

MEMORANDUM

TO: Committee on the Uniform Commercial Code and Emerging Technologies

FROM: Steven L. Harris, Reporter

RE: Electronic Negotiable Instruments

DATE: May 11, 2020

The attached document contains for the Committee's consideration indicative formulations of statutory provisions that might implement the Committee's discussions concerning the expansion of Uniform Commercial Code Article 3 to include electronic negotiable instruments. It also suggests additional issues that the Committee might wish to discuss. The appendices contain indicative formulations of provisions that relate to electronic chattel paper and electronic nonnegotiable instruments.

I look forward to "seeing" you at our forthcoming meeting.

S. L. H.

Provisions Relating to Electronic Negotiable Instruments

ARTICLE 1—GENERAL PROVISIONS.

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.

(16B) “Electronic negotiable instrument” means a negotiable instrument evidenced by an electronic record.

....

(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;

(~~BC~~) 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 negotiable instrument” means a negotiable instrument evidenced by a record consisting of information that is inscribed on a tangible medium.

...

Reporter’s Note

1. *Delivery.* 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. *Holder.* 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*.

3. *Electronic negotiable instrument.* UCC §§ 1-201(b)(16) (defining an “electronic document of title”) and 9-102(a)(31) (defining “electronic chattel paper”) both refer to a record “consisting of information stored in an electronic medium.” The UCC does not define “electronic.” However, Comment 16 to § 9-102 suggests that “[t]he concept of an electronic medium should be construed liberally to include electronic, digital, magnetic, optical, electromagnetic, or any other current or similar emerging technologies.” This draft would define “electronic negotiable instrument” by reference to the standard ULC definition of “electronic,” which in turn derives from E-SIGN.

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

ARTICLE 3—NEGOTIBLE INSTRUMENTS

PART 1

GENERAL PROVISIONS AND DEFINITIONS

SECTION 3–101. SHORT TITLE.

SECTION 3–102. SUBJECT MATTER.

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.

(19) “Take” means to receive delivery. “Taker” has a corresponding meaning.

Reporter’s Note

1. *Background.* Historically, a negotiable instrument has been a signed writing. The formal requirements appear in § 3-104. That section incorporates the requirement of a signed writing through the definitions of the “order” and “promise” in § 3-103. Draft paragraphs (8) and (11) would extend the coverage of § 3-104 to electronic orders and promises.

2. *Sign.* The draft proposes to use the standard ULC definition of “sign,” which appears in § 7-102(a)(11). As used in the definition, “electronic” means “relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.” Draft § 1-201(b)(16A).

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”) and so would not be appropriate for electronic negotiable instruments. § 1-201(b)(37). Article 9 uses the term “authenticate,” which means to sign (in the Article 1 sense) or “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).

Sections 3-602(f) and 3-604(c) provide that, for the purposes of that section, 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 § 3-103 is amended to include a medium-neutral definition of “signed.”

3. *Take.* The undefined terms “take,” “takes,” “took,” and “taken” appear throughout Article 3. Inasmuch as all Article 3 instruments currently are tangible, the undefined terms appear to refer to the taking of possession. This draft would clarify that the terms apply to both tangible and electronic instruments. As regards “delivery” of an electronic Article 3 instrument, see draft § 1-201.

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. *Instrument; negotiable instrument.* 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. *Money.* The Committee may wish to consider whether Article 3 should allow for negotiable instruments payable in virtual currency, whether fiat or private.

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

4. *Conspicuous.* The 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.

5. *Electronic checks.* New subsection (c *bis*) would exclude electronic checks, including cashier’s checks and teller’s checks, and electronic traveler’s checks from the definition of “negotiable instrument.”

6. *Choice of law.* The Committee may wish to consider whether subsection (a)(3) should be amended to clarify that the inclusion of a choice-of-law or forum-selection clause does not prevent a record from qualifying as a negotiable instrument.

SECTION 3-104A. CONTROL OF ELECTRONIC INSTRUMENT.

[bracketed language is for the Committee to consider]

(a) In this section, “record constituting the electronic instrument” means the electronic instrument together with any record that is attached to or logically associated with the electronic instrument and readily enables the identification of the original payee or the transferee, as the case may be, of the electronic instrument.

(b) A person has control of an electronic instrument if:

(1) the record constituting the electronic instrument:

(A) is readily identifiable as the authoritative record of the electronic instrument [for the purpose of this Article]; and

(B) readily enables the person to be identified as the original payee or the transferee, as the case may be, of the electronic instrument;

(2) the person has the power to cause the record constituting the electronic instrument to [provide] [indicate] that another person is the transferee of the electronic instrument; and

(3) the person has the power to prevent another person from changing the record constituting the electronic instrument.

(c) A record constituting an electronic instrument which [provides] [indicates] that it is the authoritative record of the electronic instrument [for the purpose of this Article] is readily identifiable as the authoritative record of the electronic instrument within the meaning of subparagraph (b)(1)(A).

Reporter’s Note

1. *Meaning of control.* 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:

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

This section defines *control* by reference to those powers. Draft subsections (b)(2) and (b)(3) expressly adopt points (ii) and (iii) above. Under draft subsection (b)(1)(B), a person would not have control under this section unless the relevant record readily enables the person to be identified as the original payee or the transferee, as the case may be, of the electronic instrument. A person who has the power to prevent changes under draft subsection (b)(3) would have the power to prevent changes to the identity of the transferee and so would have the power specified in point (iv).

A person's powers under subsections (b)(2) and (b)(3) should be determined as if the system with which the electronic instrument is maintained were working properly. The remote possibility that the system might be hacked or the record otherwise affected by a malefactor does not *ipso facto* prevent a purchaser from having the "power to prevent" changes under subsection (b)(3).

Regarding point (i): To perceive the connection between a person and any given instrument, one must identify the relevant record constituting the instrument and its connection to the relevant person. With respect to tangible instruments, the common understanding – which we think of as the default rule and is not expressed in the statute – is that the "original" paper, *i.e.*, the one that the parties actually signed, constitutes the relevant instrument for purposes of possession. The relevant person is the person who has possession of the original. Possession of a copy conveys no rights.

This draft makes the "original" electronic record irrelevant to the question of control. Rather, subsection (b)(1)(A) contemplates that the relevant record is the "record constituting the electronic instrument" that is "readily identifiable as the authoritative record of the electronic instrument." as defined in subsection (a). As defined in subsection (a), the "record constituting the electronic instrument" comprises the electronic instrument together with any record that (1) is attached to or logically associated with the electronic instrument and (2) readily enables the identification of the original payee or the transferee, as the case may be, of the electronic instrument.

The relevant person for purposes of control is the person that the authoritative record readily enables to be identified as the original payee of the electronic instrument or the transferee, as the case may be. See subparagraph (b)(1)(B). Whether a record readily enables a person to be so

identified should be determined within the context of the system with which the electronic chattel paper is maintained. Access to and familiarity with the system may be necessary to make the determination.

2. *Safe harbor.* 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 for having control. However, it does provide a safe harbor for determining whether a record is “readily identifiable” as the authoritative record of the electronic instrument. Under subsection (c), a record that provides/indicates that it is the authoritative record would be “readily identifiable” as such. Subparagraph (b)(1)(B) should be read to allow for systems to develop. A record that satisfies the purpose of this subparagraph is sufficient, even if it does not fall within the safe harbor of subsection (c).

3. *Control of other electronic assets.* Possible revisions to the concept of *control* of electronic chattel paper appear in Appendix 1. Possible revisions to the concept of *control* of electronic nonnegotiable instruments appear in Appendix 2. The Committee will also consider the concept of *control* of other electronic assets, including electronic documents.

4. *Relationship to UETA.* 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 Committee may wish to consider whether the two statutes should be reconciled and, if so, how.

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. *Issuance to a nonholder.* 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. Under draft § 3-104(c *bis*), electronic cashier’s checks and electronic teller’s checks would not be Article 3 “instruments.”

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

SECTION 3-105A. 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 instrument to the issuer.

Reporter’s Note

1. *Background.* 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 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].

2. *Issues for discussion.* The Committee may wish to consider whether the Article 7 approach is appropriate for negotiable instruments. In particular, the Committee may wish to consider the following issues:

- a. Is *reissuance* an appropriate concept? Would *conversion* or some other concept be better?
- b. Who should be able to reissue a negotiable instrument? On what conditions?
- c. When, if ever, must a negotiable instrument be reissued?
- d. Would the draft be sufficient to protect an obligor on a negotiable instrument from double liability?
- e. Does the draft, and in particular subsection (b), adequately deal with negotiable instruments that are reissued more than once, *e.g.*, a tangible note that is reissued as (converted to) an electronic note and thereafter reissued as (converted to) a tangible note (“papered out”)?
- f. Is there a need to provide for instruments that are evidenced by more than one record at a time (“hybrid”)?

SECTION 3–107. INSTRUMENT PAYABLE IN FOREIGN MONEY.

SECTION 3–108. PAYABLE ON DEMAND OR AT DEFINITE TIME.

SECTION 3–109. PAYABLE TO BEARER OR TO ORDER.

- (a) A promise or order is payable to bearer if it:

(1) states that it is payable to bearer or to the order of bearer or otherwise indicates that the person in possession or control of the promise or order is entitled to payment;

(2) does not state a payee; or

(3) states that it is payable to or to the order of cash or otherwise indicates that it is not payable to an identified person.

....

SECTION 3–110. IDENTIFICATION OF PERSON TO WHOM INSTRUMENT IS PAYABLE.

SECTION 3–111. PLACE OF PAYMENT.

Except as otherwise provided for items in Article 4, an instrument is payable at the place of payment stated in the instrument. If no place of payment is stated, an instrument is payable at the address of the drawee or maker stated in the instrument. If no address is stated, the place of payment is the place of business of the drawee or maker. If a drawee or maker has more than one place of business, the place of payment is any place of business of the drawee or maker chosen by the person entitled to enforce the instrument. If the drawee or maker has no place of business, the place of payment is the residence of the drawee or maker.

Reporter’s Note

1. *Vocabulary.* The Committee may wish to consider whether terms such as “place of payment,” “address,” and “place of business” would appropriate for electronic instruments.

SECTION 3–112. INTEREST.

SECTION 3–113. DATE OF INSTRUMENT.

SECTION 3–114. CONTRADICTORY TERMS OF INSTRUMENT.

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

SECTION 3-116. JOINT AND SEVERAL LIABILITY; CONTRIBUTION.

SECTION 3-117. OTHER AGREEMENTS AFFECTING INSTRUMENT.

SECTION 3-118. STATUTE OF LIMITATIONS.

SECTION 3-119. NOTICE OF RIGHT TO DEFEND ACTION.

PART 2

NEGOTIATION, TRANSFER, AND INDORSEMENT

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

SECTION 3–202. NEGOTIATION SUBJECT TO RESCISSION.

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. If the Committee adopts the revisions 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. For the purpose of determining whether a signature is made on an instrument, a paper affixed to the instrument is a part of the instrument.

....

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 attaches the information to, or logically associates the information with, the signature of the indorser.

....

Reporter’s Note

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

SECTION 3–206. RESTRICTIVE INDORSEMENT.

SECTION 3–207. REACQUISITION.

PART 3

ENFORCEMENT OF INSTRUMENTS

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 possession or 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 3–302. HOLDER IN DUE COURSE.

(a) Subject to subsection (c) and Section 3–106(d), "holder in due course" means the holder of an instrument if:

...

(2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the

instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 3–306, and (vi) without notice that any party has a defense or claim in recoupment described in Section 3–305(a).

....

Reporter’s Note

1. *Vocabulary.* As to the meaning of “took,” see draft § 3-103.

SECTION 3–303. VALUE AND CONSIDERATION.

SECTION 3–304. OVERDUE INSTRUMENT.

SECTION 3-305. DEFENSES AND CLAIMS IN RECOUPMENT; CLAIMS IN CONSUMER TRANSACTIONS.

SECTION 3–306. CLAIMS TO AN INSTRUMENT.

A person taking an instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A person having rights of a holder in due course takes free of the claim to the instrument.

Reporter’s Note

1. *Vocabulary.* The Committee may wish to consider whether “possessory right” and “recover the instrument” would be appropriate for electronic instruments.

SECTION 3–307. NOTICE OF BREACH OF FIDUCIARY DUTY.

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. *Vocabulary.* The 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. As regards “signature on the instrument,” see draft § 3-401.

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. *Vocabulary.* 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 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.

As regards the phrase "produced the instrument," see the Reporter's Note to draft § 3-308.

2. *Scope of this section.* More generally, the 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.

SECTION 3-310. EFFECT OF INSTRUMENT ON OBLIGATION FOR WHICH TAKEN.

....

(b) Unless otherwise agreed and except as provided in subsection (a), if a note or an uncertified check is taken for an obligation, the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken, and the following rules apply:

....

(4) If the person entitled to enforce the instrument taken for an obligation is a person other than the obligee, the obligee may not enforce the obligation to the extent the obligation is suspended. If the obligee is the person entitled to enforce the instrument but no longer has possession or control of it because it was lost, stolen, or destroyed, the obligation may not be enforced to the extent of the amount payable on the instrument, and to that extent the obligee’s rights against the obligor are limited to enforcement of the instrument.

....

SECTION 3-311. ACCORD AND SATISFACTION BY USE OF INSTRUMENT.

(a) If a person against whom a claim is asserted proves that (i) that person in good faith tendered an instrument to the claimant as full satisfaction of the claim, (ii) the amount of the claim was unliquidated or subject to a bona fide dispute, and (iii) the claimant obtained payment of the instrument, the following subsections apply.

(b) Unless subsection (c) applies, the claim is discharged if the person against whom the claim is asserted proves that the instrument or an accompanying ~~written~~ communication contained a conspicuous statement to the effect that the instrument was tendered as full satisfaction of the claim.

...

Reporter's Note

1. *Vocabulary.* As to “conspicuous,” see Note 4 to draft § 3-104.

SECTION 3-312. LOST, DESTROYED, OR STOLEN CASHIER'S CHECK, TELLER'S CHECK, OR CERTIFIED CHECK.

PART 4

LIABILITY OF PARTIES

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.

Reporter's Note

1. *How a signature may be made.* The proposed addition derives from the standard ULC definition of "sign."

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

SECTION 3–403. UNAUTHORIZED SIGNATURE.

SECTION 3–404. IMPOSTORS; FICTITIOUS PAYEES.

....

(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. *Responsibility.* The Committee may wish to consider whether the definition of “responsibility” is adequate for electronic instruments.

As used in the definition of “responsibility,” the word “control” does not have the meaning specified in draft § 3-105A.

SECTION 3-406. NEGLIGENCE CONTRIBUTING TO FORGED SIGNATURE OR ALTERATION OF INSTRUMENT.

SECTION 3-407. ALTERATION.

SECTION 3-408. DRAWEE NOT LIABLE ON UNACCEPTED DRAFT.

SECTION 3-409. ACCEPTANCE OF DRAFT; CERTIFIED CHECK.

(a) “Acceptance” means the drawee’s signed agreement to pay a draft as presented. It must be written on or attached to or logically associated with the draft and may consist of the drawee’s signature alone. Acceptance may be made at any time and becomes effective when notification pursuant to instructions is given or the accepted draft is delivered for the purpose of giving rights on the acceptance to any person.

....

SECTION 3-410. ACCEPTANCE VARYING DRAFT.

SECTION 3-411. REFUSAL TO PAY CASHIER’S CHECKS, TELLER’S CHECKS, AND CERTIFIED CHECKS.

SECTION 3-412. OBLIGATION OF ISSUER OF NOTE OR CASHIER’S CHECK.

The issuer of a note or cashier’s check or other draft drawn on the drawer is obliged to pay the instrument (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession or control of a holder, or (ii) if the issuer signed an incomplete

instrument, according to its terms when completed, to the extent stated in Sections 3–115 and 3–407. The obligation is owed to a person entitled to enforce the instrument or to an indorser who paid the instrument under Section 3–415.

SECTION 3–413. OBLIGATION OF ACCEPTOR.

SECTION 3–414. OBLIGATION OF DRAWER.

(a) This section does not apply to cashier's checks or other drafts drawn on the drawer.

(b) If an unaccepted draft is dishonored, the drawer is obliged to pay the draft (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession or control of a holder, or (ii) if the drawer signed an incomplete instrument, according to its terms when completed, to the extent stated in Sections 3–115 and 3–407. The obligation is owed to a person entitled to enforce the draft or to an indorser who paid the draft under Section 3–415.

....

SECTION 3–415. OBLIGATION OF INDORSER.

SECTION 3-416. TRANSFER WARRANTIES.

SECTION 3-417. PRESENTMENT WARRANTIES.

SECTION 3–418. PAYMENT OR ACCEPTANCE BY MISTAKE.

SECTION 3-419. INSTRUMENTS SIGNED FOR ACCOMMODATION.

SECTION 3–420. CONVERSION OF INSTRUMENT.

PART 5
DISHONOR

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.

(3) Without dishonoring the instrument, the party to whom presentment is made may (i) return the instrument for lack of a necessary indorsement, or (ii) refuse payment or acceptance

for failure of the presentment to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule.

....

Reporter's Note

1. *Vocabulary.* Subsection (b)(2) requires that, under certain circumstances, the person making presentment must “exhibit,” “sign a receipt on” or “surrender” the instrument. Subsection (b)(2) permits the party to whom presentment is made to “return” the instrument. The Committee may wish to consider whether this language would be appropriate for electronic instruments.

SECTION 3-502. DISHONOR.

SECTION 3-503. NOTICE OF DISHONOR.

(a) The obligation of an indorser stated in Section 3-415(a) and the obligation of a drawer stated in Section 3-414(d) may not be enforced unless (i) the indorser or drawer is given notice of dishonor of the instrument complying with this section or (ii) notice of dishonor is excused under Section 3-504(b).

(b) Notice of dishonor may be given by any person; may be given by any commercially reasonable means, including an oral, written, or electronic communication; and is sufficient if it reasonably identifies the instrument and indicates that the instrument has been dishonored or has not been paid or accepted. Return of an instrument given to a bank for collection is sufficient notice of dishonor.

(c) Subject to Section 3-504(c), with respect to an instrument taken for collection by a collecting bank, notice of dishonor must be given (i) by the bank before midnight of the next banking day following the banking day on which the bank receives notice of dishonor of the instrument, or (ii) by any other person within 30 days following the day on which the person

receives notice of dishonor. With respect to any other instrument, notice of dishonor must be given within 30 days following the day on which dishonor occurs.

Reporter's Note

1. *Vocabulary.* The Committee may wish to consider whether “return” and “given to” in subsection (b) would be appropriate for electronic instruments. As to “taken” in subsection (c), see the Reporter’s Note to draft § 3-302.

SECTION 3–504. EXCUSED PRESENTMENT AND NOTICE OF DISHONOR.

SECTION 3–505. EVIDENCE OF DISHONOR.

(a) The following are admissible as evidence and create a presumption of dishonor and of any notice of dishonor stated:

(1) a document regular in form as provided in subsection (b) which purports to be a protest;

(2) a purported stamp or ~~writing~~ record of the drawee, payor bank, or presenting bank on, ~~or~~ accompanying, attached to, or logically associated with the instrument stating that acceptance or payment has been refused unless reasons for the refusal are stated and the reasons are not consistent with dishonor;

(3) a book or record of the drawee, payor bank, or collecting bank, kept in the usual course of business which shows dishonor, even if there is no evidence of who made the entry.

PART 6

DISCHARGE AND PAYMENT

SECTION 3–601. DISCHARGE AND EFFECT OF DISCHARGE.

SECTION 3-602. PAYMENT.

(a) Subject to subsection (e), an instrument is paid to the extent payment is made by or on behalf of a party obliged to pay the instrument, and to a person entitled to enforce the instrument.

(b) Subject to subsection (e), a note is paid to the extent payment is made by or on behalf of a party obliged to pay the note to a person that formerly was entitled to enforce the note only if at the time of the payment the party obliged to pay has not received adequate notification that the note has been transferred and that payment is to be made to the transferee. A notification is adequate only if it is signed by the transferor or the transferee; reasonably identifies the transferred note; and provides an address at which payments subsequently are to be made. Upon request, a transferee shall seasonably furnish reasonable proof that the note has been transferred. Unless the transferee complies with the request, a payment to the person that formerly was entitled to enforce the note is effective for purposes of subsection (c) even if the party obliged to pay the note has received a notification under this paragraph.

(c) Subject to subsection (e), to the extent of a payment under subsections (a) and (b), the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under Section 3-306 by another person.

(d) Subject to subsection (e), a transferee, or any party that has acquired rights in the instrument directly or indirectly from a transferee, including any such party that has rights as a holder in due course, is deemed to have notice of any payment that is made under subsection (b) after the date that the note is transferred to the transferee but before the party obliged to pay the note receives adequate notification of the transfer.

(e) The obligation of a party to pay the instrument is not discharged under subsections (a) through (d) if:

(1) a claim to the instrument under Section 3-306 is enforceable against the party receiving payment and (i) payment is made with knowledge by the payor that payment is prohibited by injunction or similar process of a court of competent jurisdiction, or (ii) in the case of an instrument other than a cashier's check, teller's check, or certified check, the party making payment accepted, from the person having a claim to the instrument, indemnity against loss resulting from refusal to pay the person entitled to enforce the instrument; or

(2) the person making payment knows that the instrument is a stolen instrument and pays a person it knows is in wrongful possession of the instrument.

~~(f) As used in this section, "signed," with respect to a record that is not a writing, includes the attachment to or logical association with the record of an electronic symbol, sound, or process with the present intent to adopt or accept the record.~~

Reporter's Note

1. The draft proposes a definition of "sign" in § 3-103 and so would delete subsection (c).

SECTION 3-603. TENDER OF PAYMENT.

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.

....

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

Reporter’s Note

1. *Vocabulary.* Subsection (a) refers to “surrender” and “mutilation” of the instrument and “cancellation or striking out” of a signature. The Committee may wish to consider whether the text would be adequate for electronic instruments.
2. *Sign.* The draft proposes a definition of “sign” in § 3-103 and so would delete subsection (c).

SECTION 3-605. DISCHARGE OF SECONDARY OBLIGORS.

PART 7

GOVERNING LAW

SECTION 3-701. GOVERNING LAW.

[to come?]

Reporter’s Note

1. *Choice of law.* Article 3 does not contain a choice-of-law rule. The Committee may wish to consider whether to add a choice-of-law rule or whether the general choice-of-law rules in § 1-301 are adequate:

SECTION 1-301. TERRITORIAL APPLICABILITY; PARTIES’ POWER TO CHOOSE APPLICABLE LAW.

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

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

(c)

Among the specific issues the Committee may wish to consider are:

- Whether the choice-of-law rule should be a mandatory or a gap-filler in the absence of agreement;
- Whether the same governing law should apply to all issues that might arise with respect to a negotiable instrument. For example, should different choice-of-law rules apply to the obligations of the issuer than apply to the obligations of a transferor?

ARTICLE 4—BANK DEPOSITS AND COLLECTIONS

SECTION 4-104. DEFINITIONS AND INDEX OF DEFINITIONS.

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

. . . .

(6) “Documentary draft” means a draft to be presented for acceptance or payment if specified documents, certificated securities (Section 8-102) or instructions for uncertificated securities (Section 8-102), or other certificates, statements, or the like are to be received by the drawee or other payor before acceptance or payment of the draft;

(7) “Draft” means a written draft ~~as defined in Section 3-104~~ or an item, other than ~~an~~ a tangible negotiable instrument, that is an order.

. . . .

(9) “Item” means ~~an~~ a tangible negotiable instrument or a written promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by Article 4A or a credit or debit card slip;

. . . .

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

. . . .

(c) “Control” as provided in Section 7-106 and the following definitions in other Articles apply to this Article:

“Acceptance” Section 3-409.

“Alteration” Section 3-407.

“Cashier’s check” Section 3-104.

“Certificate of deposit” Section 3-104.

“Certified check” Section 3-409.

“Check” Section 3-104.

“Draft” Section 3-104.

“Holder in due course” Section 3-302.

~~“Instrument” Section 3-104.~~

“Notice of dishonor” Section 3-503.

“Order” Section 3-103.

“Ordinary care” Section 3-103.

“Person entitled to enforce” Section 3-301.

“Presentment” Section 3-501.

“Promise” Section 3-103.

“Prove” Section 3-103.

“Record” Section 3-103.

“Remotely-Created consumer item” Section 3-103.

“Teller’s check” Section 3-104.

“Unauthorized signature” Section 3-403.

(d) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

Reporter's Note

1. *Scope of Article 4.* The draft amendments to this section are meant to ensure that the amendments to Article 3 do not expand the scope of Article 4. Article 4 currently covers the collection of written *items* but not electronic records other than electronic documents of title. (The reference to “control” in subsection (c) addresses the collection of written drafts that are accompanied by electronic documents of title. See § 4-210(c) (referring to a bank that does not “give up possession of the item or possession or control of the accompanying documents”).)

ARTICLE 9—SECURED TRANSACTIONS

SECTION 9-102. DEFINITIONS AND INDEX OF DEFINITIONS.

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

....

(47) “Instrument” means ~~a~~ an electronic negotiable instrument, 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. 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. *Definitions.* 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.”

Regarding the possible expansion to the definition of “instrument” to include other electronic records, see Appendix 2.

SECTION 9-105A. CONTROL OF ELECTRONIC NEGOTIABLE INSTRUMENT.

A person has control of an electronic negotiable instrument as provided in Section 3-104A.

Reporter's Note

1. *Implications for control.* The draft adds *control* as a method of perfection of a security interest in an electronic negotiable instrument. See draft § 9-314(a). A security interest perfected by control would be eligible for superpriority. See draft § 9-330.

The draft addresses *control* in the context of an electronic negotiable instrument. Regarding the possible revision of the concept of control as applied to electronic chattel paper, see Appendix 1.

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;

....

Reporter's Note

1. *Sale of electronic promissory notes.* Section 9-102 defines “promissory note” as a subset of Article 9 “instruments.” The draft would include electronic negotiable instruments within the definition of “instrument,” thus bringing the sale of electronic promissory notes within the scope of Article 9.

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. *Duty to preserve rights.* The 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 under § 9-207(a).

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 negotiable instrument under Section 9-105A shall deliver the electronic negotiable instrument to the debtor.

Reporter's Note

1. *Duties when secured obligation is discharged.* The Committee may wish to consider whether the duties of a secured party having control of an electronic negotiable 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. *Choice of law.* The draft would apply the standard choice-of-law rule to perfection and priority of security interests in 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 Committee may wish to consider whether this result is acceptable.

Two alternative approaches have been suggested.

- A choice-of-law rule keyed to the system with which the electronic negotiable instrument is maintained. This would be a cascade (“waterfall”) along the lines of that found in §§ 8-110(e) (determining a security intermediary’s jurisdiction) and 9-304(b) (determining a bank’s jurisdiction).
- An approach akin to those found in the amendments to the UCC that were designed to accompany the draft National Residential Mortgage Note Repository Act. Under this approach, the local law of the District of Columbia would govern (A) perfection by control of a security interest in an electronic negotiable instrument and (B) the effect of

perfection or nonperfection and the priority of a security interest in an electronic negotiable instrument perfected by control.)

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

3. *Other electronic collateral.* If the Committee chooses to adopt a special choice-of-law rule for electronic nonnegotiable instruments, the Committee may wish to consider whether the same rule should be applied to electronic chattel paper, electronic nonnegotiable instruments, and electronic documents.

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 negotiable 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 or control 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. *Applicability of section.* 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 negotiable instruments, or electronic chattel paper 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 security interest in deposit accounts, electronic chattel paper, electronic negotiable instruments, or letter-of-credit rights is perfected by control under Section 7-106, 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 negotiable 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 negotiable 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 negotiable instrument for the secured party's benefit.

(e) [Acknowledgment not required.] A person having control of an electronic negotiable 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 negotiable 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 negotiable 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. *Source.* 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. *Application of section.* 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. Draft § 1-201(b)(15) would define “delivery” with respect to electronic negotiable instruments.

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. *Hybrid instruments.* The Committee may wish to consider whether additional statutory provisions would be needed to deal with a single instrument comprised of one or more tangible records and one or more electronic records, or whether official comments would suffice.

APPENDIX 1

Provisions Relating to Control of Electronic Chattel Paper

[The following would replace current UCC § 9-105]

SECTION 9-105. CONTROL OF ELECTRONIC CHATTEL PAPER.

(a) In this section, “record constituting the electronic chattel paper” means the electronic chattel paper together with any record that is attached to or logically associated with the electronic chattel paper and readily enables the identification of the transferee of the electronic chattel paper.

(b) A purchaser has control of electronic chattel paper if:

(1) the record constituting the electronic chattel paper:

(A) is readily identifiable as the authoritative record of the electronic chattel paper [for the purpose of this Article]; and

(B) readily enables the person to be identified as the transferee of the electronic chattel paper;

(2) the person has the power to cause the record constituting the electronic chattel paper to [provide] [indicate] that another person is the transferee of the electronic chattel paper; and

(3) the person has the power to prevent another person from changing the record constituting the electronic chattel paper.

(c) A record constituting electronic chattel paper which [provides] [indicates] that it is the authoritative record of the electronic chattel paper [for the purpose of this Article] is readily identifiable as the authoritative record of the electronic chattel paper within the meaning of subparagraph (b)(1)(A).

APPENDIX 2

Provisions Relating to Electronic Nonnegotiable Article 9 Instruments

SECTION 9-102. DEFINITIONS AND INDEX OF DEFINITIONS. [marked to show changes from the official text]

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

....

(47) “Instrument” means a negotiable instrument or any other ~~writing~~ record that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, [or] (iii) ~~writings~~ records that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card[, or (iv) records whose principal use is as a medium of exchange]. As used in this paragraph, “delivery” of a nonnegotiable instrument means the voluntary transfer of control.

....

SECTION 9-105A. CONTROL OF ELECTRONIC NONNEGOTIABLE INSTRUMENT. [New]

(a) In this section:

(1) “electronic nonnegotiable instrument” means an electronic instrument that is not a negotiable instrument; and

(2) “record constituting the electronic nonnegotiable instrument” means the electronic nonnegotiable instrument together with any record that is attached to or logically associated with

the electronic nonnegotiable instrument and readily enables the identification of the transferee of the electronic nonnegotiable instrument.

(b) A purchaser has control of an electronic nonnegotiable instrument if:

(1) the record constituting the electronic nonnegotiable instrument:

(A) is readily identifiable as the authoritative record of the electronic nonnegotiable instrument [for the purpose of this Article]; and

(B) readily enables the person to be identified as the transferee of the electronic nonnegotiable instrument;

(2) the person has the power to cause the record constituting the electronic nonnegotiable instrument to [provide] [indicate] that another person is the transferee of the electronic nonnegotiable instrument; and

(3) the person has the power to prevent another person from changing the record constituting the electronic nonnegotiable instrument.

(c) A record constituting electronic nonnegotiable instrument which [provides] [indicates] that it is the authoritative record of the electronic nonnegotiable instrument [for the purpose of this Article] is readily identifiable as the authoritative record of the electronic nonnegotiable instrument within the meaning of subparagraph (b)(1)(A).