

## MEMORANDUM

TO: Study Committee

FROM: Steven L. Harris, Reporter

RE: Draft Term Sheet for Intangible Negotiable Instruments

DATE: January 2, 2020

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This draft term sheet suggests how the Uniform Commercial Code might address intangible negotiable instruments. There are two parts. The first sets forth guiding principles for the Study Committee's consideration. The second contains indicative formulations of how some of these terms might be operationalized in amendments to UCC Articles 3 and 9.

### **Part 1: Terms**

1. Intangible negotiable instruments would have the same formal requirements as written (tangible)<sup>1</sup> negotiable instruments under § 3-104, except that they would be intangible rather than written.
2. Intangible checks, including intangible teller's checks, cashier's checks, and traveler's checks, would not be negotiable instruments under Article 3.
3. The substantive legal rules governing issuance, transfer, and negotiation of intangible negotiable instruments would be the same as the rules for written negotiable instruments insofar as possible. Statutory terms that are limited to written negotiable instruments, *e.g.*, *negotiable instrument*, *issue*, *delivery*, *transfer of an instrument*, *possession*, and *indorsement*, would be adjusted (replaced or expanded) to cover intangible instruments.
4. The rights and obligations of parties to a negotiable instrument should not change if the form in which the instrument is maintained changes, *i.e.*, if an instrument is "converted" from a written record to an intangible record, from an intangible record to a written record, or from an intangible record maintained in one system to an intangible record maintained in another system.
5. A negotiable instrument cannot be comprised of multiple records unless they are associated with one another.
6. The substantive legal rules governing attachment, perfection, priority and enforcement of a security interest in intangible negotiable instruments would be the same as the rules for written

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<sup>1</sup> Section 1-201(b)(43) provides, "'Writing' includes printing, typewriting, or any other intentional reduction to tangible form. 'Written' has a corresponding meaning."

negotiable instruments insofar as possible. An analogous concept would substitute for *possession*.

## **Part 2: Indicative Formulations**

This part gives an indication of how many of the principles in Part 1 might be operationalized in amendments to the UCC.

### **SECTION 1-201. GENERAL DEFINITIONS.**

....

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

....

(15) “Delivery”, with respect to an electronic document of title and electronic negotiable instrument means voluntary transfer of control and with respect to ~~an~~ a tangible instrument, a tangible document of title, or tangible chattel paper, means voluntary transfer of possession.

....

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

....

(21) “Holder” means:

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

(B) the person having control of an electronic negotiable instrument that is payable either to bearer or to an identified person that is the person having control;

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

(€D) the person in control of a negotiable electronic document of title.

....

(39A) “Tangible” means evidenced by a record consisting of information that is inscribed on a tangible medium.

....

### Reporter’s Note

1. The definition of “delivery” for an electronic (intangible) negotiable instrument, *i.e.*, “voluntary transfer of control” would be the same as for an electronic document of title. However, the meaning of *control* in this draft differs from the meaning in §§ 7-106 and 9-105. See draft § 3-104A & accompanying Reporter’s Note.

2. Consistent with other uniform acts and E-SIGN, this draft uses the defined term “electronic” rather than “intangible.” The draft uses the standard ULC definition, which derives from E-SIGN but does not appear in the UCC. Compare §§ 1-201(b)(16) (defining an “electronic document of title”) and 9-102(a)(31) (defining “electronic chattel paper”), both of which refer to a record “consisting of information stored in an electronic medium.”

3. The draft definition of “holder” of an electronic negotiable instrument is the same as the definition of “holder” of a tangible negotiable instrument, except that *control* is substituted for *possession*.

4. The draft definition of “tangible” tracks those of “tangible document of title” in § 1-102(b)(16) and “tangible chattel paper” in § 9-102(a)(79).

### SECTION 3-103. DEFINITIONS.

In this Article:

....

(8) “Order” means ~~a written~~ an instruction to pay money signed by the person giving the instruction. ....

(11) “Promise” means ~~a written~~ an undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation.

...

(18) “Sign” means, with present intent to authenticate or adopt a record:

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

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

process.

### **Reporter’s Note**

1. Historically, a negotiable instrument has been a signed writing. The formal requirements currently appear in § 3-104. That section incorporate the requirement of a signed writing by using the terms “order” and “promise,” which terms are defined in § 3-103.

2. The draft definition of “sign” is the standard ULC definition, which appears in § 7-102(a)(11). The definition of “signed” in Article 1 is limited to writings: “‘Signed’ includes using any symbol executed or adopted with present intention to adopt or accept a writing.” § 1-201(b)(37). Article 9 uses the term “authenticate,” which means to sign (in the Article 1 sense) or (B) with present intent to adopt or accept a record, to attach to or logically associate with the record an electronic sound, symbol, or process. § 9-102(a)(7).

3. Certain provisions of Article 3, *e.g.*, § 3-604(c), provide that the term “signed” “includes the attachment to or logical association with the record of an electronic symbol, sound, or process with the present intent to adopt or accept the record.” These provisions would be deleted if Article 3 is amended to include a medium-neutral definition of “signed.”

### **SECTION 3-104. NEGOTIABLE INSTRUMENT.**

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

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

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

(3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order

may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

(b) “Instrument” means a negotiable instrument.

(c) An order that meets all of the requirements of subsection (a), except paragraph (1), and otherwise falls within the definition of “check” in subsection (f) is a negotiable instrument and a check.

(c *bis*) An electronic instrument that falls within the definition of “check” or “traveler’s check” is not a negotiable instrument, even if it also falls within the definition of “note.”

(d) A promise or order is not an instrument if, at the time it is issued or first comes into possession or control of a holder, it provides a conspicuous statement, however expressed, to the effect that the promise is not negotiable or is not a negotiable instrument governed by this Article.

(e) An instrument is a “note” if it is a promise and is a “draft” if it is an order. If an instrument falls within the definition of both “note” and “draft,” a person entitled to enforce the instrument may treat it as either.

(f) “Check” means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank or (ii) a cashier’s check or teller’s check. An order to pay may be a check even though it is described on its face by another term, such as “money order.”

(g) “Cashier’s check” means a draft with respect to which the drawer and drawee are the same bank or branches of the same bank.

(h) “Teller’s check” means a draft drawn by a bank (i) on another bank, or (ii) payable at or through a bank.

(i) “Traveler's check” means an instrument that (i) is payable on demand, (ii) is drawn on or payable at or through a bank, (iii) is designated by the term “traveler's check” or by a substantially similar term, and (iv) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the instrument.

(j) “Certificate of deposit” means an instrument containing an acknowledgment by a bank that a sum of money has been received by the bank and a promise by the bank to repay the sum of money. A certificate of deposit is a note of the bank.

### **Reporter’s Note**

1. The changes to the definitions of “order” and “promise” in draft § 3-103 would have the effect of expanding the definition of “negotiable instrument” in this section to include electronic records as well as tangible ones. Under subsection (b), a negotiable instrument, whether electronic or tangible, would be an Article 3 “instrument.”

2. *Possession* applies to tangible instruments. *Control*, explained in draft § 3-104A, would apply to electronic instruments.

3. The Study Committee may wish to consider whether the requirement in subsection (d) that a statement of non-negotiability be “conspicuous” should apply to electronic negotiable instruments and, if it should apply, whether the definition, which appears in § 1-201(b)(10), should be revised.

“‘Conspicuous’, with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it. Whether a term is ‘conspicuous’ or not is a decision for the court. Conspicuous terms include the following:

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

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

4. New subsection (*c bis*) would exclude electronic cashier's checks, teller's checks, and traveler's checks from the definition of "negotiable instrument."

**SECTION 3-104A. CONTROL OF ELECTRONIC INSTRUMENT.** A person has control of an electronic instrument if:

(1) a system employed for evidencing the transfer of interests in the instrument reliably establishes that the person is the person to which the instrument was issued or transferred; and

(2) the person:

(A) has the power to cause the system to reliably establish that another person is the person to which the instrument has been transferred;

(B) has the power to prevent another person from changing the instrument; and

(C) has the right to prevent the system from reliably establishing that another person is the person to which the instrument has been transferred.

### **Reporter's Note**

1. This draft uses *control* of an electronic negotiable instrument as analogous to possession of a tangible negotiable instrument. The Uniform Commercial Code does not define *possession*. The term is generally understood to denote a relationship between a person and a tangible asset such that:

- other persons can perceive the connection between the person and the asset;
- the person has the power to enable another person to enjoy this relationship, *i.e.*, the person can physically transfer possession;
- the person has the power to prevent another person from changing the asset; and
- the person has the right to prevent another person from enjoying this relationship.

2. Unlike the control provisions of §§ 7-107 (electronic documents of title) and 9-105 (electronic chattel paper), this draft does not contain a safe harbor. The Study Committee may wish to consider whether certain technologies should be privileged with a statutory safe harbor.

3. For the convenience of the Study Committee, here is current § 9-105, which explains when a secured party has *control* of electronic chattel paper.

**SECTION 9-105. CONTROL OF ELECTRONIC CHATTEL PAPER.**

(a) [**General rule: control of electronic chattel paper.**] A secured party has control of electronic chattel paper 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.

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

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

(2) the authoritative copy identifies the secured party as the assignee of the record or records;

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

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

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

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

4. A person having *control* of a transferable record under UETA § 16(b) would not necessarily have *control* under the draft. If the approach of the draft is acceptable, the Study Committee may wish to consider whether UETA should be amended.

**SECTION 3-105. ISSUE OF INSTRUMENT.**

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

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

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

### **Reporter’s Note**

1. The most common case in which an instrument is issued to a nonholder is that of a “remitter,” *i.e.*, “a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser.” § 3-103(a)(15). “Remitter transactions usually involve a cashier’s or teller’s check.” § 3-201, comment 2.

2. Regarding incomplete instruments, see *infra* § 3-115.

### **SECTION 3-105. REISSUANCE IN ALTERNATIVE MEDIUM.**

(a) Upon request of the holder, the issuer of a tangible instrument may issue an electronic instrument as a substitute for the tangible instrument and the issuer of an electronic instrument may issue a tangible instrument as a substitute for the electronic instrument if:

(1) the holder delivers the instrument to the issuer; and

(2) the substitute instrument when issued contains a statement that it is issued in

substitution for the initial instrument.

(b) Upon issuance of a substitute instrument in accordance with subsection (a):

(1) the initial instrument ceases to have any effect or validity; and

(2) the holder warrants to all subsequent holders that the warrantor was a holder of the initial instrument when the warrantor delivered the initial document to the issuer.

## Reporter's Note

1. This section derives from § 7-105, which allows for documents of title issued in one medium (tangible or electronic) to be reissued in the other medium. The Study Committee may wish to consider whether this approach is appropriate for negotiable instruments. The official comment to that section explains that:

1. . . . This section sets forth minimum requirements for giving the reissued document effect and validity. The issuer is not required to issue a document in an alternative medium and if the issuer chooses to do so, it may impose additional requirements. Because a document of title imposes obligations on the issuer of the document, it is imperative for the issuer to be the one who issues the substitute document in order for the substitute document to be effective and valid.

2. The request must be made to the issuer by the person entitled to enforce the document of title [who, in the case of a negotiable document, is the holder, see § 7-102(a)(9)] and that person must surrender possession or control of the original document to the issuer. The reissued document must have a notation that it has been issued as a substitute for the original document. These minimum requirements must be met in order to give the substitute document effect and validity. If these minimum requirements are not met for issuance of a substitute document of title, the original document of title continues to be effective and valid. However, if the minimum requirements imposed by this section are met, in addition to any other requirements that the issuer may impose, the substitute document will be the document that is effective and valid.

3. To protect parties who subsequently take the substitute document of title, the person who procured issuance of the substitute document warrants that it was a person entitled under the original document at the time it surrendered possession or control of the original document to the issuer. This warranty is modeled after the warranty found in Section 4-209 [concerning encoding and retention of checks and other items handled by the warrantor for collection].

### **SECTION 3-115. INCOMPLETE INSTRUMENT.**

(a) "Incomplete instrument" means a signed ~~writing~~ record, whether or not issued by the signer, the contents of which show at the time of signing that it is incomplete but that the signer intended it to be completed by the addition of words or numbers.

(b) Subject to subsection (c), if an incomplete instrument is an instrument under Section 3-104, it may be enforced according to its terms if it is not completed, or according to its terms as

augmented by completion. If an incomplete instrument is not an instrument under Section 3–104, but, after completion, the requirements of Section 3–104 are met, the instrument may be enforced according to its terms as augmented by completion.

(c) If words or numbers are added to an incomplete instrument without authority of the signer, there is an alteration of the incomplete instrument under Section 3–407.

(d) The burden of establishing that words or numbers were added to an incomplete instrument without authority of the signer is on the person asserting the lack of authority.

#### **Reporter’s Note**

1. The Study Committee may wish to consider whether this section is appropriate for electronic negotiable instruments.

#### **SECTION 3-201. NEGOTIATION.**

(a) “Negotiation” means a transfer of possession or control, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder.

(b) Except for negotiation by a remitter, if an instrument is payable to an identified person, negotiation requires transfer of possession or control of the instrument and its indorsement by the holder. If an instrument is payable to bearer, it may be negotiated by transfer of possession or control alone.

#### **Reporter’s Note**

1. Negotiation by a remitter occurs by delivery without an indorsement. See § 3-201, comment 2.

**SECTION 3-203. TRANSFER OF INSTRUMENT; RIGHTS ACQUIRED BY TRANSFER.**

(a) An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.

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

(c) Unless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the transferee has a specifically enforceable right to the unqualified indorsement of the transferor, but negotiation of the instrument does not occur until the indorsement is made.

(d) If a transferor purports to transfer less than the entire instrument, negotiation of the instrument does not occur. The transferee obtains no rights under this Article and has only the rights of a partial assignee.

**Reporter's Note**

1. Given the changes to the definition of "delivery" in draft § 1-201, no change to this section would be needed.

**SECTION 3-204. INDORSEMENT.**

(a) "Indorsement" means a signature, other than that of a signer as maker, drawer, or acceptor, that alone or accompanied by other words is added to an instrument for the purpose of (i) negotiating the instrument, (ii) restricting payment of the instrument, or (iii) incurring

indorser's liability on the instrument, but regardless of the intent of the signer, a signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement.

....

### **Reporter's Note**

1. Given the changes to the definitions of "sign" in draft § 3-103 and the provisions on signatures in draft § 3-401, this section appears to be suitable for electronic instruments.

### **SECTION 3-205. SPECIAL INDORSEMENT.**

(a) If an indorsement is made by the holder of an instrument, whether payable to an identified person or payable to bearer, and the indorsement identifies a person to whom it makes the instrument payable, it is a "special indorsement." When specially indorsed, an instrument becomes payable to the identified person and may be negotiated only by the indorsement of that person. The principles stated in Section 3-110 apply to special indorsements.

(b) If an indorsement is made by the holder of an instrument and it is not a special indorsement, it is a "blank indorsement." When indorsed in blank, an instrument becomes payable to bearer and may be negotiated by transfer of possession or control alone until specially indorsed.

(c) The holder may convert a blank indorsement that consists only of a signature into a special indorsement by:

(1) in the case of a tangible instrument, writing, above the signature of the indorser, words identifying the person to whom the instrument is made payable; or

(2) in the case of an electronic instrument, adding to the instrument information identifying the person to whom the instrument is made payable, in a manner that associates the information with the signature of the indorser.

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

1. Section 3-110 contains rules for identifying the person to whom an instrument is payable.

**SECTION 3-301. PERSON ENTITLED TO ENFORCE INSTRUMENT.** “Person entitled to enforce” an instrument means (i) the holder of the instrument, (ii) a nonholder in possession or control of the instrument who has the rights of a holder, or (iii) a person not in possession or control of the instrument who is entitled to enforce the instrument pursuant to Section 3-309 or 3-418(d). A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful control of the instrument.

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

1. Section 3-309 appears *infra*.
2. Section 3-418(d) provides:

Notwithstanding Section 4-215, if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance under subsection (a) or (b), the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument.

**SECTION 3-308. PROOF OF SIGNATURES AND STATUS AS HOLDER IN DUE COURSE.**

(a) In an action with respect to an instrument, the authenticity of, and authority to make, each **signature on the instrument** is admitted unless specifically denied in the pleadings. If the

validity of a signature is denied in the pleadings, the burden of establishing validity is on the person claiming validity, but the signature is presumed to be authentic and authorized unless the action is to enforce the liability of the purported signer and the signer is dead or incompetent at the time of trial of the issue of validity of the signature. If an action to enforce the instrument is brought against a person as the undisclosed principal of a person who signed the instrument as a party to the instrument, the plaintiff has the burden of establishing that the defendant is liable on the instrument as a represented person under Section 3-402(a).

(b) If the validity of signatures is admitted or proved and there is compliance with subsection (a), a plaintiff **producing the instrument** is entitled to payment if the plaintiff proves entitlement to enforce the instrument under Section 3-301, unless the defendant proves a defense or claim in recoupment. If a defense or claim in recoupment is proved, the right to payment of the plaintiff is subject to the defense or claim, except to the extent the plaintiff proves that the plaintiff has rights of a holder in due course which are not subject to the defense or claim.

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

1. The Study Committee may wish to consider whether, in subsection (b), the phrases "signature on the instrument" and "producing the instrument" would be appropriate for electronic negotiable instruments.

#### **SECTION 3-309. ENFORCEMENT OF LOST, DESTROYED, OR STOLEN INSTRUMENT.**

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

(1) the person seeking to enforce the instrument:

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

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

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

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

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

### **Reporter's Note**

1. In subsection (a)(3), among the reasons why the person not having control cannot reasonably obtain control is that "its [the instrument's] whereabouts cannot be determined." This phrase appears to be inapplicable to electronic negotiable instruments. The Study Committee may wish to consider whether it should be supplemented with an analogous phrase or whether the official comments would suffice to address the issue.

2. More generally, the Study Committee may wish to consider whether there are additional circumstances for which the procedure in this section should be made available with respect to electronic instruments, *e.g.*, when the record is unavailable from the control system because the system fails to respond. Note that an "alteration," *i.e.*, "(i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party," would be treated in § 3-407. Presumably, "alteration" would encompass at least some situations in which data are corrupted or tampered with.

3. As regards the phrase “produced the instrument,” see the Reporter’s Note to draft § 3-308.

**SECTION 3–401. SIGNATURE.**

(a) A person is not liable on an instrument unless (i) the person signed the instrument, or (ii) the person is represented by an agent or representative who signed the instrument and the signature is binding on the represented person under Section 3–402.

(b) A signature may be made (i) manually, ~~or~~ by means of a device or machine, or electronically, and (ii) by the use of any name, including a trade or assumed name, ~~or by a word, mark, or symbol executed or adopted by a person with present intention to authenticate a record with present intent to authenticate or adopt a record, by executing or adopting a tangible symbol or attaching to or logically associating with the instrument an electronic sound, symbol, or process.~~

**SECTION 3–402. SIGNATURE BY REPRESENTATIVE.**

(a) If a person acting, or purporting to act, as a representative signs an instrument by signing either the name of the represented person or the name of the signer, the represented person is bound by the signature to the same extent the represented person would be bound if the signature were on a simple contract. If the represented person is bound, the signature of the representative is the "authorized signature of the represented person" and the represented person is liable on the instrument, whether or not identified in the instrument.

(b) If a representative signs the name of the representative to an instrument and the signature is an authorized signature of the represented person, the following rules apply:

(1) If the **form of the signature** shows unambiguously that the signature is made on behalf of the represented person who is identified in the instrument, the representative is not liable on the instrument.

(2) Subject to subsection (c), if (i) the **form of the signature** does not show unambiguously that the signature is made in a representative capacity or (ii) the represented person is not identified in the instrument, the representative is liable on the instrument to a holder in due course that took the instrument without notice that the representative was not intended to be liable on the instrument. With respect to any other person, the representative is liable on the instrument unless the representative proves that the original parties did not intend the representative to be liable on the instrument.

(c) [Applicable only to checks.]

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

1. Under subsection (b), the liability of a representative who signs an instrument depends on the "form of the signature." The Study Committee may wish to consider whether this phrase would be appropriate for electronic instruments.

#### **SECTION 3-404. IMPOSTORS; FICTITIOUS PAYEES.**

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(b) If (i) a person whose intent determines to whom an instrument is payable (Section 3-110(a) or (b)) does not intend the person identified as payee to have any interest in the instrument, or (ii) the person identified as payee of an instrument is a fictitious person, the following rules apply until the instrument is negotiated by special indorsement:

(1) Any person in possession or control of the instrument is its holder.

(2) An indorsement by any person in the name of the payee stated in the instrument is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

....

**SECTION 3-405. EMPLOYER'S RESPONSIBILITY FOR FRAUDULENT INDORSEMENT BY EMPLOYEE.**

(a) In this section:

(1) "Employee" includes an independent contractor and employee of an independent contractor retained by the employer.

(2) "Fraudulent indorsement" means (i) in the case of an instrument payable to the employer, a forged indorsement purporting to be that of the employer, or (ii) in the case of an instrument with respect to which the employer is the issuer, a forged indorsement purporting to be that of the person identified as payee.

(3) "Responsibility" with respect to instruments means authority (i) to sign or indorse instruments on behalf of the employer, (ii) to process instruments received by the employer for bookkeeping purposes, for deposit to an account, or for other disposition, (iii) to prepare or process instruments for issue in the name of the employer, (iv) to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer, (v) to control the disposition of instruments to be issued in the name of the employer, or (vi) to act otherwise with respect to instruments in a responsible capacity. "Responsibility" does not include authority that merely allows an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are part of incoming or outgoing mail, or similar access.

(b) For the purpose of determining the rights and liabilities of a person who, in good faith, pays an instrument or **takes it** for value or for collection, if an employer entrusted an employee with responsibility with respect to the instrument and the employee or a person acting in concert with the employee makes a fraudulent indorsement of the instrument, the indorsement is effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person. If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from the fraud, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

....

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

1. The Study Committee may wish to consider whether the definition of “responsibility” is adequate for electronic instruments.
2. This is one of several provisions that refer to a person who “takes” or “took” an instrument or that uses another variation of the word “take.” See, *e.g.*, § 3-420(a) (providing that an instrument is converted if, *inter alia*, it is “taken by transfer”). The Study Committee may wish to consider whether “take” and its variations would be appropriate for electronic instruments.

#### **SECTION 3-501. PRESENTMENT.**

(a) “Presentment” means a demand made by or on behalf of a person entitled to enforce an instrument (i) to pay the instrument made to the drawee or a party obliged to pay the instrument or, in the case of a note or accepted draft payable at a bank, to the bank, or (ii) to accept a draft made to the drawee.

(b) The following rules are subject to Article 4, agreement of the parties, and clearing-house rules and the like:

(1) Presentment may be made at the place of payment of the instrument and must be made at the place of payment if the instrument is payable at a bank in the United States; may be made by any commercially reasonable means, including an oral, written, or electronic communication; is effective when the demand for payment or acceptance is received by the person to whom presentment is made; and is effective if made to any one of two or more makers, acceptors, drawees, or other payors.

(2) Upon demand of the person to whom presentment is made, the person making presentment must (i) **exhibit** the instrument, (ii) give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of authority to do so, and (iii) **sign a receipt on** the instrument for any payment made or **surrender** the instrument if full payment is made.

### **Reporter's Note**

1. Subsection (b)(2) requires that, under certain circumstances, the person making presentment must “exhibit,” “sign a receipt on” or “surrender” the instrument. The Study Committee may wish to consider whether the text would be appropriate for electronic instruments.

### **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.

### **Reporter's Note**

1. Subsection (a) refers to “surrender” and “mutilation” of the instrument and “cancellation or striking out” of a signature. The Study Committee may wish to consider whether the text would be adequate for electronic instruments.

### **SECTION 9-102. DEFINITIONS AND INDEX OF DEFINITIONS.**

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

....

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

....

(65) “Promissory note” means an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds.

### **Reporter's Note**

1. This draft would classify an electronic negotiable instrument as “instrument” under Article 9. Consequently, an electronic negotiable note would be a “promissory note,” the sale of which ordinarily would be an automatically perfected Article 9 “security interest.” As is the case with the obligor on a written negotiable instrument, the obligor on an electronic negotiable instrument would not be an “account debtor.”

2. If the Study Committee is content with treating an electronic negotiable instrument as Article 9 “instrument,” it may wish to consider whether to expand the definition to include other electronic records.

3. The draft National Residential Mortgage Note Repository Act (Repository Act) contemplated that the repository would accept a “controlled record,” *i.e.*, a record that is in a control system and would be an Article 9 “instrument,” but not an Article 3 “negotiable instrument,” if the record were in writing. The amendments to the UCC that were designed to accompany the Repository Act would have treated an electronic mortgage note in the repository as a “payment intangible” but allowed for superpriority by control, which would have been determined by a person’s status with respect to the electronic mortgage note.

**SECTION 9-105A. CONTROL OF ELECTRONIC INSTRUMENT.** A person has control of an electronic instrument as provided in Section 3-104A.

**SECTION 9-109. SCOPE.**

(a) **[General scope of article.]** Except as otherwise provided in subsections (c) and (d), this article applies to:

...

(3) a sale of accounts, chattel paper, payment intangibles, or promissory notes;

....

**SECTION 9-207. RIGHTS AND DUTIES OF SECURED PARTY HAVING POSSESSION OR CONTROL OF COLLATERAL.**

(a) **[Duty of care when secured party in possession.]** Except as otherwise provided in subsection (d), a secured party shall use reasonable care in the custody and preservation of collateral in the secured party’s possession. In the case of chattel paper or an instrument, reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

(b) [**Expenses, risks, duties, and rights when secured party in possession.**] Except as otherwise provided in subsection (d), if a secured party has possession of collateral:

(1) reasonable expenses, including the cost of insurance and payment of taxes or other charges, incurred in the custody, preservation, use, or operation of the collateral are chargeable to the debtor and are secured by the collateral;

(2) the risk of accidental loss or damage is on the debtor to the extent of a deficiency in any effective insurance coverage;

(3) the secured party shall keep the collateral identifiable, but fungible collateral may be commingled; and

(4) the secured party may use or operate the collateral:

(A) for the purpose of preserving the collateral or its value;

(B) as permitted by an order of a court having competent jurisdiction; or

(C) except in the case of consumer goods, in the manner and to the extent agreed by the debtor.

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

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

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

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

(d) **[Buyer of certain rights to payment.]** If the secured party is a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor:

(1) subsection (a) does not apply unless the secured party is entitled under an agreement:

(A) to charge back uncollected collateral; or

(B) otherwise to full or limited recourse against the debtor or a secondary obligor

based on the nonpayment or other default of an account debtor or other obligor on the collateral;

and

(2) subsections (b) and (c) do not apply.

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

1. The Study Committee may wish to consider whether the duty to exercise “reasonable care,” which “includes taking necessary steps to preserve rights against prior parties unless otherwise agreed,” should apply to a person in control of an electronic negotiable instrument as it does to a person in possession of a tangible negotiable instrument.

### **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 electronic chattel paper under Section 9-105 shall:

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

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

...

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

(A) give control of the electronic document 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 document is maintained for the secured party, communicate to the custodian an authenticated record releasing the designated custodian from any further obligation to comply with instructions originated by the secured party and instructing the custodian to comply with instructions originated by the debtor; and

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

(7) a secured party, other than a buyer, having control of an electronic instrument under Section 9-105A shall deliver the instrument to the debtor.

## Reporter's Note

1. The Study Committee may wish to consider whether the duties of a secured party having control of an electronic instrument should track those in paragraph (3) (electronic chattel paper) or (6) (electronic document of title), or whether draft paragraph (7) is sufficient.

**SECTION 9-301. LAW GOVERNING PERFECTION AND PRIORITY OF SECURITY INTERESTS.** Except as otherwise provided in Sections 9-303 through 9-306, the following rules determine the law governing perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral:

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

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

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

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

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

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

(4) The local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in as-extracted collateral.

## Reporter's Note

1. The draft would apply the standard choice-of-law rule to electronic negotiable instruments. Note that when a debtor is located in a non-UCC jurisdiction that does not provide for perfection of an electronic negotiable instrument by control, a secured party that has control within the meaning of Article 9 but does not file would be unperfected. The Study Committee may wish to consider whether this result is acceptable. (Amendments to the UCC that were designed to accompany the draft National Residential Mortgage Note Repository Act would have amended this section to provide that the local law of the District of Columbia would govern (A) perfection by control of a security interest in an electronic mortgage note and (B) the effect of perfection or nonperfection and the priority of a security interest in an electronic mortgage note perfected by control.)

2. The Study Committee may wish to determine the choice-of-law rule applicable to a negotiable instrument that comprises both a tangible and an electronic record.

### **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.**

(a) **[General rule: perfection by filing.]** Except as otherwise provided in subsection (b) and Section 9-312(b), a financing statement must be filed to perfect all security interests and agricultural liens.

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

...

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

....

### **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.**

(a) **[Perfection by filing permitted.]** A security interest in chattel paper, negotiable documents, instruments, or investment property may be perfected by filing.

...

(e) **[Temporary perfection: new value.]** A security interest in certificated securities, negotiable documents, or instruments is perfected without filing or the taking of possession for a period of 20 days from the time it attaches to the extent that it arises for new value given under an authenticated security agreement.

....

(g) **[Temporary perfection: delivery of security certificate or instrument to debtor.]** A perfected security interest in a certificated security or instrument remains perfected for 20 days without filing if the secured party delivers the security certificate or instrument to the debtor for the purpose of:

- (1) ultimate sale or exchange; or
- (2) presentation, collection, enforcement, renewal, or registration of transfer.

(h) **[Expiration of temporary perfection.]** After the 20-day period specified in subsection (e), (f), or (g) expires, perfection depends upon compliance with this article.

**Reporter's Note**

1. These portions of current § 9-312 would apply to electronic negotiable instruments.

**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, tangible instruments, 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, letter-of-credit rights, electronic instruments, or electronic chattel paper may be perfected by control of the collateral under Section 9-104, 9-105, 9-105A, 9-106, or 9-107.

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

(c) . . . .

(d) **[Collateral in control of person other than debtor.]** A secured party takes control of an electronic instrument in the control of a person other than the debtor or secured party when:

(1) the person having control authenticates a record acknowledging that it has control of the instrument for the secured party's benefit; or

(2) the person acquires control of the instrument after having authenticated a record acknowledging that it will have control of the instrument for the secured party's benefit.

(e) [Acknowledgment not required.] A person having control of an electronic instrument is not required to acknowledge that it has control for a secured party's benefit.

(f) [Effectiveness of acknowledgment; no duties or confirmation.] If a person acknowledges that it has control of an electronic instrument for the secured party's benefit:

(1) the acknowledgment is effective under subsection (e), even if the acknowledgment violates the rights of a debtor; and

(2) unless the person otherwise agrees or law other than this article otherwise provides, the person does not owe any duty to the secured party and is not required to confirm the acknowledgment to another person.

(g) [Secured party's delivery to person other than debtor.] A secured party having control of an electronic instrument does not relinquish control by delivering the instrument to a person other than the debtor if the person was instructed before the delivery or is instructed contemporaneously with the delivery:

(1) to hold control of the instrument for the secured party's benefit; or

(2) to redeliver the instrument to the secured party.

(h) [Effect of delivery under subsection (g); no duties or confirmation.] A secured party does not relinquish control, even if a delivery under subsection (g) violates the rights of a debtor. A person to which an instrument is delivered under subsection (g) does not owe any duty to the secured party and is not required to confirm the delivery to another person unless the person otherwise agrees or law other than this article otherwise provides.

### Reporter's Note

1. Subsections (d) through (h) track subsections (c) and (f) through (i) of current § 9-313, which deals with perfection by possession.

### **SECTION 9-317. INTERESTS THAT TAKE PRIORITY OVER OR TAKE FREE OF SECURITY INTEREST OR AGRICULTURAL LIEN.**

....

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

....

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

### Reporter's Note

1. Existing subsection (b) applies to tangible collateral, whereas subsection (d) applies to intangibles. This draft would amend the definition of "instrument" in § 9-102 to include an electronic (intangible) negotiable instrument to which, left unchanged, subsection (b) would apply by its terms.

**SECTION 9-330. PRIORITY OF PURCHASER OF CHATTEL PAPER OR INSTRUMENT.**

....

(d) **[Instrument purchaser's priority.]** Except as otherwise provided in Section 9-331(a), a purchaser of an instrument has priority over a security interest in the instrument perfected by a method other than possession or control if the purchaser gives value and takes possession or control of the instrument in good faith and without knowledge that the purchase violates the rights of the secured party.

....

(f) **[Indication of assignment gives knowledge.]** For purposes of subsections (b) and (d), if chattel paper or an instrument indicates that it has been assigned to an identified secured party other than the purchaser, a purchaser of the chattel paper or instrument has knowledge that the purchase violates the rights of the secured party.

**Reporter's Note**

1. Additional provisions may be needed to deal with a single instrument comprised of one or more tangible records and one or more electronic records.

**SECTION 9-331. PRIORITY OF RIGHTS OF PURCHASERS OF INSTRUMENTS, DOCUMENTS, AND SECURITIES UNDER OTHER ARTICLES; PRIORITY OF INTERESTS IN FINANCIAL ASSETS AND SECURITY ENTITLEMENTS UNDER ARTICLE 8.**

(a) **[Rights under Articles 3, 7, and 8 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. These holders or purchasers

take priority over an earlier security interest, even if perfected, to the extent provided in Articles 3, 7, and 8.

....