-605
16 and 9-628], a secured party could incur liability to unknown persons and under circumstances that
17 would not allow the secured party to protect itself." The draft amendments to this section reflect
18 the policy that a secured party should not be free to avoid statutory duties or absolve itself from
19 liability by entering into a transaction when the secured party can protect itself, *i.e.*, when the
20 secured party has notice that the nature of the collateral or any system in which the collateral is
21 recorded would prevent the secured party from acquiring the knowledge necessary to fulfill its
22 statutory duties. (A person has notice of a fact if, *inter alia*, from all the facts and circumstances
23 known to the person at the time in question, has reason to know that it exists. Section 1-202(a)(3).)
24

25 **EFFECTIVE DATE AND TRANSITION PROVISIONS**

26 [The Drafting Committee will not consider these provisions until after ~~the Annual Meeting~~
27 its November 5-6, 2021 meeting.]

28 **B. Money**

29 **Prefatory Note**

30 With ~~one exception~~ two exceptions, all of these amendments address the use of intangible
31 fiat currency (money) as collateral under UCC Article 9.¹²

¹² The ~~exception is an~~ exceptions are the amendment to UCC § 1-201(b)(24), ~~that would delete from the UCC's~~
generally applicable definition of "money," ~~a unit of account that is established by an intergovernmental organization~~

1 We have no way of knowing how intangible money might develop. There are indications
2 that some countries might authorize or adopt intangible tokens as a medium of exchange (the
3 Peoples Bank of China has been developing a digital Yuan), whereas others might authorize or
4 adopt accounts with a central bank.¹³

5
6 Section 1-201(b)(24) defines “money” as “a medium of exchange currently authorized or
7 adopted by a domestic or foreign government.” For many purposes, there is no need for the UCC
8 to distinguish among types of money. *See, e.g.*, UCC § 3-103(a)(12) (“‘Promise’ means a written
9 undertaking to pay money . . .”) For Article 9 purposes, however, distinctions must be drawn.
10 Only tangible money is susceptible of perfection by possession. The acts needed for perfection by
11 control with respect to intangible tokens will not work for accounts with a central bank, and vice
12 versa. Thus, the draft draws a sharp distinction between money that is an account maintained with
13 a bank, and other intangible money, including token-based money.

14
15 The existing Article 9 provisions governing “deposit accounts” would remain suitable for
16 accounts with a central bank, even if a government has adopted these accounts as money. The draft
17 makes no changes with respect to Article 9’s treatment of these accounts, aside from distinguishing
18 them from other intangible money. The draft draws this distinction by excluding “deposit
19 accounts” from the defined term “intangible money.” Under the draft, a security interest in
20 intangible money as original collateral can be perfected only by control. The requirements for
21 obtaining control of intangible money are the same as those for obtaining control of a controllable
22 electronic record under draft Article 12.

23 24 ARTICLE 1

25 GENERAL PROVISIONS

26 Section 1-201. General Definitions.

27 * * *

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

30 * * *

31 (24) “Money” means a medium of exchange currently authorized or adopted by a
32 domestic or foreign government, by an intergovernmental organization, or pursuant to an
33 agreement between two or more governments. The term does not include a medium of exchange

~~or by agreement between two or more countries and the amendment of UCC § 9-322, which deals with transfers of money and transfers of funds from a deposit account.~~

¹³ These accounts sometimes are referred to as central bank digital currency or CBDC. Regarding El Salvador’s adoption of ~~Bitcoin~~ bitcoin as legal tender, *see supra* note 1.

1 unless it was initially issued, created, or distributed by one or more of such persons.

2 * * *

3 **Reporter's Note**

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

7
8 ~~“Money” does not include credits in a deposit account, money market account, securities~~
9 ~~account, or payment processor account (e.g., PayPal), inasmuch as those do not constitute a~~
10 ~~medium of exchange that is authorized or adopted by a government. However, future~~
11 ~~governmental action could bring one or more of these accounts within the definition. Likewise,~~
12 ~~virtual currency that is not “money” today may become so in the future.~~

13
14 Only something currently authorized or adopted as a medium of exchange can be money.
15 Coins and paper currency formerly issued by a government but now owned and traded only for
16 their numismatic or historical value, and not as a medium of exchange, are not money. To be
17 money, a medium of exchange must be initially issued, created or distributed by a government, by
18 a governmental organization, or pursuant to an agreement between two or more governments. For
19 this purpose, a currency printed or minted by a country’s central bank, treasury, or other similar
20 department, and then distributed or circulated by or on behalf of the country, is money. So too is a
21 currency printed or minted, and then circulated, by or on behalf of several countries, such as the
22 Euro. An electronic medium of exchange established pursuant to a country’s law and initially
23 distributed by or on behalf of the country also constitutes money, even if ownership is established
24 or maintained through a blockchain or other system not operated by the government. In contrast, a
25 medium of exchange initially issued, created, or distributed by one or more private parties is not
26 money solely because the government of one or more countries later authorizes or later adopts it as
27 a medium of exchange.

28
29 Note that the qualification “initially issued, created, or distributed” used in the second
30 sentence of this definition is a subset of the broader, generally applicable terms, “authorized or
31 adopted,” used in the first sentence.

32
33 2. “*Monetary unit of account.*” The draft deletes 2021 AM Draft deleted the second
34 sentence of the existing definition, which covers, e.g., special drawing rights (SDRs) created by the
35 International Monetary Fund. Despite the deletion, a monetary unit of account would be “money”
36 if it also a medium of exchange that falls within the remaining sentence definition as revised.
37 (SDRs are not a medium of exchange.)

38
39 3. *Examples:* The following examples illustrate the definition of “money.”

40
41 **Example 1:** Nation A enacts legislation making sea shells a medium of exchange. Sea
42 shells do not thereby become “money” because Nation A did not initially issue, create, or
43 distribute the sea shells.

Example 2: Nation B enacts legislation making an existing crypto currency, created on a private blockchain, a medium of exchange. The crypto currency does not thereby become “money” because Nation B did not initially issue, create, or distribute the crypto currency.

Example 3: Nation C enacts legislation making the existing printed currency of Nation D a medium of exchange. Nation C’s action is not relevant to whether the printed currency of Nation D is “money.” If the currency was money prior to Nation C’s action, then it remains money; if the currency was not “money” prior to Nation C’s actions, then it has not become money merely as a result of Nation C’s actions because Nation C did not initially issue, create, or distribute the printed currency.

Example 4: Nation E creates a virtual currency and authorizes it as a medium of exchange. Nation E’s virtual currency is “money.”

ARTICLE 9

SECURED TRANSACTIONS

* * *

Section 9-102. Definitions and Index of Definitions.

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

* * *

(29) “Deposit account” means a demand, time, savings, passbook, or similar account maintained with a bank. The term includes an account that is money under Section 1-201. The term does not include investment property or accounts evidenced by an instrument.

* * *

(47A) “Intangible money” does not include [money that is] a deposit account.

* * *

Reporter’s Note

1. “*Deposit account.*” The new (second) sentence clarifies that an account that otherwise would fall within the definition of “deposit account” would not be excluded from the definition even if the account is “money,” i.e., if a government adopts or authorizes such an account as a medium of exchange. The new sentence does *not* provide that all deposit accounts are “money.”

2. “*Intangible money-*” and “*tangible money.*” By excluding deposit accounts from the definition of “intangible money,” the draft leaves within that category intangible token-money and other non-deposit-account intangible money that may be created in the future. This definition of

1 “intangible money” is unusual inasmuch as it does not contain a positive statement of the meaning
2 of the term and contains only an exclusion from the term’s meaning. However, in modifying the
3 term “money,” defined in Section 1-201, the word “intangible” should be given its normal meaning
4 (something that has no physical or corporeal existence). In similar fashion, there is no need to
5 define “tangible money.” The word “tangible” modifies “money” and that word also should be
6 given its normal meaning (something that does have physical or corporeal existence, such as
7 goods).

8
9 * * *

10
11 **Section 9-105A. Control of Intangible Money.**

12 (a) A person has control of intangible money if the following conditions are met:

13 (1) the intangible money or the system in which the intangible money is recorded, if
14 any, gives the person:

15 (A) the power to avail itself of substantially all the benefit from the
16 intangible money; and

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

18 (i) prevent others from availing themselves of substantially all the
19 benefit from the intangible money; and

20 (ii) transfer control of the intangible money to another person or
21 cause another person to obtain control of intangible money that is traceable to the intangible
22 money; and

23 (2) the intangible money, a record attached to or logically associated with the
24 intangible money, or the system in which the intangible money is recorded, if any, enables the
25 person to readily identify itself as having the powers under subsection (a)(1). The person may be
26 identified in any way, including by name, identifying number, cryptographic key, office, or account
27 number.

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

29 (1) the intangible money or the system in which the intangible money is recorded, if

any, limits the use to which the intangible money 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.

Reporter's Note

1. "*Control*." A security interest in intangible money as original collateral may be perfected only by control under this section. See draft § 9-312(b)(4). The requirements for obtaining control track those in draft § 12-105.

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 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;

(B) the collateral is not a certificated security and is in the possession of the secured party under Section 9-313 pursuant to the debtor's security agreement;

(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 deposit accounts, electronic chattel paper, intangible

1 money, investment property, letter-of-credit rights, or electronic documents and the secured party
2 has control under Section 7-106, 9-104, 9-105, 9-105A, 9-106, or 9-107 pursuant to the debtor's
3 security agreement.

4 * * *

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

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

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

11 * * *

12 (8) a secured party having control of intangible money under Section 9-105A shall
13 transfer control of the intangible money to the debtor or to a person designated by the debtor.

14 * * *

15 **Section 9-301. Law Governing Perfection and Priority of Security Interests.** Except as
16 otherwise provided in Sections 9-303 through 9-306, the following rules determine the law
17 governing perfection, the effect of perfection or nonperfection, and the priority of a security
18 interest in collateral:

19 (1) Except as otherwise provided in this section, while a debtor is located in a jurisdiction,
20 the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and
21 the priority of a security interest in collateral.

22 (2) While collateral is located in a jurisdiction, the local law of that jurisdiction governs
23 perfection, the effect of perfection or nonperfection, and the priority of a possessory security
24 interest in that collateral.

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

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

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

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

8 * * *

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

11 * * *

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

14 * * *

15 (8) in deposit accounts, electronic chattel paper, electronic documents, intangible
16 money, investment property, or letter-of-credit rights which is perfected by control under Section
17 9-314;

18 * * *

19 * * *

20 **Section 9-312. Perfection of Security Interests in Chattel Paper, Deposit Accounts,**
21 **Documents, Goods Covered by Documents, Instruments, Investment Property, Letter-of-**
22 **Credit Rights, and Money; Perfection by Permissive Filing; Temporary Perfection Without**
23 **Filing or Transfer of Possession.**

24 (a) [Perfection by filing permitted.] A security interest in chattel paper, negotiable

documents, instruments, or investment property may be perfected by filing.

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

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

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

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

(4) a security interest in intangible money may be perfected only by control under section 9-105A.

Section 9-313. When Possession by or Delivery to Secured Party Perfects Security Interest Without Filing.

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

* * *

Section 9-314. Perfection by Control.

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

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

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

5 * * *

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

7 (a) [Transferee of tangible money.] A transferee of tangible money takes the money free
8 of a security interest if the transferee receives delivery of the money without acting unless the
9 ~~transferee acts~~ in collusion with the debtor in violating the rights of the secured party.

10 (b) [Transferee of intangible money.] A transferee of intangible money takes the money
11 free of a security interest if the transferee obtains control of the money without acting in collusion
12 with the debtor in violating the rights of the secured party.

13 (b)(c) [Transferee of funds from deposit account.] A transferee of funds from a deposit
14 account takes the funds free of a security interest in the deposit account if the transferee receives
15 the funds without acting unless the transferee acts in collusion with the debtor in violating the
16 rights of the secured party.

17 **Reporter's Note**

18 1. ~~“Transferee.” The undefined term “transferee” has given rise to a fair number of~~
19 ~~reported cases under Section 9-332(b). The analysis and results of the cases vary considerably.~~
20 ~~The Drafting Committee plans to consider resolving the uncertainty by amending the text of, or~~
21 ~~comments to, this section.~~

22
23 1. “Delivery” of tangible money; “control” of intangible money. Conditioning the takes-
24 free rule of subsection (a) on delivery of money reflects what has always been assumed—that a
25 transfer of an interest in money that is not accompanied by a physical delivery would not impair the
26 rights of third parties. Inasmuch as “intangible money” is a new classification, no pattern of past
27 practices or understandings exists. New subsection (b) provides a rule for intangible money that
28 complements draft subsection (a) by conditioning the takes-free rule on the transferee obtaining
29 control.
30

1 2. Transferees of funds from deposit account. Similarly, the revisions to subsection (c)
2 (formerly subsection (b)) make a corresponding change for a transfer of funds from a deposit
3 account. To qualify for the takes-free protection under subsection (c), the transferee must
4 “receive[] the funds without acting in collusion [etc.] . . .” The draft amendments to Section 9-
5 322(a) and (c) are intended to clarify what is implicit under the original text.

6
7 3. Meaning of “transfer”. A “transfer” of property occurs when the transferee has obtained
8 a property interest in the relevant property. See Section 9-102, Comment 26 (“In numerous
9 provisions, this Article refers to the “assignment” or the “transfer” of *property* interests.” (emphasis
10 added)). Other law determines when the transferee has acquired a property interest. See Section 9-
11 408, Comment 3 (“Other law determines whether a debtor has a property interest (‘rights in the
12 collateral’) and the nature of that interest.”). Although the terms “transfer” and “transferee” are not
13 defined in the UCC, the term “transfer” is broader in scope than “purchase,” which requires taking
14 in a “voluntary transaction creating an interest in property.” Section 1-201(29). For example,
15 “transfer” includes involuntary transfers such as the acquisition of a judicial lien by a lien creditor.
16 See Section 9-102(a)(52) (defining “lien creditor”).

17
18 4. Transfer of interest in deposit account. With respect to subsection (c), because a deposit
19 account is a debt of the bank to its customer, a transfer of the deposit account itself does not
20 transfer the funds credited to the deposit account. See Section 9-332, Comment 2 (5th paragraph)
21 (distinguishing “*transfers of funds from a deposit account*” from “*transfers of the deposit account*
22 *itself or an interest therein.*” (Emphasis in original.) Even when a “transfer” of a deposit account
23 has occurred under other law, the transferee does not take free of a security interest under
24 subsection (c) until the actual receipt of funds has occurred. The proper construction of current
25 subsection (b) and draft subsection (c) rejects cases that treat garnishment of a deposit account as
26 an immediate transfer of an interest in funds credited to the deposit account.

27
28 The last event that provides a recovery for a creditor in a garnishment action virtually
29 always would be a transfer of funds from a deposit account. However, this does not mean that a
30 security interest will always be cut off by a garnishing creditor. By intervening in the garnishment
31 proceeding to assert its senior security interest before funds are disbursed, the secured party might
32 assert and retain its priority. However, the relevant procedural law may not provide the secured
33 party with adequate advance notice. In some cases, a control agreement that perfects a security
34 interest in the deposit account may require the garnished bank to provide prompt notice to the
35 secured party. But not all control agreements will so provide. Moreover, the secured party’s
36 priority is not absolute. See, e.g., Section 9-401, Comment 6 (explaining that the equitable doctrine
37 of marshaling may be appropriate in the case of a lien creditor’s interest in collateral when a senior
38 secured party is oversecured).

39 40 **C. Chattel Paper**

41 **Prefatory Note**

42 These amendments to Uniform Commercial Code Article 9 address issues that have arisen
43 with respect to transactions in chattel paper. Stripped to its essentials, chattel paper is a monetary
44 obligation that is secured by a security interest in specific goods or that arises under a lease of
45 specific goods. Article 9 treats chattel paper differently from accounts and other rights to payment.

1 In particular, it provides for perfection of a security interest in chattel paper by taking possession of
2 tangible chattel paper or control of electronic chattel paper and affords a “superpriority” to
3 financiers that perfect in this manner.

4
5 The issues that the draft amendments address arise from the fact that:

- 6
7 • The definition of “chattel paper” creates uncertainty over the circumstances in which
8 a transaction that gives rise to monetary obligations not only under a lease of goods
9 but also with respect to software and services relating to the leased goods gives rise
10 to chattel paper.
- 11
12 • The statutory distinction between “tangible chattel paper” and “electronic chattel
13 paper” causes practical problems.

14
15 Concern #1: The definition of “chattel paper” creates uncertainty over the circumstances in which
16 a transaction that gives rise to monetary obligations not only under a lease of goods but also with
17 respect to software and services relating to the leased goods gives rise to chattel paper.

18
19 Section 9-102 defines “chattel paper” to include a record that evidences a monetary
20 obligation that is owed under a lease of goods and a monetary obligation with respect to software
21 used in the goods. Lease transactions have increasingly given rise not only to obligations for goods
22 and related software but also for services (e.g., cloud services) relating to the goods. Not
23 infrequently, the value of the non-goods aspect of the transaction is substantially greater than the
24 value of the lessee’s rights under the lease. Those who finance chattel paper and other rights to
25 payment have become uncertain as to whether these transactions give rise to chattel paper.

26
27 The draft resolves this issue by treating only those transactions whose predominant purpose
28 was to give the obligor (lessee) the right to possession and use of the goods as giving rise to
29 “chattel paper.”

30
31 Consider this example: Customer agrees to pay Cable Company for 12 months of
32 television programming and for 12 months’ use of a cable box needed to access the programming.
33 Customer agrees to pay \$150 a month for the programming and the use of the cable box. The
34 predominant purpose of this transaction is to provide television programming to Customer, not to
35 enable Customer to use the cable box. Under the draft, this transaction does not give rise to chattel
36 paper.

37
38 Issue #2: The statutory distinction between “tangible chattel paper” and “electronic chattel paper”
39 causes practical problems.

40
41 *Background.*

42
43 “Chattel paper” is one of several types of collateral that relate to rights to payment
44 (receivables). Others include “accounts,” “instruments,” and “payment intangibles.”

45
46 Until Article 9 was revised in the 1990s, chattel paper was deserving of its name. It was a
47 writing (*paper*), that was connected with a security interest in or lease of specific goods (*chattels*).

1 A common example is an installment sale contract, under which a buyer of goods on credit
2 promises to pay the sale price and secures that promise with a security interest in the goods.
3 Another common example is an equipment lease, where the lessee promises to pay rent and the
4 lessor retains a leasehold interest in the leased goods.

5
6 The 1999 official text expanded the definition of chattel paper to allow for an electronic
7 record instead of a writing. Traditional, written chattel paper was denominated “tangible chattel
8 paper,” whereas intangible chattel paper was denominated (despite the oxymoron) “electronic
9 chattel paper.” The principal difference between tangible chattel paper and electronic chattel paper
10 is that a security interest in the former can be perfected by taking possession (which, of course, is
11 impossible to do with respect to an electronic record), whereas a security interest in the latter can
12 be perfected by having control, a concept that subsequently appeared in UETA and E-SIGN.

13
14 *Shortcomings in the current Article 9 provisions.*

15
16 *Tangible chattel paper.* Even before the 1999 revision of Article 9, “everyone” understood
17 that the copy of the lease that constituted *the* chattel paper, *i.e.* the writing with respect to which
18 possession was necessary and sufficient for perfection of a security interest, was the signed
19 original. In a typical lease transaction for which the lessor receives financing, however, the lessor,
20 the lessee, and the financier each would receive a signed copy of the lease.

21
22 When there was more than one original, litigation required judges to determine whether
23 possession of all signed originals was necessary to perfect by taking possession of the chattel paper
24 or whether possession of one of several originals would suffice. The comments to the 1999
25 revision addressed this issue.

26
27 In addition, different aspects of a single transaction may be evidenced by separate writings.
28 For example, a transaction in which several items of equipment are leased often includes a master
29 lease, which includes the terms applicable to all the goods, and specific schedules, which apply to
30 specific leased goods. This issue, too, arose in litigation before the 1999 revision was promulgated
31 and was addressed in the official comments.

32
33 *Electronic chattel paper.* As for electronic chattel paper, *control* was designed to function
34 to the extent possible like *possession*. Just as Article 9 contemplated that only one person at a time
35 can have possession of tangible chattel paper, so Article 9 defined control of electronic chattel
36 paper by reference to a “single authoritative copy.”

37
38 As secured parties tried to take advantage of the electronic-chattel-paper provisions, they
39 confronted some difficulties.

- 40
41 • *First*, the rule that a secured party cannot obtain control of electronic chattel paper unless
42 there is a “single authoritative copy” impeded system design.
43
44 • *Second*, in some cases it has proven to be commercially desirable to “convert” tangible
45 chattel paper into electronic chattel paper or to “paper out” electronic chattel paper into
46 tangible chattel paper. The legal consequences of doing so are thought to be uncertain.

- *Third*, existing law does not deal satisfactorily with the situation where the records referred to in the current definition comprise one or more tangible authoritative copies of the records that evidence the right to payment and rights in related property and one or more electronic authoritative copies of those records.¹⁴ This situation might arise when, e.g., electronic chattel paper is subsequently amended by a writing, such that some material terms of the chattel paper are contained in a tangible authoritative copy and some are contained in an electronic authoritative copy.

The 2010 amendments to Article 9 addressed the first issue by adding a general standard for control (borrowed from UETA and E-SIGN) and turning the 1999 conditions for control into a safe harbor. Under the general standard, a person would have control if “a system employed for evidencing the transfer of interests in the chattel paper reliably establishes the secured party as the person to which the chattel paper was assigned.” UCC § 9-105(a). The amendments addressed the second and third issues in official comments.

Lawyers proved uncomfortable issuing a legal opinion to the effect that a particular system satisfied the general standard for control. As a result, their clients had strong incentives to use systems that allow for a “single authoritative copy” rather than, for example, utilizing distributed ledger technology, which always involves multiple authoritative copies. Thus, the technology for maintaining electronic chattel paper remains frozen in time.

Lawyers remain uncertain as to how a court would resolve the second and third issues described above.

Controllable electronic records v. chattel paper.

A fundamental principle underlying draft Article 12, dealing with controllable electronic records, is the distinction between a record that evidences a right (e.g., a right to payment) and the right itself.

The current definitions of “chattel paper,” “tangible chattel paper,” and “electronic chattel paper” muddle that distinction and so would be in tension with draft Article 12. Article 9 defines “chattel paper” as a “record or records” that evidence a monetary obligation and a security interest in or lease of specific goods. A record of this kind, e.g., the paper on which an installment sale contract or equipment lease is written, typically is of no value, other than as evidence of the right to payment and interest in goods.¹⁵ For the most part, this has not presented a problem, as those who deal with chattel paper understand that even though Article 9 defines “chattel paper” as a record or records, a security interest in chattel paper is in fact a security interest in the right to payment of the monetary obligation and in the interest in related property that are evidenced by the chattel paper.

Approach taken in the draft.

¹⁴ The only copies that are relevant under the draft are those that are “authoritative.” Regarding the meaning of the term, see the Reporter’s Notes to draft § 9-314A.

¹⁵ Where a record evidencing the monetary obligation is a negotiable instrument, the paper itself is likely to have considerable value. See the Concluding Note below for a discussion of chattel paper evidenced by a negotiable instrument.

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

6
7 The draft also defines chattel paper more accurately, as the right to payment of a monetary
8 obligation that is secured by a security interest in specific goods or owed under a lease of specific
9 goods, if the right to payment and interest in the goods are evidenced by a record.

10 11 **ARTICLE 1**

12 **GENERAL PROVISIONS**

13 **~~Section 1-201. General Definitions.~~**

14 ~~***~~

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

17 ~~***~~

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

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

4 * * *

5 ARTICLE 2

6 SALES

7 * * *

8 **Section 2-102. Scope; Certain Security and Other Transactions Excluded from this**
9 **Article.**

10 * * *

11 Official Comment

12 * * *

13 2. This section does not specifically address the extent to which this Article applies to
14 transactions that cover both goods and non-goods, such as transactions that involve the sale of
15 goods and either the provision of services or the transfer of property other than goods. (Such
16 transactions are often referred to as “hybrid,” “mixed,” or “bundled” transactions.) This provides
17 courts some flexibility in deciding whether, and to what extent, this Article should be applied to
18 such transactions.

19
20 As a general matter, courts have applied this Article to such transactions when the goods
21 aspect of the transaction predominates and have declined to apply this Article when the non-goods
22 aspect predominates. See, e.g., *Bonebrake v. Cox*, 499 F.2d 951 (8th Cir. 1974). This approach,
23 which has been adopted in the definition of “chattel paper” in Section 9-102(a)(11)(B), is
24 appropriate, particularly when the issue is one that goes to the entire transaction, such as whether a
25 binding contract has been formed. When, however, an issue relates solely to the goods aspect of
26 the transaction, such as the characteristics the goods must have in order to conform to the contract,
27 application of this Article to that issue is appropriate even if the goods aspect of the transaction
28 does not predominate. This approach, sometimes referred to as the “gravamen” approach, has
29 expressly been applied by some courts and has implicitly been adopted by others. Examples of
30 express application of this approach include *Data Processing Servs., Inc. v. L.H. Smith Oil Corp.*,
31 492 N.E.2d 314 (Ind. Ct. App. 1986); *Skelton v. Druid City Hosp. Bd.*, 459 So. 2d 818, 821-22
32 (Ala. 1984). A good example of implicit application of this approach is provided by *Frantz v.*
33 *Cantrell*, 711 N.E.2d 856, 38 UCC Rep.Serv.2d 785 (1999). In *Frantz*, the plaintiff brought suit
34 against a lumber company that had contracted to install a new shingled roof on the plaintiff’s
35 house, asserting a claim for breach of implied warranty because the shingles curled and failed to

1 seal properly and, thus, were defective. The court analyzed the case entirely under this Article
2 without considering whether the goods aspect of the transaction predominated or rather, which is
3 more likely, the service aspect predominated.

4
5 * * *

6 ARTICLE 9

7 SECURED TRANSACTIONS

8 Section 9-102. Definitions and Index of Definitions.

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

10 * * *

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

25 * * *

26 (11) “Chattel paper” means:

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

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

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

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

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

13 * * *

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

20 * * *

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

23
24 **Reporter’s Note**

25 1. “*Account.*” As the Prefatory Note explains, the draft redefines “chattel paper” to mean a
26 right to payment rather than a record evidencing a right to payment. The amendments to the

1 definition of “account” reflect the redefinition. (Note that the definition of “account” in the 2021
2 AM Draft inadvertently situated it in Section 1-201 instead of Section 9-102, which has been
3 adjusted in this draft.)

4
5 42. “*Chattel paper.*” Under the revised definition, “chattel paper” is a right to payment
6 rather than a record evidencing a right to payment. Records evidencing chattel paper remain
7 relevant to perfection of a security interest in chattel paper. *See* draft § 9-314A.

8
9 The right to payment that constitutes “chattel paper” under ~~section~~ subparagraph (a)(11)(B)
10 may include the right to payment of a variety of “bundled” monetary obligations owed by a lessee
11 of specific goods. These obligations may include obligations arising in connection with the
12 transaction giving rise to the lease, such as obligations for software or services. However, to
13 constitute “chattel paper,” these obligations must include the right to payment of a monetary
14 obligation owed by the lessee under the lease agreement.

15
16 A right to payment is not “chattel paper” under ~~section~~ subparagraph (a)(11)(B) unless the
17 predominant purpose of the transaction giving rise to the lease was to give the lessee the right to
18 possession and use of the goods. The comments will explain the predominant-purpose test and
19 give examples of its application. (The Prefatory Note provides one example.)

20
21 3. The Drafting Committee also may wish to consider the additional issues posed below
22 relating to chattel paper and related transactions. For background, see the following documents
23 distributed with this draft (i) April 25, 2021, Memorandum from Steven Harris, Reporter, on
24 Bundled Hardware, Software, and Service Transactions, and (ii) May 22, 2020, Report and
25 Recommendations of the Subcommittee on Bundled Hardware, Software, and Service Transactions
26 (Attachment A omitted). At its May 3, 2021 meeting the Drafting Committee decided that issues
27 (b), (c), and (d) should be referred to the Subcommittee to consider whether they might be
28 addressed by revisions to the relevant official comments. See draft new Official Comment to
29 Section 2-102.

30
31 (a) Should the predominant-purpose test be extended beyond lease chattel paper to
32 apply to chattel paper that involves of a right to payment secured by specific goods under
33 subparagraph (a)(11)(A)?

34
35 (b) Should the predominant-purpose test be applied to determine whether, in a
36 “bundled” transaction, Article 2 or Article 2A applies (i.e., when the predominant purpose relates
37 to the acquisition or use of goods)? If so, should this result be implemented by changes to the
38 statutory text or pursuant to the official comments?

39
40 (c) When the predominant-purpose test does not result in the general application of
41 Article 2 or Article 2A to a “bundled” transaction, should the relevant article nonetheless be
42 applied to a specific matter that relates only to the goods involved in the transaction (e.g., a claim
43 that goods are nonconforming)? If so, should this result be implemented by changes to the
44 statutory text or pursuant to the official comments?

45
46 (d) In a “bundled” transaction involving a lease of goods and in which a service
47 component is significant, is the transaction a “finance lease,” as defined in Section 2A-103(1)(g), if

1 the lease would be characterized as a “finance lease” if the transaction involved only goods?

2
3 4. “Instrument” and “writing.” Reminder: Although in many places the term “writing”
4 has been and is proposed to be replaced by the technology neutral term, “record,” instruments
5 (under both Articles 3 and 9) must be “written” and in “writing.”
6

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

8 (a) **[When secured party has control.]** A secured party has control of an electronic copy
9 of a record evidencing chattel paper if[:

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

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

14 (B) enables the secured party to readily identify itself as the assignee of each
15 authoritative electronic copy of the record; and

16 (C) subject to subsection (b), gives the secured party the exclusive power to:

17 (i) prevent others from adding or changing an identified assignee of
18 each authoritative electronic copy of the record; and

19 (ii) transfer control of the authoritative copy of the record; or

20 [(2) another person on behalf of the secured party obtains control of the electronic
21 copy of a record evidencing chattel paper or, having previously obtained control of the electronic
22 copy, acknowledges in an authenticated record that it has control ~~on behalf of the secured party.~~]

23 (b) **[Meaning of exclusive.]** A power specified in paragraph (a)(1) is exclusive, even if:

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

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

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

4 **Reporter's Note**

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

10
11 2. *Conditions for obtaining control.* As explained in the preceding Note, control relates to
12 perfection of a security interest in chattel paper. One method of perfecting a security interest in
13 chattel paper is to take possession of all tangible authoritative copies of the record evidencing the
14 chattel paper and obtain control of all electronic records. Perfection generally serves the function
15 of enabling the public to determine that the asset in question (here, chattel paper) may be
16 encumbered with a security interest.

17
18 The amended definition of “control” is meant to reflect the functions that possession serves
19 with respect to writings in a more accurate and technologically flexible way than does the current
20 definition.

21
22 To show that it has possession of all tangible authoritative copies of a record evidencing
23 chattel paper, a secured party can produce the copies in its possession and provide evidence that
24 these are authoritative copies and that no other tangible authoritative copies exist. (The Reporter’s
25 Note to draft § 9-314A explains the meaning of “authoritative copy.”) The secured party’s
26 possession of the tangible authoritative copies gives the secured party the power to prevent others
27 from taking possession of the copies and to transfer possession of the copies.

28
29 Under the draft, to obtain control of an electronic copy of a record evidencing chattel paper
30 a secured party must be able to identify each electronic copy as authoritative or nonauthoritative
31 and identify itself as the assignee of each authoritative copy. In addition, the secured party must
32 have the exclusive power to prevent others from adding or changing an identified assignee and to
33 transfer control of the authoritative copies.

34
35 The utility of distributed ledger technology (blockchain) depends on there being multiple
36 authoritative copies of a record. The safe harbor under existing Section 9-105(b) contemplates a
37 “single authoritative copy” and so is unavailable when the relevant record is maintained on a
38 blockchain. The draft allows a secured party to obtain control when there are multiple authoritative
39 copies.

40
41 3. *Use of singular.* The draft refers to “record” and “copy.” In any given case, there may
42 be more than one relevant record and more than one copy. Under Section 1-106, unless the
43 statutory context otherwise requires, words in the singular number include the plural.

1 4. Control on behalf of another person. Draft subsection (a)(2) provides for a secured
2 party to obtain control of an electronic copy by virtue of the acknowledgement by another person
3 in control of the electronic copy in an authenticated record. This approach follows in general the
4 definition of control in Section 8-106(d)(3) and provision for taking possession under Section 9-
5 313(c). The Drafting Committee is invited to consider more generally the treatment of a person
6 having control on behalf of another person at its November 2021 meeting. See the discussion in
7 Reporter's Note 7 to draft § 12-105.

8
9 **Section 9-203. Attachment and Enforceability of Security Interest; Proceeds;**
10 **Supporting Obligations; Formal Requisites.**

11 * * *

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

14 (1) value has been given;

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

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

18 (A) the debtor has authenticated a security agreement that provides a
19 description of the collateral and, if the security interest covers timber to be cut, a description of the
20 land concerned;

21 (B) the collateral is not a certificated security and is in the possession of the
22 secured party under Section 9-313 pursuant to the debtor's security agreement;

23 (C) the collateral is a certificated security in registered form and the security
24 certificate has been delivered to the secured party under Section 8-301 pursuant to the debtor's
25 security agreement;

26 (D) the collateral is deposit accounts, investment property, or letter-of-credit
27 rights, and the secured party has control under Section 9-104, 9-106, or 9-107 pursuant to the
28 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

1. *Substitute for authenticated security agreement.* Under existing subparagraphs (b)(3)(B) and (b)(3)(D), possession of tangible collateral and control of intangible collateral may substitute for an authenticated 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, may substitute for an authenticated security agreement.

* * *

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

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

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

* * *

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

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

~~(B) if the debtor designates a custodian that is the designated custodian with which the authoritative copy of the electronic chattel paper is maintained for the secured party, communicate to the custodian an authenticated record releasing the designated custodian from any~~

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

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

6 * * *

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

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

11 (1) Except as otherwise provided in this section, while a debtor is located in a
12 jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or
13 nonperfection, and the priority of a security interest in collateral.

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

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

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

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

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

23 (4) * * *

24 (5) While a tangible authoritative copy of a record evidencing chattel paper is

1 located in a jurisdiction, the local law of that jurisdiction governs:

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

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

6 **Reporter's Note**

7
8 1. *Choice of governing law.* Under the amended definition of chattel paper, a right to
9 payment and rights in related property may be evidenced by one or more tangible authoritative
10 copies and one or more electronic authoritative copies.

11
12 Draft paragraph (5) would address these cases by tying the choice-of-law rules to the
13 authoritative tangible copy. As a consequence, the local law of the jurisdiction where the
14 authoritative tangible copy is physically located would govern perfection of a security interest in
15 the chattel paper by possession and control under Section 9-314A.

16
17 The location of the debtor would govern perfection by filing. *See* paragraph (1). However,
18 under paragraph (5), if there is a tangible authoritative copy, the location of that copy would govern
19 the effect of perfection or nonperfection and the priority of a security interest in the chattel paper.

20
21 This approach is modeled on paragraph (3), which is designed to reduce the confusion that
22 might arise when the choice-of-law rules of a given jurisdiction result in each of two conflicting
23 security interests in the same collateral being governed by a different priority rule. The Drafting
24 Committee plans to reconsider the approach, as it may create difficulties when, for example, all
25 existing tangible authoritative copies are destroyed.

26
27 2. *Multiple tangible authoritative records.* Like existing law, paragraph (5) assumes that
28 all the tangible authoritative records are located in the same jurisdiction.

29
30 **Section 9-310. When Filing Required to Perfect Security Interest or Agricultural Lien;**
31 **Security Interests and Agricultural Liens to Which Filing Provisions Do Not Apply.**

32 * * *

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

35 * * *

36 (8) in deposit accounts, investment property, or letter-of-credit rights which is

perfected by control under Section 9-314;

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

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

(11) in chattel paper which is perfected by possession and control under Section 9-314A.

* * *

Section 9-313. When Possession by or Delivery to Secured Party Perfects Security Interest Without Filing.

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

* * *

Reporter's Note

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

Section 9-314. Perfection by Control.

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

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

1 evidencing the chattel paper “papered out” (replaced with tangible records evidencing the same
2 chattel paper) or tangible records are “converted” to electronic records.

3
4 To accommodate current practices and future technology, the draft would allow the parties
5 considerable flexibility in determining the method used to establish whether a particular copy is
6 authoritative, as long as third parties are able to reasonably identify the authoritative copies that
7 must be possessed or controlled to achieve perfection. For example, the parties could develop a
8 system or protocol where each copy is watermarked as authoritative or nonauthoritative or where
9 the terms of the records themselves describe how to determine which copies are authoritative and
10 which are not.

11
12 *2. Time of perfection.* Subsection (b) is modeled on Sections 9-313(d) and 9-314(b).

13
14 3. Applicability of Section 9-313. New subsection (c) makes specified subsections of
15 Section 9-313 applicable to possession of tangible authoritative copies of records evidencing
16 chattel paper.

17
18 **Section 9-317. Interests That Take Priority Over or Take Free of Security Interest or**
19 **Agricultural Lien.**

20 * * *

21 (b) **[Buyers that receive delivery.]** Except as otherwise provided in subsection (e), a buyer,
22 other than a secured party, of documents, goods, instruments, or a security certificate takes free of a
23 security interest or agricultural lien if the buyer gives value and receives delivery of the collateral
24 without knowledge of the security interest or agricultural lien and before it is perfected.

25 * * *

26 (d) **[Licensees and buyers of certain collateral.]** A licensee of a general intangible or a
27 buyer, other than a secured party, of accounts, general intangibles, or investment property other
28 than a certificated security takes free of a security interest if the licensee or buyer gives value
29 without knowledge of the security interest and before it is perfected.

30 * * *

31 (f) **[Buyers of chattel paper.]** A buyer, other than a secured party, of chattel paper takes
32 free of a security interest if, without knowledge of the security interest and before it is perfected,

1 the buyer gives value and receives delivery of the tangible authoritative copy, if any, of the record
2 evidencing the chattel paper and obtains control of the electronic authoritative copy, if any, of the
3 record evidencing the chattel paper.

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

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

8 (1) in good faith and in the ordinary course of the purchaser's business, the
9 purchaser gives new value and takes possession of the tangible authoritative copy, if any, of the
10 record evidencing the chattel paper ~~or~~ and obtains control of the electronic authoritative copy, if
11 any, of the record evidencing the chattel paper; and

12 (2) the authoritative copy of the record evidencing the chattel paper does not
13 indicate that the copy has been assigned to an identified assignee other than the purchaser.

14 (b) **[Purchaser's priority: other security interests.]** A purchaser of chattel paper has
15 priority over a security interest in the chattel paper which is claimed other than merely as proceeds
16 of inventory subject to a security interest if the purchaser gives new value and takes possession of
17 the tangible authoritative copy, if any, of the record evidencing the chattel paper and obtains
18 control of the electronic authoritative copy, if any, of the record evidencing the chattel paper in
19 good faith, in the ordinary course of the purchaser's business, and without knowledge that the
20 purchase violates the rights of the secured party.

21 * * *

22 **Reporter's Concluding Note**

23 As noted above in footnote 2, a right to payment that is evidenced by an Article 3
24 negotiable instrument is different from a right to payment that is evidenced by a nonnegotiable
25 record. This is because the obligation to pay a negotiable instrument is "embodied in" or "travels

1 with” the negotiable instrument. For this reason, the definition of “account debtor” excludes the
2 obligor on a negotiable instrument, even if the negotiable instrument constitutes part of chattel
3 paper.
4

5 The reason why Article 9 distinguishes negotiable instruments that are secured by a security
6 interest in specific goods or relate to a lease of specific goods from other negotiable instruments is
7 unclear. Perhaps the distinction arose because the drafters of former Article 9 wanted to create an
8 exception to the general rule that a security interest in a negotiable instrument could not be
9 perfected by filing. Regardless, under revised (current) Article 9, a security interest in a negotiable
10 instrument, like a security interest in chattel paper, may be perfected by filing or possession. Many
11 other Article 9 rules apply to both chattel paper and negotiable instruments. Perhaps the main
12 exception appears in Section 9-330, under which the “superpriority” rules applicable to chattel
13 paper (§ 9-330(a) through (c)) differ from the rule applicable to negotiable instruments (§ 9-
14 330(d)).
15

16 The Drafting Committee plans to consider whether a right to payment evidenced by a
17 negotiable instrument should be excluded from the definition of “chattel paper,” even if the
18 accompanying records evidence a security interest or lease of specific goods.
19

20 **NOTE: PART D IS NEW**

21 **D. Documents of Title**

22 **ARTICLE 1**

23 **GENERAL PROVISIONS**

24 **Section 1-201. General Definitions.**
25

26 * * *

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

29 * * *

30 (16) “Document of title” means a record (i) that in the regular course of business or
31 financing is treated as adequately evidencing that the person in possession or control of the record
32 is entitled to receive, control, hold, and dispose of the record and the goods the record covers
33 and (ii) that purports to be issued by or addressed to a bailee and to cover goods in the bailee’s
34 possession which are either identified or are fungible portions of an identified mass. The term

1 includes a bill of lading, transport document, dock warrant, dock receipt, warehouse receipt, and
2 order for delivery of goods. ~~[An electronic document of title means a document of title evidenced~~
3 ~~by a record consisting of information stored in an electronic medium. A tangible document of title~~
4 ~~means a document of title evidenced by a record consisting of information that is inscribed on a~~
5 ~~tangible medium.]~~

6 * * *

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

8 (a) ~~A person has control of an electronic document of title if a system employed for~~
9 ~~evidencing the transfer of interests in the electronic document reliably establishes that person as the~~
10 ~~person to which the electronic document was issued or transferred.~~

11 (b) ~~A system satisfies subsection (a), and a person is deemed to have control of an~~
12 ~~electronic document of title, if the document is created, stored, and assigned in such a manner that:~~

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

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

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

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

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

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

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

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

3 **Section 7-106. Control of Electronic Copy of Document of Title.**

4 **(a) [When secured party has control.]** A secured party has control of an electronic copy of
5 a document of title if:

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

8 (A) enables the secured party to readily identify each electronic copy of the
9 document of title as an authoritative copy or nonauthoritative copy of the document of title;

10 (B) enables the secured party to readily identify itself as the assignee of each
11 authoritative electronic copy of the document of title; and

12 (C) subject to subsection (b), gives the secured party the exclusive power to:

13 (i) prevent others from adding or changing an identified assignee of
14 each authoritative electronic copy of the document of title; and

15 (ii) transfer control of the authoritative copy of the document of title[;
16 or

17 (2) another person obtains control of the document of title or, having previously
18 obtained control of the electronic copy, acknowledges in an authenticated record that it has control
19 on behalf of the secured party.]

20 **(b) [Meaning of exclusive.]** A power specified in paragraph (a)(1) is exclusive, even if:

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

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

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

Reporter's Note

1. Background. Draft § 7-106 on control of an electronic copy of a document of title is intended to focus discussion by the Drafting Committee on whether the provisions for electronic documents of title should be revised along the lines of the proposed revisions relating to chattel paper evidenced by electronic records. *See generally* the Prefatory Note to Part C (chattel paper).

2. Control of documents of title evidenced by an electronic record. Draft § 7-106 generally follows draft § 9-105 on control of an authoritative electronic copy of a record evidencing chattel paper. It would replace the safe harbor based on a “single authoritative copy” of an electronic document of title.

3. *Additional amendments.* If the Drafting Committee wishes to pursue this approach, it will also be necessary to add conforming amendments to various provisions of Articles 7 and 9 and also to consider whether the approach taken for electronic copies of chattel paper should be followed in other respects, including adjustments to the definition of “document of title” in Section 1-201(b)(16). The terms “electronic document of title” and “tangible document of title,” are separately defined within that definition. The “electronic” and “tangible” dichotomy has been eliminated in the draft provisions on chattel paper. Accordingly, these terms have been placed in square brackets in the definition of “document of title” in this draft. The problems relating to “hybrid” chattel paper—involving some electronic and some tangible records evidencing the same chattel paper—may not be prevalent in the context of documents of title. For this reason, fewer statutory modifications may be needed with respect to authoritative electronic copies of documents of title.

DE. Payments

Reporter's Prefatory Note

~~These amendments address issues arising under UCC Articles 3, 4, and 4A.~~
The changes relating to payments are fewer and simpler than in prior drafts. They cover the
following six topics:

Negotiability. An amendment to § 3-106 specifies that negotiability is not negated by the inclusion of either a choice-of-law term or a choice-of-forum term in an instrument.

Remote Deposit Capture. Amendments to §§ 3-105 and 3-604, and to the official comments to §§ 3-309 and 4-207, clarify that an instrument is “issued,” if a drawer sends an image of and information describing an item, but never delivers the item. Prior drafts included warranty terms associated with such a process, but those warranties have been omitted as unnecessarily duplicative of federal law.

1 Statement of Account. Amendments to the official comment to § 4-406 clarify what
2 constitutes a statement of account. A previously proposed amendment that would have required a
3 statement of account to include an image of paid items for the statement to qualify under the safe
4 harbor for sufficiency has been omitted.

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

10 References to a “Writing.” Amendments to §§ 4A-202, 4A-203, 4A-207, 4A-208 and
11 4A-305 change the references to a “writing” to an “authenticated record.”

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

19 ARTICLE 3

20 NEGOTIABLE INSTRUMENTS

21 Section 3–104. Negotiable Instrument.

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

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

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

28 (3) does not state any other undertaking or instruction by the person promising or
29 ordering payment to do any act in addition to the payment of money, but the promise or order may
30 contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii)
31 an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or
32 (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor; (iv)
33 an agreement as to what law governs the instrument [or the rights and obligations created by the

instrument]; or (v) an undertaking to resolve a dispute concerning the promise or order in a specified forum.

* * *

Reporter's Note

1. *Choice-of-law provisions.* Pursuant to a suggestion made, the amendment now makes clear that a choice-of-law provision does not affect negotiability.

2. *Arbitration.* By now referring to an undertaking to “resolve” a dispute, rather than to “litigate,” the amendment would prevent an arbitration clause from undermining negotiability.

Section 3–105. Issue of Instrument.

(a) “Issue” means the first delivery of an instrument or first transmission of an image of an item and of information describing the item by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person.

* * *

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.”

Subsection (a) permits an instrument to be issued by an electronic transmission of an image of and information describing the instrument by maker and drawer, rather than by delivery. In some cases, the relevant information can be ascertained from the image itself, in which case it is not necessary for the information to be transmitted separately from the image. Thus, for example, a drawer might 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. In many cases, the electronic image can be formatted to be an “electronic check” under Regulation CC. See 12 C.F.R. § 229.2(ggg). But even if not, the check is “issued” and hence can be enforced pursuant to this Article.

2. Subsection (b) continues the rule that nonissuance, conditional issuance or issuance for a special purpose is a defense of the maker or drawer of an instrument. Thus, the defense can be asserted against a person other than a holder in due course. The same rule applies to nonissuance of an incomplete instrument later completed.

3. Subsection (c) defines “issuer” to include the signer of an unissued instrument for convenience of reference in the statute.

Reporter's Note

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

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

Official Comment

* * *

4. 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 does not, by itself, prevent application of this section. See Section 3-604, Comment 1.

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

Section 3–604. Discharge by Cancellation or Renunciation.

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

* * *

1 **Official Comment**

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

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

8
9 **ARTICLE 4**

10 **BANK DEPOSITS AND COLLECTIONS**

11 **Section 4–207. Transfer Warranties.**

12 * * *

13 **Official Comment**

14 * * *

15
16 3. The warranties provided for in this Section, and in Sections 4-208 and 4-209 are
17 supplemented by warranties created under federal law. For example, pursuant to Section 4-209(b),
18 a person who undertakes to retain an item in connection with an agreement for electronic
19 presentment makes a warranty that retention and presentment comply with the agreement. Under
20 federal law, such a person might also make a warranty that no person will be asked to make
21 payment based on a check already paid. See 12 C.F.R. § 229.34(a).

22
23 **Section 4–406. Customer’s Duty to Discover and Report Unauthorized Signature or**
24 **Alteration.**

25 (a) A bank that sends or makes available to a customer a statement of account showing
26 payment of items for the account shall either return or make available to the customer the items
27 paid or provide information in the statement of account sufficient to allow the customer reasonably
28 to identify the items paid. ~~The A statement of account provides sufficient information if the item is~~
29 ~~described~~ that describes each item paid by item number, amount, and date of payment and includes
30 an image of each item showing the name of the payee and date of the item is sufficient. Whether a
31 statement of account that does not include an image of each item is sufficient is a question of fact.

32 * * *

Official Comment

1. Under subsection (a), if a bank that has paid a check or other item for the account of a customer makes available to the customer a statement of account showing payment of the item, the bank must either return the item to the customer or provide a description of the item sufficient to allow the customer to identify it. Under subsection (c), the customer has a duty to exercise reasonable promptness in examining the statement or the returned item to discover any unauthorized signature of the customer or any alteration and to promptly notify the bank if the customer should reasonably have discovered the unauthorized signature or alteration.

The duty stated in subsection (c) becomes operative only if the “bank sends or makes available a statement of account or items pursuant to subsection (a).” A bank is not under a duty to send a statement of account or the paid items to the customer; but, if it does not do so, the customer does not have any duties under subsection (c). A bank that permits a customer to access the customer’s account online and to view there the activity associated with the account does not thereby make available a “statement of account.” A “statement of account” is a periodic record, typically monthly, not a continuous record, of the debits and credits to an account.

Subsection (a) applies when the bank “sends or makes available to a customer a statement of account.” A bank that provides a customer with online access to a monthly statement of account, along with a notification, such as an email or text message, that the statement of account has been posted there, makes the statement of account available to the customer.

Under subsection (a), a statement of account must provide information “sufficient to allow the customer reasonably to identify the items paid.” If the bank supplies its customer with an image of the paid item, it complies with this standard. But a safe harbor rule is provided. The bank complies with the standard of providing “sufficient information” if “the item is described by item number, amount, and date of payment.” This means that the customer’s duties under subsection (c) are triggered if the bank sends a statement of account complying with the safe harbor rule without returning the paid items. A bank does not have to return the paid items unless it has agreed with the customer to do so. Whether there is such an agreement depends upon the particular circumstances. See Section 1–201(3). If the bank elects to provide the minimum information that is “sufficient” under subsection (a) and, as a consequence, the customer could not “reasonably have discovered the unauthorized payment,” there is no preclusion under subsection (d). ~~If the customer made a record of the issued checks on the check stub or carbonized copies furnished by the bank in the checkbook, the customer should usually be able to verify the paid items shown on the statement of account and discover any unauthorized or altered checks. But there could be exceptional circumstances.~~ For example, if a check is altered by changing the name of the payee, the customer could not normally detect the fraud unless the customer is given the paid check, the statement of account includes an image of the check, or the statement of account discloses the name of the payee of the altered check. If the customer could not “reasonably have discovered the unauthorized payment” under subsection (c) there would not be a preclusion under subsection (d).

The safe harbor provided by subsection (a) serves to permit a bank, ~~based on the state of existing technology~~, to trigger the customer’s duties under subsection (c) by providing a “statement of account showing payment of items” without having to return the paid items, in any case in which the bank has not agreed with the customer to return the paid items. The safe harbor does not, however, preclude a customer under subsection (d) from asserting its unauthorized signature or

1 an alteration against a bank in those circumstances in which under subsection (c) the customer
2 should not “reasonably have discovered the unauthorized payment.” Whether the customer has
3 failed to comply with its duties under subsection (c) is determined on a case-by-case basis.
4

5 The provision in subsection (a) that a statement of account contains “sufficient information
6 if the item is described by item number, amount, and date of payment” is based upon the existing
7 state of technology. This information was chosen because it can be obtained by the bank’s
8 computer from the check’s MICR line without examination of the items involved. The other two
9 items of information that the customer would normally want to know—the name of the payee and
10 the date of the item—cannot currently be obtained from the MICR line. The safe harbor rule is
11 important in determining the feasibility of payor or collecting bank check retention plans. A
12 customer who keeps a record of checks written, e.g., on the check stubs or carbonized copies of the
13 checks supplied by the bank in the checkbook, will usually have sufficient information to identify
14 the items on the basis of item number, amount, and date of payment. But customers who do not
15 utilize these record-keeping methods may not. The policy decision is that accommodating
16 customers who do not keep adequate records is not as desirable as accommodating customers who
17 keep more careful records. This policy results in less cost to the check collection system and thus
18 to all customers of the system. It is expected that technological advances such as image processing
19 may make it possible for banks to give customers more information in the future in a manner that is
20 fully compatible with automation or truncation systems. At that time the Permanent Editorial
21 Board may wish to make recommendations for an amendment revising the safe harbor
22 requirements in the light of those advances.
23

24 * * *

25 ARTICLE 4A

26 FUNDS TRANSFERS

27 Section 4A–103. Payment Order - Definitions.

28 (a) In this Article:

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

32 * * *

33 Section 4A–104. Funds Transfer - Definitions.

34 * * *

- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10
- 11
- 12
- 13
- 14
- 15
- 16
- 17
- 18
- 19
- 20
- 21
- 22
- 23
- 24
- 25
- 26
- 27
- 28
- 29
- 30
- 31
- 32
- 33
- 34
- 35
- 36
- 37
- 38
- 39
- 40
- 41
- 42
- 43
- 44
- 45
- 46
- 47

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

An instruction to pay might be a component of a so-called “smart contract”: a computer program or a transaction protocol intended to execute automatically. The fact that the smart contract itself is subject to a condition does not necessarily mean that an instruction to a payment made pursuant to that smart contract “state[s] a condition to payment of the beneficiary” within the meaning of Section 4A-103(a)(1)(i). Whether the instruction does state such a condition

1 depends on what the instruction says when it is received by the receiving bank. An instruction that
2 neither grants discretion nor imposes a limitation on payment by the receiving bank does not state a
3 condition to payment. What distinguishes the prior example is that the New York bank's
4 instruction to the California bank did state a condition when the California bank received it.
5

6 Similarly, an instruction that is subject to a condition when received by Bank A, and which
7 therefore does not constitute a payment order, does not become a payment order when the
8 condition is satisfied. However, if, after the condition is satisfied, Bank A sends the instruction to
9 Bank B without the stated condition, that second instruction could be a payment order if the
10 instruction otherwise complies with Section 4A-103(a).
11

12 * * *

13 **Section 4A-201. Security Procedure.**

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

24 **Official Comment**

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

1 that may result from the transmission of a spurious or erroneous payment order will be borne by the
2 receiving bank or the sender or purported sender is affected by whether a security procedure was or
3 was not in effect and whether there was or was not compliance with the procedure. Security
4 procedures are referred to in Sections 4A-202 and 4A-203, which deal with authorized and verified
5 payment orders, and Section 4A-205, which deals with erroneous payment orders.

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

12 **Section 4A–202. Authorized and Verified Payment Orders.**

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

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

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

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

9 * * *

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

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

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

16 * * *

17 **Official Comment**

18 * * *

19
20 3. Subsection (b) of Section 4A-202 is based on the assumption that losses due to
21 fraudulent payment orders can best be avoided by the use of commercially reasonable security
22 procedures, and that the use of such procedures should be encouraged. The subsection is designed
23 to protect both the customer and the receiving bank. A receiving bank needs to be able to rely on
24 objective criteria to determine whether it can safely act on a payment order. Employees of the
25 bank can be trained to “test” a payment order according to the various steps specified in the
26 security procedure. The bank is responsible for the acts of these employees. Subsection (b)(ii)
27 requires the bank to prove that it accepted the payment order in good faith and “in compliance with
28 the bank's obligations under the security procedure.” If the fraud was not detected because the
29 bank's employee did not perform the acts required by the security procedure, the bank has not
30 complied. Subsection (b)(ii) also requires the bank to prove that it complied with any agreement or

1 instruction that restricts acceptance of payment orders issued in the name of the customer. If an
2 agreement establishing a security procedure places obligations on both the sender and the receiving
3 bank, the receiving bank need prove only that it complied with the obligations placed on the
4 receiving bank. A customer may want to protect itself by imposing limitations on acceptance of
5 payment orders by the bank. For example, the customer may prohibit the bank from accepting a
6 payment order that is not payable from an authorized account, that exceeds the credit balance in
7 specified accounts of the customer, or that exceeds some other amount. Another limitation may
8 relate to the beneficiary. The customer may provide the bank with a list of authorized beneficiaries
9 and prohibit acceptance of any payment order to a beneficiary not appearing on the list. Such
10 limitations may be incorporated into the security procedure itself or they may be covered by a
11 separate agreement or instruction. In either case, the bank must comply with the limitations if the
12 conditions stated in subsection (b) are met. Normally limitations on acceptance would be
13 incorporated into an agreement between the customer and the receiving bank, but in some cases the
14 instruction might be unilaterally given by the customer. If standing instructions or an agreement
15 state limitations on the ability of the receiving bank to act, provision must be made for later
16 modification of the limitations. Normally this would be done by an agreement that specifies
17 particular procedures to be followed. Thus, subsection (b) states that the receiving bank is not
18 required to follow an instruction that violates ~~a written~~ an agreement evidenced by a record. The
19 receiving bank is not bound by an instruction unless it has adequate notice of it. Subsections (25),
20 (26) and (27) of Section 1-201 apply.

21
22 Subsection (b)(i) assures that the interests of the customer will be protected by providing an
23 incentive to a bank to make available to the customer a security procedure that is commercially
24 reasonable. If a commercially reasonable security procedure is not made available to the customer,
25 subsection (b) does not apply. The result is that subsection (a) applies and the bank acts at its peril
26 in accepting a payment order that may be unauthorized. Prudent banking practice may require that
27 security procedures be utilized in virtually all cases except for those in which personal contact
28 between the customer and the bank eliminates the possibility of an unauthorized order. The burden
29 of making available commercially reasonable security procedures is imposed on receiving banks
30 because they generally determine what security procedures can be used and are in the best position
31 to evaluate the efficacy of procedures offered to customers to combat fraud. The burden on the
32 customer is to supervise its employees to assure compliance with the security procedure and to
33 safeguard confidential security information and access to transmitting facilities so that the security
34 procedure cannot be breached.

35
36 If a receiving bank and its customer agree to make the technology or service of a third
37 party, for example a cloud service provider, part of the security procedure, the selected technology
38 or service might become unavailable or might fail to perform as expected. In such a situation, it
39 might have been impossible for the customer, the receiving bank, or both to comply with the
40 obligations under security procedure. If the receiving bank is unable to prove compliance with the
41 security procedure for purposes of Section 4A-202 and Section 4A-203, the receiving bank will be
42 unable to treat a payment order as effective against the customer under Section 4A-202(b).

43
44 **Example:** Bank and Customer agree that the authenticity of Customer's payment orders
45 will be verified pursuant to a security procedure that provides that both parties will use

1 Service Provider's Secure Communication Product. The Secure Communication Product
2 includes an authenticated connection between users and an algorithm that produces a fraud
3 risk score for each payment order sent over the connection. In order to use the Secure
4 Communication Product, Customer and Bank must each individually enter into an
5 agreement with Service Provider. Service Provider is the victim of a cyberattack that
6 compromises the fraud score feature of the Secure Communication Product such that every
7 payment order sent over the connection receives a low fraud risk score. After the attack but
8 before it is discovered, Bank processes a payment order in Customer's name that Customer
9 claims was unauthorized. Whether Bank followed the security procedure is a question of
10 fact. If it is determined that, because the product malfunctioned or otherwise, Bank did not
11 follow the security procedure, Bank will not be able to treat the payment orders as
12 authorized under 4A-202. If instead it is determined that Bank did follow the security
13 procedure, Customer may be able to shift the loss back to Bank if Customer can make the
14 required showing under Section 4A-203(a)(2).

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

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

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

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

41
42 56. The effect of Section 4A-202(b) is to place the risk of loss on the customer if an
43 unauthorized payment order is accepted by the receiving bank after verification by the bank in
44 compliance with a commercially reasonable security procedure. An exception to this result is
45 provided by Section 4A-203(a)(2). The customer may avoid the loss resulting from such a

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

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

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

34 * * *

35 36 **Section 4A–206. Transmission of Payment Order Through Funds-Transfer or Other** 37 **Communication System.**

38 * * *

39 **Official Comment**

40 1. A payment order may be issued to a receiving bank directly by delivery of a ~~writing or~~
41 ~~electronic device~~ record or by an oral or ~~electronic~~ communication. If an agent of the sender is

1 employed to transmit orders on behalf of the sender, the sender is bound by the order transmitted
2 by the agent on the basis of agency law. Section 4A-206 is an application of that principle to cases
3 in which a funds transfer or communication system acts as an intermediary in transmitting the
4 sender's order to the receiving bank. The intermediary is deemed to be an agent of the sender for
5 the purpose of transmitting payment orders and related messages for the sender. Section 4A-206
6 deals with error by the intermediary.

7
8 * * *

9
10 **Section 4A-207. Misdescription of Beneficiary.**

11 * * *

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

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

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

26 * * *

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

28 * * *

(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.

* * *

(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~~ authenticated a record stating the information to which the notice relates.

* * *

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

* * *

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

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

* * *

Official Comment

* * *

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

* * *

EF. Miscellaneous Amendments

ARTICLE 1

GENERAL PROVISIONS

Section 1-201. General Definitions.

* * *

(b) Subject to definitions contained in other articles of ~~the~~ the Uniform Commercial Code]

that apply to particular articles or parts thereof:

* * *

1 [Note: Revisions to the definition of “conspicuous” are new in this draft.]

2 (10). “Conspicuous”, with reference to a term, means so written, displayed, or
3 presented that a reasonable person against which it is to operate ought to have noticed it. ~~Whether a~~
4 ~~term is “conspicuous” or not is a decision for the court. Conspicuous terms include the following:~~

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

7 ~~(B) language in the body of a record or display in larger type than the~~
8 ~~surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or~~
9 ~~set off from surrounding text of the same size by symbols or other marks that call attention to the~~
10 ~~language.~~

11 * * *

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

14 * * *

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

22 * * *

23 ***Legislative Note:*** *The added second sentence would provide needed clarity as to the status of a*
24 *protected series for purposes of the Uniform Commercial Code. A number of states have enacted*
25 *statutes that provide for protected series within a limited liability company or other unincorporated*

1 organization. These statutes afford rights and impose duties upon a protected series and generally
2 empower a protected series to conduct its own activities under its own name.
3

4 By providing that a protected series is a “person” for purposes of the enacting state’s
5 Uniform Commercial Code, the sentence will expressly permit a protected series, whether created
6 under the law of the enacting state or of another state, to be, for example, (a) a “seller” or a
7 “buyer” under Article 2, (b) a “lessor” or a “lessee” under Article 2A, or (c) an “organization”
8 and a “debtor” under Article 9, and (d) if the law under which the protected series is organized
9 requires a public filing for the protected series to be recognized under that law, a “registered
10 organization” under Article 9. These matters are not clear under the current Uniform Commercial
11 Code.
12

13 A state should enact this amendment regardless of whether the state has enacted the
14 Uniform Protected Series Act (2017) or otherwise recognizes a protected series under its own
15 domestic law. Since the sentence applies only for purposes of the enacting state’s Uniform
16 Commercial Code, inclusion of the sentence in and of itself does not require the enacting state to
17 recognize a limit on liability of a protected series organized under the law of another state or a
18 limit on liability of the entity that established the protected series. It merely clarifies the status of a
19 protected series as a “person” for purposes of the choice-of-law and substantive law rules of the
20 enacting state’s Uniform Commercial Code.
21

22 Reporter’s Note

23 1. “Conspicuous.” Whether a term is conspicuous should be determined by the fact-finder.
24 Thus, the sentence assigning that issue to the court should be deleted. Deletion of the examples in
25 the text will facilitate a thorough discussion of conspicuousness in the official comments.
26

27 2. Additional issues relating to “conspicuous.” The Drafting Committee may wish to
28 consider which of the following points are appropriate for the official comments to address:
29

30 a. What a reasonable person ought to notice may vary depending upon the market
31 in which a transaction occurs. For example, a merchant with respect to goods of the kind that
32 wishes to disclaim the implied warranty of merchantability may sell to business buyers, consumer
33 buyers, or both, and even within those broad markets there might be buyers who can be expected to
34 have greater and lesser levels of sophistication. When a business uses the same standard form
35 documents in transactions both with other businesses and with consumers, a term in the documents
36 might be conspicuous to other businesses (because it is so presented that a reasonable business
37 person against whom it is to operate ought to have noticed it) but not be conspicuous to consumers
38 (because it is not the case that a reasonable consumer against whom it is to operate ought to have
39 noticed it). Concerns over conspicuousness are particularly acute in online transactions.
40

41 b. The harder a person has to work to access a non-obvious term, the less likely it is
42 that the term is conspicuous with respect to that person. For example, there might be a difference
43 between a situation in which a person can discover a term by clicking a single link and a situation
44 in which the term can be discovered only by clicking more than one link. Even if a term can be
45 accessed by clicking a single link, how the link is labeled might affect whether a term is
46 conspicuous. For example, a disclaimer of implied warranties might not be conspicuous if the link

1 to the disclaimer is labeled “warranty rights.”

2
3 c. How information is displayed on a user’s screen depends on the user’s equipment
4 and display settings and is not within the sole control of the person drafting the language. For
5 example, a term that is seen easily when displayed on a 24-inch monitor may not be so noticeable
6 when displayed on a cell phone. This is different from the paper environment, where the person
7 supplying the form chooses how the relevant language is displayed. The equipment and display
8 settings used by the person against which a term is to operate are relevant to determining whether
9 the term is conspicuous.

10
11 d. Does conspicuousness have any meaning if the term at issue appears in a
12 document that most people do not read?

13
14 e. Can a term be conspicuous, especially in consumer contracts, if it is not
15 separately assented to or is explained in language that cannot be understood by an average
16 consumer?

17
18 3. Current UCC Provisions Using “Conspicuous” or “Conspicuously.”

19
20 Article 2. Certain disclaimers of warranty (2-316(2)).

21
22 Article 2A. Certain disclaimers of warranty (2A-214(2), (3), (4)); certain terms in
23 consumer leases (2A-303(7)).

24
25 Article 3. Statement that promise or order is not negotiable (3-104(d)); certain
26 statements related to tender of instrument in full satisfaction of claim (3-311(b), (c)(1)).

27
28 Article 7. Statement that document is not negotiable (7-104(c)); statement that issuer
29 does not know whether goods were received or conform to description (7-203(1)); statement in
30 relation to foreclosure of warehouse’s lien that goods will be advertised for sale and sold at auction
31 (7-210(b)(2); requirement that notice of sale be posted in conspicuous places (not used with
32 reference to a term) (7-210(b)(5)); statement identifying document as duplicate (7-402); indication
33 by bailee of partial delivery (7-403(c)(2)).

34
35 Article 8. Transfer restriction noted on certificate (8-204(a)).

36
37 14. *“Electronic.”* The draft adopts the standard ULC definition.

38
39 25. *“Person.”* Except for the new treatment of a “protected series,” ~~The~~ the draft retains
40 the UCC’s existing definition of “person.” Although the UCC definition differs from the ULC’s
41 current standard definition, the Drafting Committee sees no reason to create uncertainty by revising
42 the UCC definition.

43
44 As the Legislative Note explains, by enacting the draft amendment, an enacting state would
45 treat a protected series, whether organized under the law of the enacting state or under the law of
46 another state, as a “person” for purposes of the Uniform Commercial Code. The draft uses the
47 ULC’s standard language to accomplish this purpose.

1 (6B) “Assignor,” ~~in part 4 of this article,~~ means a person that (i) under a security
2 agreement creates or provides for a security interest that secures an obligation or (ii) sells accounts,
3 chattel paper, payment intangibles, or promissory notes.

4 * * *

5 **Reporter’s Note**

6
7 1. “Assignor”; “assignee”. Instead of referring to a “debtor,” “secured party,” and
8 “security interest,” all of which terms are defined in the UCC, several provisions of Article 9, Part
9 4, refer to an “assignor,” “assignee,” and “assignment,” or sometimes an “assigned contract,” none
10 of which terms are defined in the UCC. Some courts read the undefined terms in an unduly narrow
11 way. In 2020, the Permanent Editorial Board for the UCC issued a Commentary clarifying the
12 meanings of these terms and amended the official comments accordingly. *PEB Commentary No.*
13 *21, Use of the Term “Assignment” in Article 9 of the Uniform Commercial Code* (Mar. 11, 2020).
14 New ~~subsection~~ subsections (6A) and 6(B) incorporate the essence of the Commentary into the
15 statutory text. In this draft the phrase “in part 4 of this article” is deleted in both definitions
16 because the terms also appear in other Parts of Article 9.