

D R A F T
FOR DISCUSSION ONLY

Uniform Commercial Code and Emerging Technologies

Uniform Law Commission

January 28–29, 2022 Committee Meeting



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1 **UNIFORM COMMERCIAL CODE AND EMERGING TECHNOLOGIES**

2 **JANUARY 17, 2022 DRAFT**

3 ***Note on formatting:***

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

8
9 *Because Article 12 is a completely new UCC article, its provisions are not underscored.*

10
11 *New sections are numbered with an “A” at the end, e.g., Section 9-107A. It is*
12 *contemplated that this numbering convention will be retained for these sections that remain in*
13 *the final Act. This will avoid the need to renumber existing sections.*

14
15 **Reporter’s Prefatory Note to January 17, 2022 Draft**
16 **(submitted to the ALI Council)**

17
18 This Prefatory Note first describes the background of the project on Emerging
19 Technologies and the Uniform Commercial Code (UCC) and the work to date. It then provides a
20 brief overview of the proposed revisions to the UCC. Additional Prefatory Notes are provided
21 below for the proposed amendments relating to payments (Articles 3, 4, and 4A), investment
22 securities (Article 8), secured transactions (Article 9), and controllable electronic records (new
23 Article 12).

24
25 1. *Background*

26
27 The Uniform Commercial Code has been enacted in all 50 states, the District of
28 Columbia, Puerto Rico, and the U.S. Virgin Islands. Since its widespread enactment in the
29 1960s, the UCC has been periodically revised to address changes in commercial practices.

30
31 In 2019, the Uniform Law Commission and The American Law Institute (the Sponsors)
32 appointed a Joint Committee to consider whether changes to the UCC are advisable to
33 accommodate emerging technologies, such as artificial intelligence, distributed ledger
34 technology, and virtual currency. At the time when the Joint Committee was formed, invitations
35 were sent to large groups of potential stakeholders including trade organizations, financial
36 institutions, technology companies, government agencies, academicians, and consumer groups.
37 The Committee currently has more than 300 observers.

38
39 The Joint Committee was initially formed as a study committee. However, the Joint
40 Committee subsequently received the permission of the Sponsors to act as a drafting committee
41 for amendments to the UCC dealing with digital assets, bundled transactions (*i.e.*, transactions
42 involving the sale or lease of goods together with the provision of services, the licensing of
43 information, or both), and payments, as well as for certain discrete amendments to the UCC

1 unrelated to emerging technologies. For convenience, further references are to the Drafting
2 Committee.

3
4 The Drafting Committee has held the following meetings:

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

14
15 In addition, several small working groups have met remotely (and some continue to meet)
16 to discuss specific topics and to hear the views of various stakeholder groups. Since the 2021
17 ULC Annual Meeting the Chair, Vice Chair, Reporters, and several members of the Drafting
18 Committee have presented educational programs addressing the ongoing revision process to
19 groups including the Loan Syndication and Trading Association, the ABA Business Law
20 Section, and the American College of Commercial Finance Lawyers.

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

27
28 The Drafting Committee expects to hold at least two full meetings in 2022, with a view to
29 completing the draft of the amendments, obtaining American Law Institute approval of the draft
30 at its May 2022 annual meeting, and final approval of the Commission at its July 2022 annual
31 meeting. Members of the Drafting Committee will continue to reach out to industry groups and
32 other stakeholders and plan to continue participating in CLE presentations to educate members
33 of the bar and others.

34 35 2. *Overview of UCC Revisions*

36
37 The Drafting Committee’s charge is broad, and the resulting draft is expansive.

38 39 a. *New UCC Article 12 – Controllable electronic records, controllable accounts, 40 controllable payment intangibles*

41
42 The draft includes a new UCC Article 12 that would govern the transfer of property
43 rights in certain intangible digital assets (“controllable electronic records”) that have been or may
44 be created using new technologies. These assets include, for example, certain types of virtual
45 currency and nonfungible tokens (NFTs). “Control” of controllable electronic records is a central
46 organizing concept under Article 12. Controllable electronic records are defined to include only

1 those electronic records that can be subjected to control. Control is the functional equivalent of
2 “possession” of a controllable electronic record and a necessary condition for protection as a
3 good faith purchaser for value (a “qualifying purchaser”) of a controllable electronic record.
4 Article 12 confers an attribute of negotiability on controllable electronic records because a
5 qualifying purchaser takes its interest free of conflicting property claims.
6

7 Controllable electronic records also provide a mechanism for evidencing certain rights to
8 payment—controllable accounts and controllable payment intangibles. An account debtor
9 (obligor) on such a right to payment agrees to make payments to the person that has control of
10 the controllable electronic record that evidences the right to payment. Assignments and other
11 aspects of these rights to payment are governed by revisions to UCC Article 9, discussed below.
12 Because a qualifying purchaser of a controllable account or controllable payment intangible will
13 take free of competing property claims, these rights to payment also would have this attribute of
14 negotiability. Article 12 also provides some special rules with respect to the payment obligations
15 and conditions of discharge of account debtors on controllable accounts and controllable
16 payment obligations.
17

18 Article 12 includes a choice-of-law rule for the matters that it covers in connection with
19 transactions in controllable electronic records.
20

21 For a more detailed description of Article 12, see the Reporter’s Prefatory Note to Article
22 12.
23

24 b. *Secured transactions amendments – UCC Article 9*

25

26 *Article 12 conforming amendments.* The draft includes extensive amendments to UCC
27 Article 9. Several of these amendments address security interests in controllable electronic
28 records and in the rights to payment that are embedded in, or tethered to, controllable electronic
29 records—controllable accounts and controllable payment intangibles. Perfection (i.e., essentially
30 third-party effectiveness) of security interests in these assets may be achieved by a secured party
31 obtaining control of the asset or filing a financing statement in the appropriate state’s filing
32 office. A security interest perfected by control has priority over a security interest perfected by
33 filing. The draft also provides special rules for the law governing perfection and priority for
34 security interests in controllable electronic records, controllable accounts, and controllable
35 payment intangibles. These rules draw on the new Article 12 choice-of-law rule.
36

37 *Chattel paper.* UCC Article 9 affords special treatment to “chattel paper” (e.g.,
38 installment sale contracts and personal property leases). The draft redefines “chattel paper” and
39 updates the Article 9 provisions applicable to this type of collateral. The new definition resolves
40 uncertainty that has arisen under the current definition and more accurately reflects the
41 distinction between the seller’s or lessor’s right to payment and the record (e.g., installment sale
42 contract or lease) evidencing that right. The new definition also resolves uncertainty that has
43 arisen when goods are leased as part of a bundled transaction involving services as well as
44 goods. This draft also addresses additional issues relating to bundled transactions. The draft also
45 provides an amended definition of “control” of an electronic copy of a record evidencing chattel
46 paper, which reflects a more accurate and technologically flexible approach than the current

1 definition.

2
3 *Money.* The draft includes a new definition of “money” in Article 1, which applies
4 throughout the UCC unless otherwise provided. It also includes amendments that define
5 “electronic money” and provide a definition of “control” of electronic money that tracks the
6 corresponding definition for control of controllable electronic records. Perfection of a security
7 interest in electronic money as original collateral must be by control, not filing. The draft
8 provides a new definition of “money” for purposes of Article 9 that excludes deposit accounts
9 (which could in the future be adopted by a government as money). The draft also updates the
10 take-free rules for transferees of money—both electronic money and tangible money—and
11 transferees of funds from deposit accounts.

12
13 For a more detailed description of the Article 9 amendments, see the Reporter’s Prefatory
14 Note to Article 9 Amendments.

15
16 *Control through another person.* Proposed revisions to the provisions on control in draft
17 §§ 9-104 (control of deposit accounts), 9-105 (control of authoritative electronic copies of
18 records, and 9-105A (control of electronic money evidencing chattel paper) and in a proposed
19 conforming modification to Section 8-106(d)(3) (control of security entitlement) address control
20 through the acknowledgment of a person in control. For similar revisions, see draft § 7-106
21 (control of electronic document of title). For a discussion of these proposed revisions, see draft §
22 12-105, Reporter’s Note 7.

23
24 *c. Payments amendments – UCC Articles 3 (negotiable instruments), 4 (bank*
25 *deposits and collections), and 4A (funds transfers).*

26
27 The draft proposes several amendments to Articles 3, 4 and 4A. The amendments relate
28 to negotiability, remote deposit capture, statements of account, the scope of Article 4A
29 (definition of payment order), and security procedures. The draft also deletes references to a
30 “writing” (which are changed to a “record”) and adopts a revised definition of “signed” for
31 specified sections of Article 4A. Many of the proposed changes are to the official comments and
32 are intended to further clarify the black letter text.

33
34 For a more detailed description of the payments amendments, see the Reporter’s
35 Prefatory Note to Payments Amendments.

36
37 *d. Other emerging technologies-related amendments*

38
39 The draft contains a revised definition of “conspicuous” in Article 1 and a revised and
40 updated draft official comment on the term. It adds to Article 1 the current standard definition of
41 “electronic” used by the ULC. It also adopts a revised definition of “signed” for Article 5 (letters
42 of credit).

43
44 The draft proposes a new Section 7-106, defining “control” for electronic documents of
45 title. The revised section retains the general rule and the safe harbor under the current provision
46 and adds an additional safe harbor along the lines of the revised section on control of chattel

1 paper.

2
3 Finally, the draft proposes several amendments to the official comments to Article 8
4 (investment securities) to make clear that a controllable electronic record may be a “financial
5 asset” credited to a securities account.

6
7 *e. Miscellaneous amendments*
8

9 The draft contains revised definitions for Article 9 of the terms “assignee” and
10 “assignor,” which conform to current descriptions in the official comments. It also amends the
11 definition of “person” to include a protected series established under non-UCC law.
12

13 The draft proposes to revise Section 5-116 to cure an ambiguity relating to the separate
14 status of bank branches in the current provision and to override incorrectly decided case law
15 arising from that ambiguity.
16

17 *3. Organization of the draft*
18

19 Revised provisions of the UCC text and comments appear in the order that they would
20 appear in the UCC—beginning with Article 1 and continuing through Article 12.

1 **UNIFORM COMMERCIAL CODE AND EMERGING TECHNOLOGIES**

2 **ARTICLE 1**

3 **GENERAL PROVISIONS**

4 **Section 1-107. Section Captions.**

5 Section captions are part of the [Uniform Commercial Code].

6 **Official Comment**

7 * * *

8 * * *

9

10 1. Section captions are a part of the text of the Uniform Commercial Code, and not mere

11 surplusage. This is not the case, however, with respect to subsection headings appearing in

12 Article 9 and Article 12. See ~~Comment 3 to Section~~ Sections 9-101, Comment 3 (“subsection

13 headings are not a part of the official text itself and have not been approved by the sponsors.”);

14 12-101, Comment.

15 * * *

16 * * *

17

18 **Section 1-201. General Definitions.**

19 * * *

20 (b) Subject to definitions contained in other articles of the [~~the~~ Uniform Commercial

21 Code] that apply to particular articles or parts thereof:

22 * * *

23 (10) “Conspicuous”, with reference to a term, means so written, displayed, or

24 presented that a reasonable person against which it is to operate ought to have noticed it.

25 ~~Whether a term is “conspicuous” or not is a decision for the court. Conspicuous terms include~~

26 ~~the following:~~

27 ~~(A) a heading in capitals equal to or greater in size than the surrounding~~

28 ~~text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and~~

29 ~~(B) language in the body of a record or display in larger type than the~~

30 ~~surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or~~

1 ~~set off from surrounding text of the same size by symbols or other marks that call attention to the~~
2 ~~language.~~

3 * * *

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

14 * * *

15 (16A) “Electronic” means relating to technology having electrical, digital,
16 magnetic, wireless, optical, electromagnetic, or similar capabilities.

17 * * *

18 (24) “Money” means a medium of exchange that:

19 (A) Is currently authorized or adopted by a domestic or foreign
20 government, by an intergovernmental organization, or pursuant to an agreement between two or
21 more governments.

22 (B) The term includes a monetary unit of account established by an
23 intergovernmental organization, or pursuant to an agreement between two or more countries.

1 Was initially issued, created, or distributed by a domestic or foreign government, by an
2 intergovernmental organization, or pursuant to an agreement between 2 or more governments.

3 * * *

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

11 * * *

12 **Legislative Note:**

13
14 A state should enact the amendment to paragraph (b)(27) whether the state has enacted the
15 Uniform Protected Series Act (2017) or otherwise recognizes a protected series under its law.
16 Because the sentence applies only under the enacting state’s Uniform Commercial Code,
17 inclusion of the sentence does not require the enacting state to recognize a limit on liability of a
18 protected series organized under the law of another state or a limit on liability of the entity that
19 established the protected series. It clarifies the status of a protected series as a “person” under
20 the choice-of-law and substantive law rules of the enacting state’s Uniform Commercial Code.

21
22 **Official Comment**

23 * * *

24
25
26 10. “Conspicuous.” Derived from former Section 1-201(10). This definition states the
27 general standard that to be conspicuous a term ought to be noticed by a reasonable person.
28 ~~Whether a term is conspicuous is an issue for the court. Subparagraphs (A) and (B) set out~~
29 ~~several methods for making a term conspicuous. Requiring that a term be conspicuous blends a~~
30 ~~notice function (the term ought to be noticed) and a planning function (giving guidance to the~~
31 ~~party relying on the term regarding how that result can be achieved). Although these paragraphs~~
32 ~~indicate some of the methods for making a term attention calling, the test is whether attention~~
33 ~~can reasonably be expected to be called to it. The statutory language should not be construed to~~
34 ~~permit a result that is inconsistent with that test. Whether a term is conspicuous is based on the~~
35 totality of the circumstances and requires a case-by-case, fact-intensive analysis.

1 The attributes of a reasonable person against which a term is to operate varies depending
2 upon the nature of the transaction and the market in which the transaction occurs. For example,
3 assume that a merchant of goods wishes to disclaim the implied warranty of merchantability or
4 fitness for particular purpose in its contracts for sale or lease. Depending on the particular
5 contract, the person against which that term is to operate may be a large business buyer or lessee,
6 a small business, or a consumer. Similarly, the determination of whether a term is conspicuous
7 may, depending on the context, yield a different conclusion when the term is the subject of
8 negotiation or discussion than when the term is used in a standard form agreement that was not
9 the subject of such negotiation or discussion.

10
11 Presenting a term in an online record in a manner such that a reasonable person ought to
12 notice it carries with it some uncertainties not associated with presenting the same term in a
13 writing because the person presenting the term might not fully control the appearance of the
14 relevant words as viewed by the person presented with the term. How a term appears depends to
15 some extent on the equipment and settings of the reasonable person presented with the term, and
16 a term that is conspicuous when displayed on a desktop computer might not be conspicuous
17 when displayed on a smaller device.

18
19 The test of whether a term is conspicuous remains constant notwithstanding the different
20 contexts referenced [above]. A term is conspicuous if its appearance is such that it ought to be
21 noticed by a reasonable person against which the term is to operate. If the term is used in a form
22 or format that is intended to operate against a group of persons, the determination is to be made
23 with reference to a reasonable member of the group, taking into account all aspects of the
24 transaction and the education, sophistication, disabilities, and other attributes of an average
25 member of the group. If the term is intended to operate against a single person, it is conspicuous
26 if it ought to have come to the attention of a reasonable person in the position of the actual
27 person against which it is to operate.

28
29 Factors that can be relevant to whether a term is conspicuous include the following:

30
31 (i) The appearance of the text in contrast to the surrounding text. This includes the use of
32 a font of a larger size or different color, and the use of emphasis through bolding, italics, capital
33 letters, or other means. However, terms in bold, capital letters might not be conspicuous if placed
34 among other terms also in bold, capital letters so there is no contrast with the surrounding text.

35
36 (ii) The placement of the term in the document. A term appearing in, or hyperlinked
37 from, text at the beginning of a document, or near the place where the person against which the
38 term is to operate must signify assent, is more likely to be conspicuous than a term in the middle
39 of a lengthy document.

40
41 (iii) The heading used, if any. A misleading heading – such as the heading “Warranty”
42 for a paragraph that contains a disclaimer of warranties – might cause a reasonable person to fail
43 to notice the language that would disclaim warranties, so that the term would not be conspicuous.

44
45 (iv) The effort needed to access the term. A term accessible only by triggering multiple
46 hyperlinks is less likely to be conspicuous than a term accessible from a single hyperlink.

1 This definition deals only with requirements that a term be noted conspicuously, found in
2 particular provisions of the Uniform Commercial Code. Other protective doctrines designed to
3 assure that assent is meaningful that are part of general contract law may also apply. See Section
4 1-103(b).
5

6 **Reporter’s Note**

7 8 1. “*Conspicuous.*” 9

10 *a. Issue of fact.* Whether a term is conspicuous should be determined by the finder
11 of facts. Thus, the sentence in the definition assigning that issue to the court is deleted. Deletion
12 of the examples will facilitate a more thorough discussion of the conspicuous definition in the
13 revised official comment.
14

15 *b. Current UCC Provisions Using “Conspicuous” or “Conspicuously.”* 16

17 Article 2. Certain disclaimers of warranty (2-316(2)).
18

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

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

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

32 Article 8. Transfer restriction noted on certificate (8-204(a)).]
33

34 2. “*Document of title.*” This definition is not changed and is provided here for
35 convenience of reference.
36

37 3. “*Electronic.*” The draft adopts the standard ULC definition.
38

39 4. “*Money.*” The definition of “money” applies to the term as used in the UCC. The
40 definition does not determine whether an asset constitutes “money” for other purposes.
41

42 Only something currently authorized or adopted as a medium of exchange can be money.
43 Coins and paper currency formerly issued by a government but now owned and traded only for
44 their numismatic or historical value, and not as a medium of exchange, are not money. To be
45 money, a medium of exchange must be initially issued, created, or distributed by a government,
46 by an intergovernmental organization, or pursuant to an agreement between two or more

1 governments. For this purpose, a currency printed or minted by a country’s central bank,
2 treasury, or other similar department, and then distributed or circulated by or on behalf of the
3 country, is money. So too is a currency printed or minted, and then circulated, by or on behalf of
4 several countries, such as the Euro. An electronic medium of exchange established pursuant to a
5 country’s law and initially distributed by or on behalf of the country also constitutes money, even
6 if ownership is established or maintained through a blockchain or other system not operated by
7 the government. In contrast, a medium of exchange initially issued, created, or distributed by one
8 or more private parties is not money solely because the government of one or more countries
9 authorizes or adopts it as a medium of exchange.

10
11 Note that the qualification that a medium of exchange must have been “initially issued,
12 created, or distributed” by particular types of entities, which is used in the second sentence of
13 this definition, is a subset of the broader, generally applicable limitation that the medium of
14 exchange must be “authorized or adopted” by such entities, used in the first sentence. Updated
15 official comments to this definition will address in more detail the meaning of the adoption or
16 authorization of a medium of exchange.

17
18 The draft deletes the second sentence of the existing definition, which covers, *e.g.*,
19 special drawing rights (SDRs) created by the International Monetary Fund. Despite the deletion,
20 a monetary unit of account would be “money” if it also a medium of exchange that falls within
21 the definition as revised. (SDRs, however, are not a medium of exchange.)

22
23 *Examples:* The following examples illustrate the definition of “money.”

24
25 **[Example 1:** Nation A enacts legislation authorizing or adopting seashells as a medium
26 of exchange. Seashells do not thereby become “money” because Nation A did not
27 initially issue, create, or distribute the seashells.]

28
29 **Example 2:** Nation B enacts legislation authorizing or adopting an existing crypto
30 currency, created on a private blockchain, as a medium of exchange. The crypto currency
31 does not thereby become “money” because Nation B did not initially issue, create, or
32 distribute the crypto currency.

33
34 **Example 3:** Nation C creates a crypto currency and authorizes or adopts it as a medium
35 of exchange. Nation C’s crypto currency is “money.”

36
37 5. “*Person.*” Except for the new treatment of a “protected series,” the draft retains the
38 UCC’s existing definition of “person.” Although the UCC definition differs from the ULC’s
39 current standard definition, the Drafting Committee sees no reason to create uncertainty by
40 revising the UCC definition.

41
42 As the Legislative Note explains, by enacting the draft amendment, an enacting state
43 would treat a protected series, whether organized under the law of the enacting state or under the
44 law of another state, as a “person” for purposes of the UCC. The draft uses the ULC’s standard

1 language to accomplish this purpose.

2
3 The added second sentence of the definition of “person” would provide needed clarity as
4 to the status of a protected series for purposes of the Uniform Commercial Code. A number of
5 states have enacted statutes that provide for protected series within a limited liability company or
6 other unincorporated organization. These statutes afford rights and impose duties upon a
7 protected series and generally empower a protected series to conduct its own activities under its
8 own name.

9
10 Providing that a protected series is a “person” for purposes of the enacting state’s
11 Uniform Commercial Code will expressly permit a protected series, whether created under the
12 law of the enacting state or of another state, to be a “seller” or a “buyer” under Article 2, a
13 “lessor” or a “lessee” under Article 2A, or an “organization” and a “debtor” under Article 9, and,
14 if the law under which the protected series is organized requires a public filing for the protected
15 series to be recognized under that law, a “registered organization” under Article 9. These matters
16 are not clear under the current Uniform Commercial Code.

17
18 * * *

19
20 **Section 1-204. Value.** Except as otherwise provided in Articles 3, 4, ~~and~~ 5, ~~and~~ 6,
21 ~~6,~~ and 12, a person gives value for rights if the person acquires them:

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

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

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

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

28 **Reporter’s Note**

29 “Value.” The amendment to this section implements the policy choice described in
30 Reporter’s Note 9 to draft § 12-104 by making the generally applicable definition of “value”
31 inapplicable to Article 12.

32
33 * * *

34 **ARTICLE 2**

35 **SALES**

1 * * *

2 **Section 2-102. Scope; Certain Security and Other Transactions Excluded From**
3 **This Article.**

4 (1) Unless the context otherwise requires and except as provided in subsection[s (2) and]
5 (4), this Article applies to transactions in goods;

6 (2) If the predominant purpose of a transaction is a sale, this Article applies to the
7 transaction.

8 (3) If a transaction includes a sale but the predominant purpose of a transaction is not a
9 sale, the provisions of this Article that relate solely to goods apply.

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

14 **Official Comment**

15
16 **Prior Uniform Statutory Provision:** Section 75, Uniform Sales Act.

17
18 **Changes:** Section 75 has been rephrased.

19
20 **Purposes of Changes and New Matter:**

21
22 1. To make This section makes it clear that: The the Article leaves substantially
23 unaffected the law relating to purchase money security such as conditional sale or chattel
24 mortgage though it regulates the general sales aspects of such transactions. “Security
25 transaction” is used in the same sense as in the Article on Secured Transactions (Article 9).
26

27 2. In some transactions, the passing of title to goods from the seller to the buyer in return
28 for a price is part of a larger transaction. The other aspects of the transaction might involve the
29 seller providing services to the buyer or the seller transferring to the buyer rights to property
30 other than goods. When the predominant purpose of a transaction is to pass title to goods in
31 return for a price, this Article applies to the transaction.

32
33 If a transaction includes a sale of goods but the non-goods aspect of the transaction

1 predominates, under subsection (3), the provisions of this Article relating solely to the goods
2 apply. These provisions include those relating to: warranties under Sections 2-212, 2-313, 2-314,
3 2-315, 2-316, 2-317, 2-318; the passing of title to and transferring rights in the goods under
4 Sections 2-401, 2-402, 2-403; tender of delivery and risk of loss under Sections 2-503, 2-504, 2-
5 509, 2-510; and acceptance, rejection, and cure under Sections 2-508, 2-601, 2-602, 2-603, 2-
6 604, 2-605, 2-606.

7
8 **Illustration.** Owner hires Contractor to replace the roof on a structure. As part of the
9 transaction, Contractor promises to remove the existing shingles and install new shingles,
10 which Contractor is providing. The transaction is in part a sale of goods because it
11 involves the passing of title to the new shingles, even though the transaction also involves
12 extensive services. If the goods aspect of the transaction predominates, the entire
13 transaction is a contract for sale and all of the provisions of this Article apply to it. If the
14 services aspect of the transaction predominates and an issue arises about whether the
15 parties reached an agreement, the provisions of this Article dealing with contract
16 formation do not apply. However, this Article’s provisions relating solely to the goods,
17 such as those on warranties, do apply.

18 **Reporter’s Note**

19
20
21 1. *“Bundled” transactions.* Article 2 currently does not specifically address the
22 application of the Article to transactions that cover both goods and non-goods, such as
23 transactions that involve the sale of goods and either the provision of services or the transfer of
24 property other than goods. (These transactions are often referred to as “hybrid,” “mixed,” or
25 “bundled” transactions.) This has provided courts some flexibility in deciding whether, and to
26 what extent, this Article should be applied to such transactions.

27
28 2. *“Predominant purpose” and “gravamen” approaches.* As a general matter, courts
29 have applied Article 2 to such transactions when the goods aspect of the transaction
30 predominates and have declined to apply this Article when the non-goods aspect predominates.
31 Subsection (2) of the revised section adopts this “predominant purpose” approach. (This
32 approach also is proposed in the definition of “chattel paper” in Section 9-102(a)(11)(B).) When,
33 however, an issue relates solely to the goods aspect of the transaction, such as whether the
34 characteristics of the goods conform to the contract, application of Article 2 to that issue is
35 appropriate even if the goods aspect of the transaction does not predominate. This approach,
36 sometimes referred to as the “gravamen” approach, has expressly been applied by some courts
37 and has implicitly been adopted by others. Subsection (3) of the revised section adopts the
38 gravamen approach.

39
40 3. The difficulty of capturing the appropriate application of these approaches to bundled
41 transactions in the statutory text should not be underestimated. This application is especially
42 challenging in the context of determining which provisions of the article should be applied to
43 which issues when the non-goods aspects of a transaction predominate. In this connection, the
44 Drafting Committee may wish to consider whether “the provisions of this Article relating solely
45 to the goods apply,” used in subsection (3), adequately captures and implements the goal of the
46 gravamen approach. An alternative approach would be to apply only the Article 2 provisions

1 relating to the quality of goods, such as the warranty provisions (Sections 2-312 through 2-318)
2 in such transactions.

3
4 4. The Drafting Committee will consider further whether a more flexible approach would
5 be to address these scope issues only in the official comments. It also will consider whether only
6 the warranty provisions might be made applicable when non-goods aspects predominate,
7 suggested in Note 3.

8
9 * * *

10 **ARTICLE 2A**

11 **LEASES**

12 **Section 2A-102. Scope.**

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

15 (2) If the predominant purpose of a transaction is to create a lease, this Article applies to
16 the transaction.

17 (3) If a transaction includes a lease but the predominant purpose of the transaction is not
18 to create a lease, the provisions of this Article that relate solely to goods apply.

19 **Official Comment**

20 * * *

21 In some transactions, the transfer of the right to possession and use of goods for a term in
22 return for consideration, i.e., a lease, is part of a larger transaction. The other aspects of the
23 transaction might involve the provision of services or a transfer of rights to property other than
24 goods. In such a situation because the transaction includes a lease, subsection (3) applies and the
25 provisions of this Article dealing solely with the goods apply. For example, these provisions
26 include those relating to: warranties under Sections 2A-211, 2A-212, 2A-213, 2A-214, 2A-215,
27 2A-216; risk of loss under Sections 2A-219, 2A-220, 2A-221; acceptance, rejection, and cure
28 under Sections 2A-509, 2A-510, 2A-511, 2A-512, 2A-513; and finance leases, under Section 2-
29 209; 2A-407. See generally the comment to Section 2-102.

30
31 **Reporter's Note**

32
33 *"Bundled" transactions; "predominant purpose" and "gravamen" approaches.* The
34 discussion in the Reporter's Note to draft § 2-102 generally applies to this section.

1 * * *
2

3 **Reporter’s Prefatory Note to Payments Amendments**

4 The changes relating to payments address both statutory text and official comments and
5 concern the following five topics:
6

7 *Negotiability.* An amendment to § 3-104 specifies that negotiability is not negated by the
8 inclusion of either a choice-of-law term or a choice-of-forum term in an instrument.
9

10 *Remote Deposit Capture.* Amendments to §§ 3-105 and 3-604, and to the official
11 comments to §§ 3-309 and 4-207, clarify that an instrument is “issued,” if a drawer sends an
12 image of and information describing an item, but never delivers the item.
13

14 *Scope of Article 4A – Definition of Payment Order.* An amendment to the official
15 comment to § 4A-104 (which includes the comments to § 4A-103) clarifies when an instruction
16 sent pursuant to a so-called “smart contract” constitutes a payment order.
17

18 *References to a “Writing.”* Amendments to §§ 4A-202, 4A-203, 4A-207, 4A-208 and
19 4A-305 change the references to a “writing” to an “authenticated record.”
20

21 *Security Procedures.* Amendments to §§ 4A-201 and 4A-202, and to the official
22 comment to § 4A-203, clarify that: (i) a security procedure may impose obligations on the
23 receiving bank, the customer, or both; (ii) a security procedure may require the use of symbols,
24 sounds, or biometrics; and (iii) a requirement that a payment order be sent from a known email
25 address, IP address, or phone number is not by itself a security procedure.
26

27 **ARTICLE 3**

28 **NEGOTIABLE INSTRUMENTS**

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

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

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

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

2 (3) does not state any other undertaking or instruction by the person promising or
3 ordering payment to do any act in addition to the payment of money, but the promise or order
4 may contain (i) an undertaking or power to give, maintain, or protect collateral to secure
5 payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose
6 of collateral, ~~or~~ (iii) a waiver of the benefit of any law intended for the advantage or protection of
7 an obligor; (iv) a term that specifies the law that governs the promise or order; or (v) an
8 undertaking to resolve in a specified forum a dispute concerning the promise or order.

9 Official Comment

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

1 instrument.” This follows former Section 3-102(1)(e) which treated the two terms as
2 synonymous.

3
4 * * *

5
6 **Section 3-105. Issue of Instrument.**

7 (a) “Issue” means:

8 (1) the first delivery of an instrument by the maker or drawer, whether to a holder
9 or nonholder, for the purpose of giving rights on the instrument to any person; or

10 (2) if agreed by the payee, first transmission by the drawer to the payee of an
11 image of an item and information derived from the item [in a manner] that enables the depository
12 bank to collect the item by transferring or presenting under federal law an electronic check.

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

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

19 **Official Comment**

20
21 1. Under former Section 3–102(1)(a) “issue” was defined as the first delivery to a “holder
22 or a remitter” but the term “remitter” was neither defined nor otherwise used. In revised Article
23 3, Section 3–105(a) defines “issue” more broadly to include the first delivery to anyone by the
24 drawer or maker for the purpose of giving rights to anyone on the instrument. “Delivery” with
25 respect to instruments is defined in ~~Section 1–201(14)~~ Section 1-201(b)(15) as meaning
26 “voluntary transfer of possession.”

27
28 Subsection (a) permits an instrument to be issued by an electronic transmission of an
29 image of and information derived from the instrument by maker and drawer, rather than by
30 delivery. Thus, for example, a drawer might, with the permission of the payee, write and sign a
31 check, take a photograph of the check, send the photograph to the drawee for processing
32 electronically, and destroy the original check. If the electronic image and the information derived
33 from it can be processed as an “electronic check” under Regulation CC, see 12 C.F.R.

1 conflicting security interests in the same collateral being governed by a different priority rule.
2 *The Drafting Committee plans to reconsider the approach.*

3
4 2. *Multiple authoritative tangible copies.* Like existing law, paragraph (5) assumes that
5 all the authoritative tangible copies are located in the same jurisdiction.

6
7 * * *

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

11 **(a) [Governing law: general rules.]** Except as provided in subsection (b), the local law
12 of the controllable electronic record's jurisdiction as specified in Section 12-107(c) [and (d)]
13 governs perfection, the effect of perfection or nonperfection, and the priority of a security
14 interest in a controllable account, controllable electronic record, or controllable payment
15 intangible.

16 **(b) [Governing law: perfection by filing.]** The local law of the jurisdiction in which the
17 debtor is located governs:

18 (1) perfection of a security interest in a controllable electronic record by filing;
19 and

20 (2) automatic perfection of a security interest in a controllable payment intangible
21 created by a sale of the controllable payment intangible.

22 **[(c) [Location of debtor.]** In an action in which the location of the debtor is in issue for
23 purposes of subsection (b), if the evidence is not sufficient to establish the location of the debtor,
24 the debtor is located in the District of Columbia.]

25 **Reporter's Note**

26
27 1. *Perfection by control and priority.* Subsection (a) deals with perfection of a security
28 interest in a controllable account, controllable electronic record, or controllable payment

1 intangible other than by filing—i.e., perfection by control under draft § 12-105—and priority.
2 For these purposes the governing law is that of the controllable electronic record’s jurisdiction
3 under draft § 12-107(c) [and (d)].
4

5 2. *Perfection by filing.* Under subsection (b) the local law of jurisdiction of the debtor’s
6 location governs perfection of a security interest in a controllable electronic record by filing (but
7 not priority, as to which subsection (a) would apply). The same jurisdiction’s law applies to
8 perfection by filing for controllable accounts and controllable payment intangibles pursuant to
9 the general rule in Section 9-301(1).
10

11 3. *Location of debtor in District of Columbia.* As with the approach in draft § 12-107(c)
12 and (d), subsection (c) would locate the debtor in the District of Columbia when a tribunal lacks
13 sufficient evidence to determine the actual location of a debtor. Subsection (c) appears in square
14 brackets to indicate that the Drafting Committee has yet to determine whether it should be
15 included. One view is that, for purposes of perfection by filing, there is no need to address the
16 situation in which the debtor’s location is undetermined and subsection (c) is unnecessary. In
17 such a case, a secured party could not perfect its security interest by filing and control would be
18 the only available perfection method. Another view is that there is no downside to providing for
19 perfection by filing in the District of Columbia and subsection (c) should be included. The
20 rationale for permitting such a filing is similar to that supporting the location of a debtor in the
21 District of Columbia under Section 9-307(c). If subsection (c) is adopted, then subsection (b)
22 should be modified to include controllable accounts and controllable payment intangibles.
23

24 **Section 9-307. Location of Debtor.**

25 * * *

26 (b) **[Debtor’s location: general rules.]** Except as otherwise provided in this section[
27 and Section 9-306A(c)], the following rules determine a debtor’s location:

28 (1) A debtor who is an individual is located at the individual’s principal residence.

29 (2) A debtor that is an organization and has only one place of business is located
30 at its place of business.

31 (3) A debtor that is an organization and has more than one place of business is
32 located at its chief executive office.

33 * * *

34 **Reporter’s Note**

35 *Exception for draft § 9-306A(c).* If draft § 9-306A(c) is adopted, then the exception that

1 appears in square brackets in subsection (b) of this section should be adopted as well.

2
3 * * *

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

7 * * *

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

10 * * *

11 (8) in controllable accounts, controllable electronic records, controllable payment
12 intangibles, deposit accounts, ~~electronic chattel paper~~, electronic documents, investment
13 property, or letter-of-credit rights which is perfected by control under Section 9-314;

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

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

16 (11) in chattel paper which is perfected by possession and control under Section
17 9-314A.

18 **Reporter's Note**

19 *Exceptions to perfection by filing.* Exceptions to perfection by filing have been added for
20 controllable accounts, controllable electronic records, and controllable payment intangibles
21 (perfection by control) and for chattel paper (perfection by possession and control).
22

23 * * *

24 **Section 9-312. Perfection of Security Interests in Chattel Paper, Controllable**
25 **Accounts, Controllable Electronic Records, Controllable Payment Intangibles, Deposit**
26 **Accounts, Negotiable Documents, Goods Covered by Documents, Instruments,**

1 **Investment Property, Letter-of-Credit Rights, and Money; Perfection by Permissive**
2 **Filing; Temporary Perfection Without Filing or Transfer of Possession.**

3 (a) **[Perfection by filing permitted.]** A security interest in chattel paper, controllable
4 accounts, controllable electronic records, controllable payment intangibles, ~~chattel paper,~~
5 negotiable documents, instruments, ~~or investment property, or negotiable documents~~ may be
6 perfected by filing.

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

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

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

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

15 (4) a security interest in electronic money may be perfected only by control under
16 Section 9-314.

17 **Reporter's Note**

18 *Perfection for controllable accounts, controllable electronic records, controllable*
19 *payment intangibles, tangible money, and electronic money.* Perfection for controllable accounts,
20 controllable electronic records, and controllable payment intangibles may be by filing, for
21 tangible money may be only by possession, and for electronic money may be only by control.
22

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

25 (a) **[Perfection by possession or delivery.]** Except as otherwise provided in subsection

26 (b), a secured party may perfect a security interest in ~~tangible negotiable documents,~~ goods,

1 instruments, negotiable tangible documents, or tangible money, ~~or tangible chattel paper~~ by
2 taking possession of the collateral. A secured party may perfect a security interest in certificated
3 securities by taking delivery of the certificated securities under Section 8-301.

4 * * *

5 **Reporter's Note**

6
7 *Perfection by possession.* Perfection by possession of tangible chattel paper has been
8 deleted from this section. Instead, perfection by possession and control would be governed by
9 new Section 9-314A.

10

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

12 (a) **[Perfection by control.]** A security interest in ~~investment property, deposit accounts,~~
13 ~~letter-of-credit rights,~~ controllable accounts, controllable electronic records, controllable
14 payment intangibles, electronic chattel paper, or electronic documents deposit accounts,
15 electronic documents, electronic money, investment property, or letter-of-credit rights, may be
16 perfected by control of the collateral under Section 7-106, 9-104, ~~9-105,~~ 9-105A, 9-106, ~~or 9-~~
17 107, or 9-107A.

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

19 A security interest in controllable accounts, controllable electronic records, controllable payment
20 intangibles, deposit accounts, ~~electronic chattel paper, letter-of-credit rights,~~ ~~or~~ electronic
21 documents, electronic money, or letter-of-credit rights is perfected by control under Section 7-
22 106, 9-104, ~~9-105,~~ 9-105A, ~~or 9-107,~~ or 9-107A when the secured party obtains control and
23 remains perfected by control only while the secured party retains control.

24 **Reporter's Note**

25

26 *Perfection by control.* Perfection by control of controllable accounts, controllable
27 electronic records, controllable payment intangibles, and electronic money has been added to this
28 section. Perfection by control of electronic chattel paper has been deleted from this section.
29 Instead, draft § 9-314A would govern perfection for chattel paper by possession and control.

1 copies are authoritative and which are not.

2

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

4

5 3. *Applicability of Section 9-313.* New subsection (c) makes specified subsections of
6 Section 9-313 applicable to possession of tangible authoritative copies of records evidencing
7 chattel paper.

8

9 * * *

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

12 (a) [General rule: effect on perfection of change in governing law.] A security
13 interest perfected pursuant to the law of the jurisdiction designated in Section 9-301(1), ~~or 9-~~
14 ~~305(c), or 9-306A(b)~~ remains perfected until the earliest of:

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

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

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

20 * * *

21 (f) [Change in jurisdiction of controllable electronic record, bank, issuer, nominated
22 person, securities intermediary, or commodity intermediary.] A security interest in
23 controllable accounts, controllable electronic records, controllable payment intangibles, deposit
24 accounts, letter-of-credit rights, or investment property which is perfected under the law of the
25 controllable electronic record's jurisdiction, the bank's jurisdiction, the issuer's jurisdiction, a
26 nominated person's jurisdiction, the securities intermediary's jurisdiction, or the commodity
27 intermediary's jurisdiction, as applicable, remains perfected until the earlier of:

1 (1) the time the security interest would have become unperfected under the law of
2 that jurisdiction; or

3 (2) the expiration of four months after a change of the applicable jurisdiction to
4 another jurisdiction.

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

12 * * *

13 **Reporter's Note**

14
15 *Change in controllable electronic record's jurisdiction.* A change in the controllable
16 electronic record's jurisdiction has been added to this section to conform to the treatment for
17 other collateral subject to similar rules on governing law. *See* draft §§ 9-306A and 12-107.

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

21 * * *

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

1 * * *

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

7 * * *

8 **(f) [Buyers of chattel paper.]** A buyer[, other than a secured party,] of chattel paper
9 takes free of a security interest if, without knowledge of the security interest and before it is
10 perfected, the buyer gives value and receives delivery of the authoritative tangible copy of the
11 record evidencing the chattel paper and obtains control of the authoritative electronic copy of the
12 record evidencing the chattel paper.

13 **Reporter's Note**

14
15 *New rule for buyers of chattel paper.* The new take-free rule for buyers of chattel paper
16 reflects the corresponding changes in the definition of chattel paper and methods of perfection.
17 See draft §§ 9-102(a)(11) (defining “chattel paper”); 9-314A (perfection by possession and
18 control). Because this subsection applies only to chattel paper, the Drafting Committee should
19 consider whether the reference to “other than a secured party,” which appears in square brackets,
20 should be deleted.

21 * * *

22
23 **Section 9-326A. Priority of Security Interests in Controllable Account,**
24 **Controllable Electronic Record, and Controllable Payment Intangible.** A security
25 interest in a controllable account, controllable electronic record, or controllable payment
26 intangible held by a secured party having control of the account, electronic record, or payment
27 intangible has priority over a conflicting security interest held by a secured party that does not
28 have control.

1 **Reporter’s Note**

2
3 *Control priority.* This section adopts an approach to priority in controllable accounts,
4 controllable electronic records, and controllable payment intangibles that is similar to the
5 approach of Sections 9-327 (deposit accounts) and 9-328 (investment property): A security
6 interest perfected by control has priority over conflicting security interests that are not perfected
7 by control.

8
9 * * *

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

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

14 (1) in good faith and in the ordinary course of the purchaser’s business, the
15 purchaser gives new value and takes possession of the authoritative tangible copy of the record
16 evidencing the chattel paper ~~or~~ and obtains control under Section 9-105 of the authoritative
17 electronic copy of the record evidencing the chattel paper ~~under Section 9-105~~; and

18 (2) ~~the chattel paper does~~ authoritative copy of the record evidencing the chattel
19 paper does not indicate that ~~it has~~ the copy has been assigned to an identified assignee other than
20 the purchaser.

21 (b) **[Purchaser’s priority: other security interests.]** A purchaser of chattel paper has
22 priority over a security interest in the chattel paper which is claimed other than merely as
23 proceeds of inventory subject to a security interest if the purchaser gives new value and takes
24 possession of the authoritative tangible copy of the record evidencing the chattel paper ~~or~~ and
25 obtains control under Section 9-105 of the authoritative electronic copy of the record evidencing
26 the chattel paper ~~under Section 9-105~~ in good faith, in the ordinary course of the purchaser’s
27 business, and without knowledge that the purchase violates the rights of the secured party.

1 * * *

2 **Reporter’s Note**

3
4 *New rule for buyers of chattel paper.* The revisions to the rules for purchasers of chattel
5 paper reflect the corresponding changes in the definition of chattel paper and methods of
6 perfection. See draft §§ 9-102(a)(11) (defining “chattel paper”); 9-314A (perfection by
7 possession and control).

8
9 **Section 9-331. Priority of Rights of Purchasers of Controllable Accounts,**
10 **Controllable Electronic Records, Controllable Payment Intangibles, Instruments,**
11 **Documents, Instruments, and Securities Under Other Articles; Priority of Interests in**
12 **Financial Assets and Security Entitlements and Protections Against Assertions of**
13 **Claims Under ~~Article 8~~ Articles 8 and 12.**

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

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

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

25 **Reporter’s Note**

26
27 *Purpose of this section.* The revisions of this section ensure that Article 9 does not
28 interfere with the protections that Article 12 affords to qualifying purchasers under the take-free
29 and no-action rules in draft § 12-104(d) and (f).

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

2 (a) [**Transferee of tangible money.**] A transferee of tangible money takes the money
3 free of a security interest ~~unless the transferee acts~~ in the money if the transferee when receiving
4 delivery of the money does not act in collusion with the debtor in violating the rights of the
5 secured party.

6 (b) [**Transferee of electronic money.**] A transferee of electronic money takes the money
7 free of a security interest unless the transferee acts in the money if the transferee when obtaining
8 control of the money does not act in collusion with the debtor in violating the rights of the
9 secured party.

10 ~~(b)~~(c) [**Transferee of funds from deposit account.**] A transferee of funds from a
11 deposit account takes the funds free of a security interest in the deposit account ~~unless the~~
12 ~~transferee acts~~ if the transferee when receiving the funds does not act in collusion with the debtor
13 in violating the rights of the secured party.

14 **Reporter’s Note**

15
16 1. *“Delivery” of tangible money; “control” of electronic money.* Conditioning the takes-
17 free rule of subsection (a) on delivery of money reflects what has always been assumed—that a
18 transfer of an interest in money that is not accompanied by a physical delivery would not impair
19 the rights of third parties. Inasmuch as “electronic money” is a new classification, no pattern of
20 past practices or understandings exists. New subsection (b) provides a rule for electronic money
21 that complements draft subsection (a) by conditioning the takes-free rule on the transferee
22 obtaining control.

23
24 2. *Transferees of funds from deposit account.* Similarly, the revisions to subsection (c)
25 (formerly subsection (b)) make a corresponding change for a transfer of funds from a deposit
26 account. To qualify for the take-free protection under subsection (c), the transferee must
27 “receive[] the funds without acting in collusion [etc.] . . .” The draft amendments to Section 9-
28 332(a) and (c) are intended to clarify what is implicit under the original text.

29
30 3. *Meaning of “transfer”.* A “transfer” of property occurs when the transferee has
31 obtained a property interest in the relevant property. *See* Section 9-102, Comment 26 (“In
32 numerous provisions, this Article refers to the “assignment” or the “transfer” of *property*
33 interests.” (emphasis added)). Other law determines when the transferee has acquired a property

1 interest. See Section 9-408, Comment 3 (“Other law determines whether a debtor has a property
2 interest (‘rights in the collateral’) and the nature of that interest.”). Although the terms “transfer”
3 and “transferee” are not defined in the UCC, the term “transfer” is broader in scope than
4 “purchase,” which requires taking in a “voluntary transaction creating an interest in property.”
5 Section 1-201(29). For example, “transfer” includes involuntary transfers such as the acquisition
6 of a judicial lien by a lien creditor. See Section 9-102(a)(52) (defining “lien creditor”).
7

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

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

31 * * *

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

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

1 has been assigned and that payment is to be made to the assignee. After receipt of the
2 notification, the account debtor may discharge its obligation by paying the assignee and may not
3 discharge the obligation by paying the assignor.

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

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

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

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

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

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

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

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

23 * * *

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

3 (h) **[Rule for individual under other law.]** This section is subject to law other than this
4 article which establishes a different rule for an account debtor who is an individual and who
5 incurred the obligation primarily for personal, family, or household purposes.

6 (i) **[Inapplicability to health-care-insurance receivable.]** This section does not apply to
7 an assignment of a health-care-insurance receivable.

8 (j) **[Section prevails over specified inconsistent law.]** This section prevails over any
9 inconsistent provisions of the following statutes, rules, and regulations:

10 [List here any statutes, rules, and regulations containing provisions
11 inconsistent with this section.]

12 (k) **[Inapplicability to interests in certain entities.]** Subsections (d), (f),
13 and (j) do not apply to a security interest in an ownership interest in a general
14 partnership, limited partnership, or limited liability company.

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

17 ***Legislative Note:*** States that amend statutes, rules, and regulations to remove provisions
18 *inconsistent with this section need not enact subsection (j)*
19

20 **Reporter's Note**

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

24 * * *
25

26 **Section 9-601. Rights After Default; Judicial Enforcement; Consignor or Buyer**

1 **of Accounts, Chattel Paper, Payment Intangibles, or Promissory Notes.**

2 * * *

3 (b) **[Rights and duties of secured party in possession or control.]** A secured party in
4 possession of collateral or control of collateral under Section 7-106, 9-104, 9-105, 9-105A, 9-
5 106, ~~or 9-107~~, or 9-107A has the rights and duties provided in Section 9-207.

6 * * *

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

8 (a) A Except as provided in subsection (b), a secured party does not owe a duty based on
9 its status as secured party:

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

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

12 (B) the identity of the person; and

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

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

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

17 (B) the identity of the person.

18 **(b) [When secured party owes duty to debtor notwithstanding subsection (a).] A**
19 **secured party owes a duty based on its status as a secured party to a person that is a debtor if, at**
20 **the time the secured party obtains control of a controllable account, controllable electronic**
21 **record, or controllable payment intangible, the secured party has [notice] [knowledge] that the**
22 **nature of the collateral or a system in which the collateral is recorded would prevent the secured**
23 **party from acquiring the knowledge specified in subsection (a)(1)(A), (B), or (C).**

1 * * *

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

3 **Liability of Secondary Obligor.**

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

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

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

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

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

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

15 (B) the identity of the person; and

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

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

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

20 (B) the identity of the person.

21 * * *

22 **(f) [When secured party owes duty to debtor notwithstanding subsection (b).] A**

23 secured party owes a duty based on its status as a secured party to a person that is a debtor if, at

1 the time the secured party obtains control of a controllable account, controllable electronic
2 record, or controllable payment intangible, the secured party has [notice] [knowledge] that the
3 nature of the collateral or the system in which the collateral is recorded, if any, would prevent the
4 secured party from acquiring the knowledge specified in subsection (b)(1)(A), (B), or (C).

5 **Reporter’s Note to Draft §§ 9-605 and 9-628**

6
7 *Liability to unknown persons.* Practices are developing under which lenders extend
8 secured credit without knowing, or having the ability to discover, the identity of their borrowers.
9 Existing Sections 9-605 and 9-628 would excuse these secured parties from having duties to their
10 debtors, including, *e.g.*, the duty to notify the debtor before disposing of the collateral and the
11 duty to account to the debtor for any surplus arising from a disposition. In many cases these
12 debtors may be aware that their identities are unknown to their secured parties. By failing to
13 make their identities and contact information known, these debtors are knowingly preventing
14 their secured parties from complying with their duties under Article 9. However, such debtor
15 complicity notwithstanding, if secured parties were relieved of their duties in these
16 circumstances, arguably it would conflict with the policy of Section 9-602, which prohibits a
17 waiver or variance of many rights of debtors and duties of secured parties.
18

19 Comment 2 to Section 9-628 observes, “[w]ithout this group of provisions [in Sections 9-
20 605 and 9-628], a secured party could incur liability to unknown persons and under
21 circumstances that would not allow the secured party to protect itself.” That comment also notes
22 that “[t]he broadened definition of the term ‘debtor’ underscores the need for these provisions.”
23 For example, a debtor may dispose of collateral subject to a security interest, resulting in the
24 transferee becoming a debtor, but the secured party may have no knowledge of the disposition or
25 that the transferee has become a debtor. In that situation the secured party will have no means of
26 giving notice to or accounting to the transferee debtor. Sections 9-605 and 9-628 contemplate
27 such situations by relieving the secured party of its duties to the debtor.
28

29 The draft amendments to Sections 9-605 and 9-628 reflect the policy that a secured party
30 should not be free to avoid statutory duties or absolve itself from liability to a debtor when the
31 secured party has [notice] [knowledge] that the nature of the collateral or any system in which
32 the collateral is recorded would prevent the secured party from acquiring the knowledge
33 necessary to fulfill its statutory duties. As discussed in the following paragraph, this
34 [notice][knowledge] enables the secured party to protect itself from being in breach of these
35 duties. *The Drafting Committee will consider further whether the standard should be “notice” or*
36 *“knowledge.”* (A person has notice of a fact if, *inter alia*, from all the facts and circumstances
37 known to the person at the time in question, has reason to know that it exists. Section 1-
38 202(a)(3). A person has knowledge of a fact if it has “actual knowledge.” Section 1-202(b).).
39 The exceptions from the exculpatory protections otherwise afforded to secured parties are
40 determined by the secured party’s [notice] [knowledge] at the time the secured party obtains
41 control of a controllable account, controllable electronic record, or controllable payment
42 intangible.

1 Obtaining control serves as a rough proxy for the context in which a secured party may
2 have notice or knowledge that it will be unable to comply with its duties, usually because the
3 transferor is anonymous. The carve-out from the exculpatory protection is limited to duties owed
4 to a debtor—the transferor of a controllable account, controllable electronic record, or
5 controllable payment intangible over which the secured party obtains control. The secured party
6 in such situations could protect itself by choosing not to enter into a transaction in which it
7 would be unable to comply with its statutory duties or by conditioning its participation on
8 disclosure of the debtor’s identity and contact information. Ideally, systems providing for the
9 transfer of controllable electronic records would provide mechanisms that would permit
10 compliance with such duties (such as methods of communication and payments that would
11 preserve a debtor’s anonymity, where that is desired).
12

13 Secured parties that enter into transactions with [notice] [knowledge] that they will not be
14 able to comply with their Article 9 duties do so at their own peril. Note, however, that the
15 limitation on a secured party’s relief from duties and liability relates only to secured transactions
16 involving controllable accounts, controllable electronic records, or controllable payment
17 intangibles. Designing systems for these assets that would afford secured parties with the
18 opportunities to comply with their Article 9 duties, as suggested above, could eliminate the risks
19 to secured parties and also provide for the protection of debtors’ rights.

20
21 * * *

22 **ARTICLE 12**

23 **CONTROLLABLE ELECTRONIC RECORDS**

24 **Reporter’s Prefatory Note to Article 12**

25 1. *Introduction to controllable electronic records.* New UCC Article 12, which deals with
26 controllable electronic records, and the conforming amendments to Articles 1 and 9 are a major
27 part of the effort to adapt the UCC to emerging technologies as they might affect electronic
28 commerce.
29

30 Article 12 creates a legal regime that is meant to apply more broadly than to electronic
31 (intangible) assets that are created using existing technologies such as distributed ledger
32 technology (DLT), including blockchain technology, which powers transactions in bitcoin and
33 other digital assets. It also aspires to apply to electronic assets that may be created using
34 technologies that have yet to be developed, or even imagined.
35

36 The adoption of DLT has underscored two important trends in electronic commerce.
37 First, people have begun to assign economic value to some electronic records that bear no
38 relationship to extrinsic rights and interests. For example, without any law or binding agreement,
39 people around the world have agreed to treat virtual currencies such as bitcoin (or, more
40 precisely “transaction outputs” generated by the Bitcoin protocol) as a medium of exchange and
41 store of value. Second, people are using the creation or transfer of electronic records to transfer
42 rights to receive payment, rights to receive performance of other obligations (*e.g.*, services or

1 delivery of goods), and other interests in personal and real property.

2
3 These trends will inevitably result in disputes among claimants to electronic records and
4 their related rights and other benefits. Uncertainty as to the criteria for resolving these claims
5 creates commercial risk. The magnitude of these risks will grow as these trends continue.

6
7 As explained in more detail below, draft Article 12 is designed to reduce these risks by
8 providing the legal rules governing the transfer—both outright and for security—of interests in
9 some, but not all, electronic records (*controllable electronic records*). These rules specify the
10 rights in a controllable electronic record that a purchaser would acquire. Many systems for
11 transferring controllable electronic records are pseudonymous, so that the transferee of a
12 controllable electronic record is unable to verify the identity of the transferor or the source of the
13 transferor’s title. Accordingly, the Article 12 rules would make controllable electronic records
14 negotiable, in the sense that a good faith purchaser for value would take a controllable electronic
15 record free of third-party claims of a property interest in the controllable electronic record.

16
17 Experience with DLT and other records-management systems has established some
18 general functions required for electronic records to serve as an effective and reliable means of
19 transferring economic value.

- 20
21
- 22 • The electronic record must have some “use” that one person can enjoy to the
23 exclusion of all others, *e.g.*, the power to “spend” a bitcoin (or, more precisely,
24 the power to include an unspent transaction output (a UTXO) in a message that
25 the Bitcoin protocol will record to its blockchain).
 - 26 • A person must be able to transfer to another person this exclusive power to use
27 the electronic record. To remain exclusive, the transfer must divest the transferor
28 of the power to use the electronic record.
 - 29 • A person must be able to demonstrate to others that the person has the power to
30 “use” the electronic record.
- 31
32

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

40
41 Article 12 governs the rights of transacting parties and the rights of persons that might be
42 affected by the transactions. With the important exception of certain rights to payment evidenced
43 by a controllable electronic record (discussed below), Article 12 does not govern assets other
44 than controllable electronic records. Like the UCC in general, Article 12 is not a regulatory
45 statute. The fact that an asset is or is not a controllable electronic record under the UCC would
46 not necessarily affect the application of laws regulating securities, commodities, or money

1 transmission.

2
3 2. *What is the scope of draft Article 12?*
4

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

15 To determine whether Article 12 applies to a particular asset, *e.g.*, bitcoin, one must
16 determine whether the asset falls within the definition of *controllable electronic record*. A
17 controllable electronic record is a *record*, as the UCC defines the term. A *record* is information
18 that is retrievable in perceivable form.² A *controllable electronic record* is a record that is stored
19 in an electronic medium³ and that can be subjected to *control*, as defined in draft § 12-105. An
20 electronic record that cannot be subjected to control under draft § 12-105 is outside the scope of
21 Article 12.
22

23 The meaning of *control* in the UCC depends on the type of property involved.⁴ The
24 Reporter's Note accompanying draft § 12-105 explains the requirements for obtaining control of
25 a controllable electronic record. For present purposes, it is sufficient to think of bitcoin as the
26 prototypical controllable electronic record.
27

28 The existing law that governs control for some types of electronic records (including
29 provisions on control for some types that are proposed to be modified in this draft) is sufficient.
30 These electronic records are excluded from Article 12.⁵
31

32 3. *What are the substantive provisions of Article 12?*
33

34 The principal function of Article 12 is to specify the rights of a *purchaser* of a
35 controllable electronic record. A purchaser is a person that acquires an interest in property by a
36 voluntary transaction, such as a sale.⁶ Law other than Article 12 would determine whether a

² See UCC § 1-201(b)(31).

³ See draft § 12-102(a)(2) (defining "electronic record").

⁴ *E.g.*, UCC § 7-106 (electronic documents of title); § 8-106 (four different types of investment property, each with a different definition of "control"); § 9-104 (deposit accounts); § 9-105 (electronic chattel paper).

⁵ See draft § 12-102(a)(1) (defining "controllable electronic record").

⁶ "'Purchase' means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property." UCC § 1-201(b)(29).

1 person acquires any rights in a controllable electronic record and so would be eligible to be a
2 purchaser.
3

4 Draft § 12-104 adopts the “shelter” principle, under which a purchaser of a controllable
5 electronic record acquires whatever rights the transferor had or had power to transfer. This rule
6 appears in Article 2 with respect to goods and Article 8 with respect to securities.⁷
7

8 The ability to take a controllable electronic record free of third-party property claims
9 appears to be necessary for a controllable electronic record to have commercial utility. As is the
10 case with Articles 2, 3, 7, and 9, Article 12 would facilitate commerce by affording to certain
11 good-faith purchasers for value greater rights than their transferors had or had power to transfer.⁸
12 Draft Article 12 refers to these purchasers as *qualifying purchasers*. Qualifying purchasers are
13 purchasers that obtain control of a controllable electronic record for value, in good faith, and
14 without notice of any claim of a property interest in the controllable electronic record. Like a
15 holder in due course of a negotiable instrument, a qualifying purchaser of a controllable
16 electronic record takes the controllable electronic record free of property claims.
17

18 Consider the case in which *B* contracts to buy bitcoin from *S*. Assume that *S* is the owner
19 of the bitcoin.
20

- 21 • Law other than Article 12 generally would determine whether *S* is the owner of
22 the bitcoin.
- 23
- 24 • Law other than Article 12 would resolve issues concerning the formation of the
25 contract of sale between *B* and *S* and the obligations of the parties under the
26 contract.
27
- 28 • Law other than Article 12 would determine what steps are necessary for *B* to
29 acquire rights in the bitcoin.⁹
30
- 31 • By acquiring rights in the bitcoin by sale, *B* would become a *purchaser* of the
32 bitcoin within the meaning of UCC Article 1.
33
- 34 • Article 12 provides that if *B* becomes a purchaser, *B* will acquire whatever rights
35 *S* had or had power to transfer. As a general matter, law other than Article 12

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

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

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

1 would define these rights. *B* would acquire these rights regardless of whether *B*
2 obtained control of the bitcoin.

3
4 Now assume that *S* is a hacker, who acquired the bitcoin illegally from the owner, *O*.

- 5
6
- 7 • Just as a buyer of goods can obtain possession from a seller that has no rights in
8 the goods, *B* can obtain control of the bitcoin, even if *S* “stole” it from the owner.
 - 9 • If *B* obtains control of the bitcoin for value, in good faith, and without notice of
10 any claim of a property interest, *B* would be a *qualifying purchaser*.
 - 11 • Even if *B* would not have acquired any rights in the bitcoin under non-Article 12
12 law, as an Article 12 qualifying purchaser, *B* would acquire the bitcoin free of all
13 claims of a property interest in the bitcoin. In the unlikely event that *O* could
14 locate *B*, *B* would defeat *O*’s claim of ownership and own the bitcoin free and
15 clear. (The same result would obtain if *B* bought a negotiable instrument from a
16 thief under circumstances where *B* became a holder in due course.)
17

18
19 4. How would Article 12 deal with rights or property that is linked to a controllable
20 electronic record?

21
22 a. The general rules.

23
24 Recall that a controllable electronic record is a record, *i.e.*, information. Some records
25 have what one might call “inherent value” solely because the market treats them as having value
26 Bitcoin would be an example of such a record . Bitcoin can be exchanged (sold) for cash or other
27 valuable assets. Or, the owner of bitcoin can hold the bitcoin as an investment.
28

29 The value of many (if not most) records, however, is as evidence of the rights of the
30 parties to a transaction. In these situations, it is essential to differentiate between the *record* and
31 the *rights* that are evidenced by the record.
32

33 Suppose, for example, that *S* and *B* enter into a written contract for the sale of 100 air
34 purifiers. The contract provides that at a specified time in the future, *S* is to deliver the goods and
35 *B* is to pay for them. *B* may sell (assign) to *P* the right to receive delivery of the goods from *S*. *P*
36 has acquired a valuable asset, *i.e.*, the right to receive delivery.
37

38 In contrast, if *B* sells to *P* only the paper (record) on which the contract is written, *P*
39 might or might not acquire the right to delivery of the goods, depending on whether applicable
40 law treats the sale of the paper as an assignment of the right to delivery. *P* would become the
41 owner of the paper in any event, but the paper itself may be of little value.
42

43 If the contract for the sale of air purifiers were electronic rather than written, the same
44 analysis would apply. The *right* evidenced by the electronic record (*i.e.*, *B*’s right to receive
45 delivery from *S*) would be the valuable asset, not the *record* itself.
46

1 Suppose that the contract of sale between *B* and *S* is evidenced by a controllable
2 electronic record that *B* sells to *P*. Under draft § 12-104(d), *P* would acquire all rights *in the*
3 *controllable electronic record* that the transferor (*B*) had or had power to transfer. If *P* obtains
4 control of the controllable electronic record for value, in good faith, and without notice of any
5 claim of a property right in the controllable electronic record, *P* will become a *qualifying*
6 *purchaser* and, as such, would acquire its rights *in the controllable electronic record* free of any
7 claim of a property right under draft § 12-104.

8
9 But the controllable electronic record itself may or may not be a valuable asset. In this
10 example, unlike bitcoin, the record would have value to *P* only if by virtue of acquiring rights in
11 the controllable electronic record, *P* would also acquire the right to receive delivery of the goods
12 from *S*.

13
14 Article 12 leaves to other law the question whether *P*'s acquisition of rights in the
15 controllable electronic record gives *P* the right to receive delivery of the goods. We would
16 typically expect that under other law *P* would not acquire the right to receive the goods merely
17 by acquiring rights in the controllable electronic record, any more than *P* would have acquired
18 the right to receive the goods if the record were in paper form and physically delivered to *P*.

19
20 Suppose, however, that other law does provide that, by acquiring the controllable
21 electronic record, *P* would acquire the right to receive delivery of the goods from *S*. Suppose also
22 that *P* becomes a qualifying purchaser of the controllable electronic record. As we have seen, as
23 a qualifying purchaser, *P* would take its rights *in the controllable electronic record* free of
24 property claims. But even though under non-Article 12 law *P* would (as posited) acquire the right
25 to receive delivery of the goods, *P* would not acquire that right free of property claims unless
26 non-Article 12 law were to provide otherwise.

27
28 ***b. The exceptions: controllable accounts and controllable payment intangibles.***

29
30 As a general rule, draft Article 12 applies to records and not to rights evidenced by
31 records (or to rights that records purport to evidence). Law other than Article 12 would
32 determine what steps must be taken for a person to acquire an interest in a controllable electronic
33 record and the rights, if any, that the person acquires in other property as a result of acquiring an
34 interest in the record. This “other” law includes UCC Article 9.

35
36 The draft provides an important exception to this general rule. The exception concerns
37 rights to payment (specifically, accounts and payment intangibles) that are evidenced by a
38 controllable electronic record that provides that the obligor (account debtor) undertakes to pay
39 the person that has control of the controllable electronic record. These rights to payment are
40 referred to as “controllable accounts” and “controllable payment intangibles.”¹⁰

41 The draft amends several sections of Article 9 to deal with other aspects of security
42 interests in controllable accounts and controllable payment intangibles. The Reporter’s Prefatory
43 Note to Article 9 Amendments and the Reporter’s Notes to those sections discuss those
44 amendments.

¹⁰ See draft § 9-102(b) (defining “controllable account” and “controllable payment intangible”).

1 Finally, Section 12-107 provides rules on governing law. The general rule under
2 subsection (a) is that a “controllable record’s jurisdiction” governs matters covered by Article 12.
3 The controllable record’s jurisdiction is determined by an express provision in the record or in
4 the system in which the record is recorded. If not so designated, it is determined based on the
5 designation of the law governing the record or the system. Absent such designations, at the
6 bottom of this “waterfall” of alternatives, the governing law will be that of the jurisdiction of the
7 location of the transferor. Subsection (b) provides an exception for the rights and duties of
8 account debtors under draft § 12-106 if an agreement between the account debtor and an assignor
9 of the record provides for the law of another jurisdiction to govern those rights and duties.

10
11 **Section 12-101. Title.** This article may be cited as Uniform Commercial Code—
12 Controllable Electronic Records.

13 **Official Comment**

14 Subsection headings are not a part of the official text itself and have not been approved
15 by the sponsors.

16 **Section 12-102. Definitions.**

17 (a) [Article 12 definitions.] In this article:

18 (1) “Controllable electronic record” means a record stored in an electronic
19 medium that can be subjected to control under Section 12-105. The term does not include a
20 deposit account, electronic copy of a record evidencing chattel paper, electronic document of
21 title, electronic money, investment property, or a transferable record.

22 (2) “Qualifying purchaser” means a purchaser of a controllable electronic record
23 or an interest in the controllable electronic record that obtains control of the controllable
24 electronic record for value, in good faith, and without notice of a claim of a property right in the
25 controllable electronic record.

26 (3) “Transferable record” means:

27 (A) “Transferable records” as defined in the Electronic Signatures in
28 Global and National Commerce Act, 15 U.S.C. Section 7021(a)(1)[, as amended].

29 (B) “Transferable record” as defined in [cite to Uniform Electronic
30

1 Transactions Act Section 16(a)].

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

3 (b) **[Definitions in Article 9.]** The definitions in Article 9 of “account debtor”,
4 “authenticate”, “controllable account”, “controllable payment intangible”, “chattel paper”,
5 “deposit account”, “electronic money”, and “investment property” apply to this article.

6 **Legislative Note:** *It is the intent of this act to incorporate future amendments to the federal law*
7 *cited in subsection (a)(3)(A). A state in which the constitution or other law does not permit*
8 *incorporation of future amendments when a federal statute is incorporated into state law should*
9 *omit the phrase “, as amended”. A state in which, in the absence of a legislative declaration,*
10 *future amendments are incorporated into state law also should omit the phrase.*

11
12 *In subsection (a)(3)(B), the state should cite to the state’s version of the Uniform Electronic*
13 *Transactions Act Section 16(a) or comparable state law.*

14

15 **Reporter’s Note**

16

17 1. “*Controllable electronic record.*” To be a “controllable electronic record” within the
18 scope of Article 12, an electronic record must be susceptible of control under Section 12-105.
19 Unlike “transferable records” under the Electronic Signatures in Global and National Commerce
20 Act or a “transferable record” under the Uniform Electronic Transactions Act, a record can be a
21 controllable electronic record under Article 12 in the absence of an agreement to that effect.

22

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

29

30 This definition uses the term “record,” defined in Section 1-201 to include “information .
31 . . . that is stored in an electronic or other medium and is retrievable in perceivable form,” and the
32 ULC’s standard definition of “electronic,” which this draft proposes to add to Section 1-201.

33

34 2. “*Qualifying purchaser.*” The conditions for becoming a qualifying purchaser were
35 drawn from Article 3. More specifically, the conditions for becoming a qualifying purchaser
36 were drawn from Section 3-302(a)(2), which defines “holder in due course” of a negotiable
37 instrument. Among these conditions is that a person take the instrument “for value.” As
38 Reporter’s Note 9 to Section 12-104 explains, the concept of value in Article 3 differs from the
39 concept of value that is generally applicable in the UCC. Article 12 adopts the Article 3 concept.

40

41 Under Section 12-104(a), not only a purchaser of a controllable electronic record but also

1 a purchaser of a controllable account or controllable payment intangible may be a qualifying
2 purchaser. Moreover, a purchaser of a controllable account or a controllable payment intangible
3 may be a qualified purchaser even if it does not also purchase the controllable electronic record
4 that evidences the account of payment intangible. However, to obtain control of the controllable
5 account or controllable payment intangible, a requirement for of qualifying purchaser status, the
6 purchaser must obtain control of that controllable electronic record. Draft § 9-107A.

7
8 3. *Transferable record.* This definition facilitates the exclusion of transferable records
9 from the definition of controllable electronic records.

10
11 4. *Value.* The concept of value in Section 3-303 is narrower than the generally
12 applicable concept in Section 1-201. Reporter’s Note 9 to draft § 12-104 explains the difference
13 between the two concepts and that the draft adopts the Article 3 approach.

14
15 **Section 12-103. Scope.**

16 (a) **[Article 9 governs in case of conflict.]** If there is conflict between this article and
17 Article 9, Article 9 governs.

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

23 **Reporter’s Note**

24
25 1. *Source of these provisions.* Subsection (a) follows Section 3-102(b). As is the case
26 with respect to Article 3, Article 9 would defer to Article 12 in some instances. *See* subsection
27 (a) and draft § 9-331. Subsection (b) is copied from Section 9-201.

28
29 2. *Controllable accounts and controllable payment intangibles.* As to controllable
30 accounts and controllable payment intangibles, see Reporter’s Note 4 to draft § 9-102.

31
32 **Section 12-104. Rights in Controllable Account, Controllable Electronic Record,
33 and Controllable Payment Intangible.**

34 (a) **[Applicability of section to controllable account and controllable payment
35 intangible.]** This section applies to the acquisition and purchase of rights in a controllable

1 account or controllable payment intangible, including the rights of a purchaser and a qualifying
2 purchaser and under subsections (c), (d), and (f), in the same manner this section applies to a
3 controllable electronic record.

4 (b) **[Applicability of other law to acquisition of rights.]** Except as provided in this
5 section, law other than this article determines whether a person acquires a right in a controllable
6 electronic record and the right the person acquires.

7 (c) **[Shelter principle and purchase of limited interest.]** A purchaser of a controllable
8 electronic record acquires all rights in the controllable electronic record that the transferor had or
9 had power to transfer, except that a purchaser of a limited interest in a controllable electronic
10 record acquires rights only to the extent of the interest purchased.

11 (d) **[Rights of qualifying purchaser.]** A qualifying purchaser acquires its rights in the
12 controllable electronic record free of a claim of a property right in the controllable electronic
13 record.

14 (e) **[Limitation of rights of qualifying purchaser in other property.]** Except as
15 provided in subsections (a) and (d) for controllable accounts and controllable payment
16 intangibles or law other than this article, a qualifying purchaser takes a right to payment, right to
17 performance, or interest in property evidenced by the controllable electronic record subject to a
18 claim of a property right in the right to payment, right to performance, or other interest in
19 property.

20 (f) **[No-action protection for qualifying purchaser.]** An action may not be asserted
21 against a qualifying purchaser based on both a purchase by the qualifying purchaser of a
22 controllable electronic record and a claim of a property right in another controllable electronic
23 record, [whether framed in conversion, replevin, constructive trust, equitable lien, or other

1 theory] [regardless of how the action is framed].

2 (g) **[Filing not notice.]** Filing of a financing statement under Article 9 is not notice of a
3 claim of a property right in a controllable electronic record.

4 **Reporter’s Note**

5
6 1. *Source of these provisions.* Subsection (b) derives from Section 3-302(a)(2) (defining
7 “holder in due course”).

8
9 Subsection (c) derives from Section 2-403(1) (concerning the rights of a purchaser).

10
11 Subsection (d) derives from Sections 3-306 (concerning the rights of a holder in due
12 course of an instrument) and 8-303 (concerning rights of a protected purchaser of a security).

13
14 Subsection (f) derives from Section 8-502 (protecting entitlement holders) and its
15 applicability to a qualifying purchaser derives from Sections 3-302(b) (concerning notice of a
16 claim) and 3-306 (protecting holder in due course).

17
18 Subsection (g) derives from Section 9-331(c) (filing under Article 9 does not provide
19 notice for purposes of protections of purchasers under other articles).

20
21 2. *Applicability of section to controllable accounts and controllable payment intangibles.*
22 Under subsection (a), the provisions of this section apply to controllable accounts and
23 controllable payment intangibles in the same manner that they apply to controllable electronic
24 records. For example, a qualifying purchaser of a controllable account that obtains control of the
25 controllable electronic record that evidences the account (and who thereby obtains control of the
26 account under Section 9-107A) would take the account free of conflicting rights in the account
27 under subsection (d). Unless otherwise specified or the context otherwise requires, references to
28 a controllable electronic record in the Reporter’s Notes in this Article also refer to a controllable
29 account or controllable payment intangible.

30
31 3. *Applicability of other law.* As a general matter, this section leaves to other law the
32 resolution of questions concerning the transfer of rights in a controllable electronic record, such
33 as the acts that must be taken to effectuate a transfer of rights and the scope of the rights that a
34 transferee acquires. *See* subsection (b). Subsections (c) through (g) contain important exceptions
35 to this subsection.

36
37 **Example:** *A* creates a controllable electronic record. Other law would determine what
38 rights *A* has in the controllable electronic record. *A* and *B* agree to the sale of the
39 controllable electronic record to *B*. Other law would determine what steps need to be
40 taken for *B* to acquire rights in the controllable electronic record. Once *B* acquires those
41 rights, *B* would be a purchaser (as defined in Section 1-201), whose rights would be
42 determined either by subsection (b) or subsections (c) and (d), depending on whether *B*
43 was a qualifying purchaser.

1 The “law other than this article” that may apply to the transfer of rights in a controllable
2 electronic record under subsection (b) includes UCC Article 9. Section 9-203 would apply, for
3 example, to determine whether a purported secured party acquired an enforceable security
4 interest in a controllable electronic record.
5

6 4. *Purchaser and transferor under subsection (c): resulting controllable electronic*
7 *records.* Subsection (c) sets forth the familiar “shelter” principle, under which a purchaser of a
8 controllable electronic record acquires whatever rights the transferor had or had power to
9 transfer. However, in some cases the controllable electronic record that is acquired by the
10 purchaser will not be the “same” controllable electronic record that was transferred by the
11 transferor. Such a transfer might involve the elimination of a “transferred” controllable electronic
12 record and the resulting and corresponding derivative creation and acquisition of a new
13 controllable electronic record. An example of such a resulting controllable electronic record is
14 the unspent transaction output (UTXO) generated by a transaction in bitcoin. Subsection (d)
15 should be construed broadly to encompass such transfers and resulting derivative controllable
16 electronic records acquired by a purchaser. Because subsection (c) addresses the rights of a
17 purchaser in the “purchased” asset and not the “transferred” asset, this construction is wholly
18 consistent with the statutory text.
19

20 5. *Nonpurchaser having control.* Under draft § 12-105, a person may have control of a
21 controllable electronic record even if the person has no property interest in the controllable
22 electronic record. A person that has control of, but no interest in, a controllable electronic record
23 would not be a purchaser of the controllable electronic record and so would not be eligible to be
24 a qualifying purchaser under this section.
25

26 **Example:** Debtor granted to Secured Party a security interest in all Debtor’s existing and
27 after-acquired accounts, chattel paper, and payment intangibles. Secured Party perfected
28 its security interest in a specific controllable account by obtaining control of the
29 controllable electronic record that evidences the controllable account. *See* draft § 9-107A.
30

31 Because Debtor’s security agreement does not cover controllable electronic records,
32 Secured Party would have no interest in the controllable electronic record. Accordingly,
33 Secured Party would not be a purchaser of the controllable electronic record. However, as
34 a purchaser of the controllable accounts and controllable payment intangibles, Secured
35 Party could benefit from the take-free rule in subsection (d) (discussed in Note 6). Having
36 taken control of the specific controllable account, Secured Party may be a qualifying
37 purchaser. Even if Secured Party were not a qualifying purchaser of the controllable
38 account, its security interest in the account over which it obtained control would,
39 however, have priority over a conflicting security interest that was perfected by a method
40 other than control. *See* draft § 9-326A.
41

42 6. *The take-free rule.* Subsection (d) makes controllable electronic records and, under
43 subsection (a), controllable accounts and controllable payment intangibles, highly negotiable.
44 Subsection (d) derives from Section 3-306, under which a holder in due course takes a negotiable
45 instrument free of a claim of a property right in the instrument. A qualifying purchaser of a
46 controllable electronic record, controllable account, or controllable payment intangible takes free

1 of all claims of a property right in the purchased controllable electronic record, account, or
2 payment intangible.
3

4 As a general matter, law other than Article 12 would determine whether any particular
5 transaction creates a property interest in a controllable electronic record. See subsection (b). The
6 applicable law may provide that a hacker, who is essentially a thief, acquires no rights in a
7 “stolen” controllable electronic record. Even if this is the case, subsection (d) would enable a
8 purchaser that obtains control from a hacker and that otherwise meets the definition of
9 “qualifying purchaser” (for value, in good faith, and without notice of property claims) to take
10 the controllable electronic record (or any purchased controllable account or controllable payment
11 intangible) free of property claims. A person in control of a controllable electronic record
12 therefore has the power, even if not the right, to transfer rights in the record to a qualifying
13 purchaser. Of course, if the qualifying purchaser is a secured party whose security interest
14 secures an obligation, the purchaser would take free of the conflicting property right only to the
15 extent of the obligation secured. See subsection (c) (purchaser of a limited interest); cf. UCC § 3-
16 302(e).
17

18 7. *Subsection (f)—the “no-action” rule.* Subsection (f) applies in the situation (explained
19 in Note 4) in which the “resulting” controllable electronic record (or controllable account or
20 controllable payment intangible) purchased by a qualifying purchaser is not the “same” record,
21 account, or payment intangible that was transferred. In such a situation, a person claiming a
22 property right in the transferred asset may assert a claim against a purchaser of the “resulting”
23 asset even though the claimant is *not* asserting a claim of a *property right* in the purchased asset.
24 If the claim is based on both the purchaser’s purchase of the acquired asset and the claimant’s
25 rights in the transferred asset, subsection (f) protects the qualified purchaser from liability to the
26 claimant based on any theory. The qualified purchaser’s protection from the assertion of such a
27 claim does not depend on any proof that the purchased asset is somehow “traceable” to the
28 transferred asset.
29

30 If instead, such a claimant were to assert a claim based on a property right in the
31 purchased asset, then the qualified purchaser would take free of that claim under subsection (d).
32 Subsection (d) applies whether or not the acquired asset is the same asset that was transferred.
33

34 8. *“Tethered” assets.* Certain controllable electronic records may carry with them rights
35 to other assets, *e.g.*, goods or rights to payment. By its terms, the take-free rule in subsection (d)
36 applies to controllable electronic records (and, under subsection (a), controllable accounts and
37 controllable payment intangibles). One might argue that the inclusion of controllable accounts
38 and controllable payment intangibles in the scope of subsection (d) is unnecessary. By taking a
39 controllable electronic record free of property claims, the argument would be that a person takes
40 not only the controllable electronic record itself but also all rights that are “carried” in the
41 controllable electronic record free and clear.
42

43 *Subsection (e) defeats that argument.* It limits the application of the take-free rule in
44 subsection (d) to controllable electronic records and, through the application of subsection (a),
45 controllable accounts and controllable payment intangibles. Under subsection (e), except as
46 provided in subsection (a) and (d), a qualifying purchaser takes rights to payment (other than

1 controllable accounts and controllable payment intangibles), rights to performance, and interests
2 in property that are evidenced by a controllable electronic record subject to third-party property
3 claims, unless law other than Article 12 provides to the contrary. The reference in subsection (e)
4 to “law other than this article” contemplates that another article of the UCC might provide a
5 contrary rule for some types of property that might be tethered to a controllable electronic record.
6

7 *9. Creating the functional equivalent of a negotiable instrument.* Two defining
8 characteristics of an Article 3 negotiable instrument are that a holder in due course (i) takes free
9 of claims of a property or possessory right to the instrument (Section 3-306) and (ii) takes free of
10 most defenses and claims in recoupment (Section 3-305). Article 3 applies only to written
11 instruments. This draft provides a method for reaching a similar result with respect to
12 controllable accounts and controllable payment intangibles.
13

14 As regards the first characteristic, a qualifying purchaser could acquire the controllable
15 account or controllable payment intangible free of any claim of a property interest. As regards
16 the second characteristic, the definition of “qualifying purchaser” omits some of the conditions
17 for becoming a holder in due course. For example, to qualify as a holder in due course, a holder
18 must take “without notice that any party has a defense or claim in recoupment” Section 3-
19 302(a)(2)(vi). A controllable electronic record is information; there are no parties to a
20 controllable electronic record. However, there are parties to a controllable account or
21 controllable payment intangible. Accordingly, Sections 9-404 and 9-403 would determine
22 whether a purchaser of the controllable account or controllable payment intangible takes free of a
23 defense. Section 9-403 ordinarily would give effect to the account debtor’s agreement not to
24 assert claims or defenses.
25

26 Section 9-403 adopts the meaning of value in Section 3-303, as does Article 12. The
27 concept of value in Section 3-303 is narrower than the concept in Section 1-204, which applies
28 generally to UCC transactions. Under Section 1-204, a person gives value for rights if the person
29 acquires them in return for a promise. However, under Section 3-303, if a negotiable instrument
30 is issued or transferred for a promise of performance, the instrument is transferred for value only
31 to the extent that the promise has been performed.
32

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

34 (a) [**General rule: control of controllable electronic record.**] A person has control of a
35 controllable electronic record if:

36 (1) the electronic record, a record attached to or logically associated with the
37 electronic record, or a system in which the electronic record is recorded gives the person:

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

1 (B) exclusive power, subject to subsection (b), to:

2 (i) prevent others from availing themselves of substantially all the
3 benefit from the electronic record; and

4 (ii) transfer control of the electronic record to another person or
5 cause another person to obtain control of another controllable electronic record as a result of the
6 transfer of the electronic record; and

7 (2) the electronic record, a record attached to or logically associated with the
8 electronic record, or a system in which the electronic record is recorded enables the person
9 readily to identify itself in any way, including by name, identifying number, cryptographic key,
10 office, or account number, as having the powers specified in paragraph (1).

11 (b) **[Control through another person.]** A person has control of a controllable electronic
12 record if another person, other than the transferor of an interest in the electronic record:

13 (1) has control of the electronic record and acknowledges that it has control on
14 behalf of the person, or

15 (2) obtains control of the electronic record after having acknowledged that it will
16 obtain control of the electronic record on behalf of the person.

17 (c) **[Meaning of exclusive.]** A power specified in subsection (a)(1) is exclusive, even if:

18 (1) the controllable electronic record or a system in which the electronic record is
19 recorded limits the use of the electronic record or has a protocol programmed to cause a change,
20 including a transfer or loss of control or a modification of benefits afforded by the electronic
21 record; or

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

23 **Reporter's Note**
24

1 1. *Why “control” matters.* Control serves two major functions in Article 12. An
2 electronic record is a “controllable electronic record” and is subject to the provisions of this
3 article only if it can be subjected to control under this section. *See* draft § 12-102(a)(1) (defining
4 “controllable electronic record”). And only a person having control of a controllable electronic
5 record is eligible to become a qualifying purchaser and so take free of claims of a property
6 interest in the controllable electronic record or any controllable account or controllable payment
7 intangible evidenced by the controllable electronic record and to receive protection from the “no-
8 action” rule. *See* draft § 12-104.
9

10 In addition, draft amendments to Article 9 provide that obtaining control of a controllable
11 electronic record is one method by which to perfect a security interest in the controllable
12 electronic record or any controllable account or controllable payment intangible evidenced by the
13 controllable electronic record. Under these amendments, perfection of a security interest in
14 controllable accounts and controllable payment intangibles can be achieved by obtaining control
15 of the related controllable electronic record. *See* draft §§ 9-107A; 9-314. Moreover, a security
16 interest perfected by control has priority over a conflicting security interest that was perfected by
17 a method other than control. *See* draft § 9-326A.
18

19 2. *Powers and sources of powers; inability to exercise a power.* This section conditions
20 control on a person’s having the three powers specified in paragraph (a)(1). A person would have
21 a power described in this paragraph if the controllable electronic record, a record attached to or
22 logically associated with the controllable electronic record, or any system in which it is recorded
23 gives the purchaser that power. This description of the source of the relevant powers should be
24 construed broadly and functionally. For example, a system in which the person in control is
25 identified is a permissible source of a power even if it is related to but not precisely the “same”
26 system in which the controllable electronic record is recorded. Moreover, a person would have a
27 power even if the characteristics of the particular purchaser disable the person from exercising
28 the power. This would be the case, for example, when the purchaser holds the private key
29 required to access the benefit of the controllable electronic record but lacks the hardware
30 required to use it.
31

32 3. *“Benefit.”* Subparagraphs (a)(1)(A) and (a)(1)(B)(i) condition control of a controllable
33 electronic record on a person’s relationship to the benefit of the controllable electronic record.
34

35 As used in the section, the “benefit” of a controllable electronic record refers to the rights
36 that are afforded by the controllable electronic record and the uses to which the controllable
37 electronic record can be put. These, in turn, depend on the characteristics of the controllable
38 electronic record in question. For example, bitcoin can be held or disposed of (sold or spent).
39 And control of a controllable electronic record evidencing a controllable account or controllable
40 payment intangible affords the right to collect from the account debtor (obligor).
41

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

1 subparagraph (a)(1)(B)(i), only the benefit that the system makes available should be considered.

2
3 4. *Power to retrieve information.* By definition, the information constituting an electronic
4 record must be “retrievable in perceivable form.” UCC § 1-201(b)(31 (defining “record”). The
5 power to retrieve the record in perceivable form is included in the benefit of a controllable
6 electronic record. “Perceivable form” means that the contents of the record are intelligible; the
7 ability to perceive the indecipherable jumble of an encrypted record does not give a person the
8 power to retrieve the record in perceivable form.

9
10 To have control of a controllable electronic record under subparagraph (a)(1)(A), a
11 person must have at least the nonexclusive power to avail itself of this benefit. If a person also
12 has the exclusive power to decrypt the encrypted record, the person will have the exclusive
13 power to prevent others from availing themselves of substantially all the benefit from the
14 controllable electronic record and thereby satisfy the condition in subparagraph (a)(1)(B)(i).

15
16 5. *Exclusive powers.* Unlike the power in subparagraph (a)(1)(A), the powers in
17 subparagraphs (a)(1)(B)(i) and (a)(1)(B)(ii) must be held exclusively by the person claiming
18 control in order to establish control. However, subsection (c) contains two limitations on the term
19 “exclusive” as used in subsection (a)(1). Under subsection (c), a power can be “exclusive” even
20 if one or both of these limitations apply.

21
22 Paragraph (c)(1) takes account of the fact that the powers of a purchaser of a controllable
23 electronic record necessarily are subject to the attributes of the controllable electronic record and
24 the protocols of any system in which the controllable electronic record is recorded. . A transfer of
25 control resulting from a program that is a part of a system’s protocol is inherent in the
26 controllable electronic record and does not impair the exclusivity of the power of the person in
27 control of the record.

28
29 Paragraph (c)(2) allows for a person’s agreement to share a power with another person.
30 One effect of paragraph (c)(2) is that, under a multi-signature (multi-sig) agreement, any person
31 that is readily identifiable under paragraph (a)(2) and shares the relevant power would be eligible
32 to have control, even if the action of another person is a condition for the exercise of the power.
33 For example, a person in control may agree that another person’s action on the relevant system
34 would be required to effect a transfer of control without impairing the requisite exclusivity.

35
36 6. *Transfer of control.* The power to transfer control of a controllable electronic record
37 under subsection (a)(1)(B)(ii) includes the power to cause another person to obtain control of
38 another derivative controllable electronic record that results from the transfer of the controllable
39 electronic record. See draft § 12-104, Reporter’s Note 4.

40
41 7. *Control through another person.* Neither Article 12 nor any other provision of the
42 UCC (or other law that has been brought to the attention of the Drafting Committee) would
43 restrict or render ineffective any agreement of a person in control of a controllable electronic
44 record to hold control on behalf of another person. This result is implicit from paragraph (c)(2)
45 dealing with sharing of control. It would also follow under principles of agency. But such an
46 arrangement should be effective regardless of any agency or fiduciary relationship.

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

9
10 Subsection (b) likewise provides for control by a person through another person’s control
11 on behalf of the person. Subsection (b) is patterned on Section 9-313(c), but like Section 8-
12 103(d)(3), subsection (b) omits the requirement in Section 9-313(c) that an acknowledgment be
13 made in an authenticated record. Although best practices would suggest the wisdom of relying
14 on an authenticated record to evidence such an acknowledgment, subsection (b) would permit
15 proof by other means.

16
17 Substantially similar provisions are proposed to be included in draft §§ 7-106 (control of
18 electronic documents of title), 9-104 (control of deposit accounts), 9-105 (control of authoritative
19 electronic copies of records evidencing chattel paper), and 9-105A (control of electronic money)
20 and in a proposed conforming modification to Section 8-106(d)(3) (control of security
21 entitlement).

22
23 Subsection (b) qualifies this method of obtaining control by providing that the
24 acknowledging person must be one “other than the transferor of an interest in the electronic
25 record.” Section 9-313(c) expressly provides in this context that an acknowledging person
26 having possession of goods must be a person “other than the debtor.” The official comments to
27 Section 8-106 are to the same effect in the context of control of a security entitlement. Section
28 8-106(d)(3), comment 4. The same policy that underpins the inapplicability of this method of
29 control to an acknowledgment by a debtor applies as well to a transferor that is not an Article 9
30 debtor. Control is intended to be a proxy for and a functional equivalent of the transfer of
31 physical possession of goods. In general, a person can obtain control through control by an agent,
32 as noted above. However, an acknowledgment by a *debtor or transferor* that acts as an agent of
33 a secured party or other transferee would be ineffective. This corresponds to the policy
34 underlying Section 9-313 that “the debtor cannot qualify as an agent for the secured party for
35 purposes of the secured party’s taking possession.” Section 9-313, comment 3. The Drafting
36 Committee may wish to consider whether the statute should provide expressly that a debtor or
37 transferor cannot act as an agent for a secured party or other transferee. The same issue arises
38 not only under 9-313 but also in connection with the proposed modifications to Sections 7-106,
39 8-106(d)(3), 9-105, and 9-105A.

40
41 The combined operation of subsections (b) and (c)(2) ensure that the continuance of
42 various existing practices would not prevent or cause the loss of control. For example, a person
43 in control may wish to grant another person the power to approve or disapprove a transfer of
44 control on the system. Alternatively, a person in control may wish to permit a system
45 administrator to transfer control to another person under specified conditions without
46 participation by the person in control. And, of course, a person in control may wish to delegate

1 the power to transfer control to an agent or fiduciary.

2
3 8. *Readily identify.* Paragraph (a)(2) provides that a person does not have control of a
4 controllable electronic record unless the controllable electronic record, a record attached to or
5 logically associated with the controllable electronic record, or any system in which the
6 controllable electronic record is recorded enables the person readily to identify itself as the
7 person having the requisite powers. This paragraph does not obligate a person to identify itself as
8 having control. However, to prove that it has control, a person would need to prove that the
9 relevant records or any system in which the controllable electronic record is recorded readily
10 identifies the person as such. But proof that a person has the powers specified in section (a)(1)
11 does not require proof of exclusivity—i.e., proof of a negative (that no one else has such
12 powers). The means of identification mentioned in subsection (a)(2) derive from Section 3-
13 110(c). Subsection (a)(2) adds “cryptographic key” as an example of a way in which a person
14 may be identified.
15

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

18 (a) **[Discharge of account debtor.]** An account debtor on a controllable account or
19 controllable payment intangible may discharge its obligation by paying:

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

22 (2) except as provided in subsection (b), a person that formerly had control of the
23 controllable electronic record.

24 (b) **[Effect of notification.]** Subject to subsections (d) and (h), an account debtor may not
25 discharge its obligation by paying a person that formerly had control of the controllable
26 electronic record if the account debtor receives a notification that:

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

29 (2) reasonably identifies the controllable account or controllable payment
30 intangible;

31 (3) notifies the account debtor that control of the controllable electronic record

1 that evidences the controllable account or controllable payment intangible was transferred;

2 (4) identifies the transferee, in any reasonable way, including by name,

3 identifying number, cryptographic key, office, or account number; and

4 (5) provides a commercially reasonable method by which the account debtor is to

5 pay the transferee.

6 (c) **[Discharge following effective notification.]** After receipt of a notification that

7 complies with subsection (b), the account debtor may discharge its obligation only by paying in

8 accordance with the notification [and may not discharge the obligation by paying a person that

9 formerly had control].

10 (d) **[When notification ineffective.]** Subject to subsection (h), notification is ineffective

11 under subsection (b):

12 (1) unless, before the notification is sent, an account debtor and the person that, at

13 that time, had control of the controllable electronic record that evidences the controllable account

14 or controllable payment intangible agree in an authenticated record to a commercially reasonable

15 method by which a person may furnish reasonable proof that control has been transferred;

16 (2) to the extent an agreement between an account debtor and seller of a payment

17 intangible limits the account debtor's duty to pay a person other than the seller and the limitation

18 is effective under law other than this article; or

19 (3) at the option of an account debtor, if the notification notifies the account

20 debtor to:

21 (A) divide a payment;

22 (B) make less than the full amount of [a required] [an installment or other

23 periodic] payment; or

1 (C) pay any part of a payment by more than one method or to more than
2 one person.

3 (e) **[Proof of transfer of control.]** Subject to subsection (h), if requested by the account
4 debtor, the person giving the notification seasonably shall furnish reasonable proof, using the
5 agreed method, that control of the controllable electronic record has been transferred. [Unless the
6 person complies][If the person does not comply] with the request, the account debtor may
7 discharge its obligation by paying a person that formerly had control, even if the account debtor
8 has received a notification under subsection (b).

9 (f) **[What constitutes reasonable proof.]** A person furnishes reasonable proof that
10 control has been transferred if the person demonstrates, using the agreed method, that the
11 transferee has the power to:

12 (1) avail itself of substantially all the benefit from the controllable electronic
13 record;

14 (2) prevent others from availing themselves of substantially all the benefit from
15 the controllable electronic record; and

16 (3) transfer the powers mentioned in paragraphs (1) and (2) to another person.

17 (g) **[Rights not waivable.]** Subject to subsection (h), an account debtor may not waive or
18 vary its rights under subsections (d)(1) and (e) or its option under subsection (d)(3).

19 **Reporter's Note**

20 1. *Source of these provisions.* These provisions derive from Section 3-602, which governs
21 the discharge of a person obligated on a negotiable instrument, and Section 9-406, which governs
22 the discharge of an account debtor, including a person obligated on an account or payment
23 intangible.

24
25 2. *The basic rules.* This section applies only to an account debtor that has undertaken to
26 pay the person that has control of the controllable electronic record that evidences the obligation
27 to pay. *See* draft § 9-102 (defining “controllable account” and “controllable payment”).

1 intangible”). Section 9-406 would continue to apply in other respects and to all other account
2 debtors. As to the relationship between this section and Section 9-406, see Note 4.

3
4 Under subsection (a)(1), an account debtor may discharge its obligation on the
5 controllable account or controllable payment intangible by paying the person that has control of
6 the related controllable electronic record at the time of payment. Subsections (a)(2) and (b)
7 would remove from an account debtor the burden of determining who has control of the related
8 controllable electronic record at any given time—a burden that, with respect to some controllable
9 electronic records, an account debtor may be unable to satisfy. Under paragraph (a)(2), subject to
10 subsection (b), an account debtor may discharge its obligation by paying a person that formerly
11 had control of the related controllable electronic record, which presumably would include the
12 initial obligee.

13
14 Subsection (b) reflects the fact that a person to which control has been transferred may
15 not wish to take the risk that the account debtor will discharge its obligation by paying the
16 transferor. Subsection (b) would protect the transferee by providing that if the account debtor
17 receives an effective notification that control has been transferred, the account debtor may
18 discharge its obligation by paying in accordance with the notification and may not discharge its
19 obligation by paying a person that formerly had control. The notification must be authenticated
20 by a person formerly having control or by the transferee.

21
22 To be effective under subsection (b), a notification must reasonably identify the
23 controllable account or controllable payment intangible, notify the account debtor that control of
24 the controllable electronic record that evidences the controllable account or controllable payment
25 intangible was transferred, identify the transferee in any reasonable way, and provide a
26 commercially reasonable method by which the account debtor is to make payments to the
27 transferee. A change in the identity of the person to which the account debtor must make
28 payment should not, and typically will not, impose a significant burden on the account debtor.
29 However, one can imagine a method of making payment that would be burdensome, *e.g.*, making
30 a payment through a trading platform or payment service with which the account debtor does not
31 have an account. For this reason, the designated method of making payment must be
32 “commercially reasonable.”

33
34 3. “*Reasonable proof.*” As noted above, this section derives in large part from Section 9-
35 406, which provides for notification that an account or payment intangible has been assigned.
36 Account debtors that have received notification of an assignment under Section 9-406 almost
37 always make payments in accordance with the notice. Recognizing that an account debtor may
38 be uncertain whether a notification is legitimate, Section 9-406 affords to an account debtor the
39 right to request proof that the account or payment intangible was assigned.

40
41 Subsection (e) contains a similar provision. On the account debtor’s request, the person
42 giving the notification must seasonably furnish reasonable proof that control of the controllable
43 electronic record has been transferred. If the person does not comply with the request, the
44 account debtor may ignore the notification and discharge its obligation by a paying a person
45 formerly in control.

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

15 Reasonable proof that is seasonably furnished by a person other than the person that gave
16 the notification would constitute compliance with the account debtor’s request.
17

18 Subsection (e) requires that reasonable proof be provided “using the agreed method.”
19 Subsection (f) requires that a person use “the agreed method” to demonstrate that the transferee
20 has the specified powers. “Agreed method” refers to the commercially reasonable method to
21 which the parties agreed, in an authenticated record, before the notification was sent. If parties
22 did not so agree, the notification is ineffective under subsection (d)(1).
23

24 4. *Relationship to Section 9-406.* Section 9-406 governs the discharge of the obligation of
25 an account debtor. Section 9-406 is proposed to be amended to carve out transactions covered by
26 this section. *See* draft § 9-406.
27

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

29 (a) [**Governing law: general rule.**] Except as provided in subsection (b), the local law
30 of a controllable electronic record’s jurisdiction governs a matter covered by this article.

31 (b) [**Governing law: Section 12-106.**] The local law of the controllable electronic
32 record’s jurisdiction for a controllable electronic record that evidences a controllable account or
33 controllable payment intangible governs a matter covered by Section 12-106 unless an effective
34 agreement determines that the local law of another jurisdiction governs.

35 (c) [**Controllable electronic record’s jurisdiction.**] The following rules determine a
36 controllable electronic record’s jurisdiction under this section:

37 (1) If the controllable electronic record, or a record attached to or logically

1 associated with the controllable electronic record which is readily available for review, expressly
2 provides that a particular jurisdiction is the controllable electronic record's jurisdiction for
3 purposes of this article or the [Uniform Commercial Code], that jurisdiction is the controllable
4 electronic record's jurisdiction.

5 (2) If paragraph (1) does not apply and the rules of the system in which the
6 controllable electronic record is recorded are readily available for review and expressly provide
7 that a particular jurisdiction is the controllable electronic record's jurisdiction for purposes of
8 this article or the [Uniform Commercial Code], that jurisdiction is the controllable electronic
9 record's jurisdiction.

10 (3) If paragraphs (1) and (2) do not apply and the controllable electronic record,
11 or a record attached to or logically associated with the controllable electronic record which is
12 readily available for review, expressly provides that the controllable electronic record is
13 governed by the law of a particular jurisdiction, that jurisdiction is the controllable electronic
14 record's jurisdiction.

15 (4) If paragraphs (1) through (3) do not apply and the rules of the system in which
16 the controllable electronic record is recorded are readily available for review and expressly
17 provide that the controllable electronic record or the system is governed by the law of a
18 particular jurisdiction, that jurisdiction is the controllable electronic record's jurisdiction.

19 (5) If paragraphs (1) through (4) do not apply, the controllable electronic record's
20 jurisdiction is the jurisdiction in which the transferor is located.

21 (d) **[Location of transferor if evidence not sufficient.]** If subsection (c)(5) applies, the
22 governing law is in issue in an action, and the evidence is not sufficient to establish the location
23 of the transferor, the transferor is located in the District of Columbia.

1 (e) **[Applicability of Article 12.]** If subsection (d) applies and Article 12 is not in effect
2 in the District of Columbia without material modification, the governing law for a matter
3 covered by this article is the law of the District of Columbia as though Article 12 were in effect
4 in the District of Columbia without material modification. In this section, “Article 12” means
5 Uniform Commercial Code—Controllable Electronic Records (with Conforming [and
6 Miscellaneous] Amendments to Articles 1[, 2, 2A, 3, 4, 4A, 5, 7, 8,] and 9), 2022 Official Text.

7 (f) **[Relation of transaction to controllable electronic record’s jurisdiction not
8 necessary.]** Subsections (b) through (d) apply even if a transaction does not bear any relation to
9 the controllable electronic record’s jurisdiction.

10 (g) **[Location of transferor.]** Except as provided in subsection (d), Section 9-307, other
11 than Section 9-307(c), determines the location of the transferor for purposes of subsection (c)(5)
12 as if the transferor were a debtor.

13 (h) **[Rights of purchasers determined at time of purchase.]** The rights acquired by a
14 purchaser or a qualifying purchaser under Section 12-104 are governed by the law applicable
15 under this section at the time of purchase.

16 **Legislative Note:** *The state should describe where and how Article 12 is available to the public.*
17 *See, e.g., TRADES Regulations, 31 CFR 357.2, defining “Revised Article 8.” The definition of*
18 *“Article 12” should cite the official “title” of the Official Text of the article.*

19
20 * * *

21 **Reporter’s Note**

22
23 1. *Source of these provisions.* The provisions of draft § 12-107 (as well as draft § 9-
24 306A) derive from Sections 8-110 and 9-305 on law governing perfection and priority of security
25 interests in investment property and the relevance of a securities intermediary’s jurisdiction and a
26 commodity intermediary’s jurisdiction.

27
28 2. *Practical limitations on determination of governing law.* This section relating to the
29 law governing the matters covered by Article 12 must confront substantial practical limitations.
30 These limitations arise primarily from two factors. First, as described below, this section relies

1 primarily on a “waterfall” of alternatives for determining a controllable electronic record’s
2 jurisdiction. The waterfall depends on express provisions of a controllable electronic record or
3 the system in which it is recorded. Many electronic records and systems that currently exist do
4 not contain these provisions. As explained in the Note 5, the expectation is that over time
5 electronic records and related systems will adopt these provisions in reliance on this section so as
6 to create certainty as to the governing law. Second, in the absence of these provisions, at the
7 bottom of the waterfall the controllable electronic record’s jurisdiction is the jurisdiction in
8 which a transferor is located. This also is problematic because in some cases that location cannot
9 readily be determined by parties to a transaction or be determined by a tribunal, primarily
10 because the identity of the transferor may be unknown. *See* Reporter’s Prefatory Note 1 to
11 Article 12.
12

13 3. *Governing law for draft § 12-106.* Subsection (b) provides an exception to the general
14 rule of subsection (a) that “the local law of a controllable electronic record’s jurisdiction governs
15 the matters covered by this article.” The exception recognizes that an account debtor’s rights and
16 duties generally are governed by the law applicable to the underlying contract between the
17 account debtor and an assignor, and not by the law applicable to the agreement between the
18 assignor (debtor) and the assignee (secured party)—i.e., a security agreement. *See* Section 9-401,
19 Comment 3. Subsection (b) recognizes that an effective agreement between the account debtor
20 and assignor may choose a different law to cover the matters covered by draft § 12-106 (i.e., the
21 account debtor’s rights and duties addressed in that section).
22

23 4. *The basic rule: Law of controllable electronic record’s jurisdiction.* Subsection (a)
24 states the basic rule that the law of a controllable electronic record’s jurisdiction governs the
25 matters covered by Article 12. This might be viewed as a rough proxy for the traditional role of
26 the location of tangible asset (*e.g.*, goods) in determining the applicable law (*lex rei sitae*).
27 Drawing on the analogous provisions in Sections 8-110 and 9-305 in the context of a security
28 entitlement or securities account or a commodity contract or commodity account, under this draft
29 it is the controllable electronic record itself, records attached thereto or associated therewith, or
30 the system in which the controllable electronic record is recorded that determines the governing
31 law. Subsection (c) provides a “waterfall” of rules based on provisions that identify a particular
32 jurisdiction as the controllable electronic record’s jurisdiction or alternatively that provide the
33 governing law of a controllable electronic record or the system in which the record is recorded.
34

35 5. *Bottom of the waterfall: Location of the transferor.* Subsections (c)(5) and (d) address
36 a problem that does not normally exist in the context of Sections 9-110 and 9-305. As explained
37 in Note 2, currently, many controllable electronic records, associated records, and systems in
38 which such records are recorded do not identify the “controllable electronic record’s jurisdiction”
39 or the governing law (some permissioned systems being exceptions). (One hopes that once
40 Article 12 and accompanying amendments are widely adopted, systems will adapt and the
41 waterfall will become more generally viable for identifying a controllable electronic record’s
42 jurisdiction.) Consequently, the waterfall ultimately turns to the location of the “transferor” of a
43 controllable electronic record. This approach derives from the role of the location of a debtor
44 under Sections 9-301 and 9-307. Also as explained in Note 2, in many cases involving
45 controllable electronic records the transferor is not known to or easily discoverable by a
46 purchaser. Subsection (d) resolves this dilemma by providing that the transferor’s location (and,

1 therefore, the controllable electronic record’s jurisdiction) is the District of Columbia if in an
2 action there is not sufficient evidence to establish a transferor’s actual location. *Cf.* Section 9-
3 307(c).

4
5 *6. District of Columbia as default location of transferor.* The designation of the District
6 of Columbia (DC) as the location of the transferor pursuant to subsection (d) assumes that DC
7 will have adopted Article 12 and the conforming amendments to Articles 1 and 9 in substantially
8 the uniform version. This is a plausible assumption based on the history of adoptions in that
9 jurisdiction. Subsection (e) addresses the unlikely situation that DC might not so adopt Article 12
10 or might later adopt materially non-uniform amendments. Subsection (e) is patterned loosely (but
11 as closely as feasible) on the TRADES Regulations, 31 CFR § 357.11(d), for U.S. Treasury
12 securities.

13
14 The term “Article 12” is defined in draft subsection (i) as the officially promulgated
15 version of Article 12 and conforming amendments. The official comments will explain that in
16 determining whether DC has enacted Article 12 without material modification a tribunal should
17 consider the materiality of any provision in the context of the issue or issues before it. A
18 modification of a provision that would be material in another context should be disregarded if it
19 would have no bearing on the issue or issues before the tribunal.

20
21 *7. Determinative role of actual location of transferor.* When a tribunal is called upon to
22 determine the governing law concerning a matter covered by Article 12, subsection (d) instructs
23 that the location of the transferor, and consequently the controllable electronic record’s
24 jurisdiction, is the District of Columbia when there is insufficient evidence for the tribunal to
25 determine the actual location of the transferor. Subsection (d) has no application, however, when
26 a tribunal can make a finding as to the actual location. This is so, moreover, even if at the time of
27 a transaction, such as a purchaser’s acquisition of a controllable electronic record, the purchaser
28 had no practical ability to determine that location (likely because the purchaser could not
29 discover the transferor’s identity). Such a purchaser’s reasonable reliance on the governing law
30 being that of the District of Columbia necessarily is limited to a future case in which no party can
31 adduce sufficient evidence for a tribunal’s determination of the actual location. If in any such
32 future case a party does adduce such evidence and a tribunal determines that the actual location
33 of the transferor is other than the District of Columbia, subsection (d) does not apply.

34
35 *8. Relevant time for determination of governing law.* Draft subsection (h) provides that
36 the rights of purchasers are governed by the applicable law as of the time of purchase. Note that
37 Sections 8-110 and 9-305 do not contain an analogous rule with respect to a securities
38 intermediary’s jurisdiction. However, Section 8-110(c) does provide a similar rule for the
39 delivery of a security certificate and adverse claims. As to the timing of the determination of the
40 governing law for other issues under Article 12, such as the rights and duties of account debtors
41 under draft § 12-106, the section does not specify a time. As with most statutory provisions
42 relating to governing law, courts are free to determine the appropriate relevant time taking into
43 account the relevant facts and the nature of the issues involved.