

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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January 17, 2022

Uniform Commercial Code and Emerging Technologies

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UNIFORM COMMERCIAL CODE AND EMERGING TECHNOLOGIES

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UNIFORM COMMERCIAL CODE AND EMERGING TECHNOLOGIES

JANUARY 17, 2022 DRAFT

Note on formatting:

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

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

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

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

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

1. Background

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

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

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

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

The Drafting Committee has held the following meetings:

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

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

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

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

2. Overview of UCC Revisions

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

a. New UCC Article 12 – Controllable electronic records, controllable accounts, controllable payment intangibles

The draft includes a new UCC Article 12 that would govern the transfer of property rights in certain intangible digital assets (“controllable electronic records”) that have been or may be created using new technologies. These assets include, for example, certain types of virtual currency and nonfungible tokens (NFTs). “Control” of controllable electronic records is a central 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 1. Section captions are a part of the text of the Uniform Commercial Code, and not mere
9 surplusage. This is not the case, however, with respect to subsection headings appearing in
10 Article 9 and Article 12. See ~~Comment 3 to Section~~ Sections 9-101, Comment 3 (“subsection
11 headings are not a part of the official text itself and have not been approved by the sponsors.”);
12 12-101, Comment.
13 12-101, Comment.

14 * * *

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

16 * * *

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

19 * * *

20 (10) “Conspicuous”, with reference to a term, means so written, displayed, or
21 presented that a reasonable person against which it is to operate ought to have noticed it.

22 Whether a term is “conspicuous” or not is a decision for the court. Conspicuous terms include
23 the following:

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

26 (B) ~~language in the body of a record or display in larger type than the~~
27 ~~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.

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

Reporter's Note

1. “*Conspicuous.*”

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

b. Current UCC Provisions Using “Conspicuous” or “Conspicuously.”

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

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

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

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

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

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

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

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

Only something currently authorized or adopted as a medium of exchange can be money. Coins and paper currency formerly issued by a government but now owned and traded only for their numismatic or historical value, and not as a medium of exchange, are not money. To be money, a medium of exchange must be initially issued, created, or distributed by a government, 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**

* * *

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

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

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

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

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

Official Comment

Prior Uniform Statutory Provision: Section 75, Uniform Sales Act.

Changes: Section 75 has been rephrased.

Purposes of Changes and New Matter:

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

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

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

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

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

Reporter's Note

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

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

3. The difficulty of capturing the appropriate application of these approaches to bundled transactions in the statutory text should not be underestimated. This application is especially challenging in the context of determining which provisions of the article should be applied to which issues when the non-goods aspects of a transaction predominate. In this connection, the Drafting Committee may wish to consider whether "the provisions of this Article relating solely to the goods apply," used in subsection (3), adequately captures and implements the goal of the 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 **Reporter's Note**

31
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;

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

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

Official Comment

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

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

* * *

Section 3-105. Issue of Instrument.

(a) “Issue” means:

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

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

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

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

Official Comment

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

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

1 § 229.2(ggg), the check is “issued” and hence can be enforced pursuant to this Article.

2
3 * * *

4
5 **Reporter’s Note**

6
7 The reference in subsection (a)(2) to transmission of an image of an item and information
8 derived from the item is derived from Section 4–110(a), dealing with electronic presentment.

9
10 * * *

11
12 **Section 3-309. Enforcement of Lost, Destroyed, or Stolen Instrument.**

13 * * *

14 **Official Comment**

15 * * *

16 4. The destruction of a check in connection with a truncation process in which
17 information is extracted from the check and an image of the check is made, and then such
18 information and image are transmitted for payment does not, by itself, prevent application of this
19 section. See Section 3-604 comment 1.

20
21 **Example:** The payee of a check creates an image of the check, destroys the check, and
22 transmits the image and information derived from the check for payment. Due to an error
23 in transmission, the depository bank never receives the transmission. The payee may be
24 able to enforce the check if the payee can prove the terms of the check and otherwise
25 satisfy the requirements of this section. The result would be different if there were no
26 error in the transmission and the payor discharged its obligation on the check.

27
28 * * *

29
30 **Section 3-604. Discharge by Cancellation or Renunciation.**

31 (a) A person entitled to enforce an instrument, with or without consideration, may
32 discharge the obligation of a party to pay the instrument (i) by an intentional voluntary act, such
33 as surrender of the instrument to the party, destruction, mutilation, or cancellation of the
34 instrument, cancellation or striking out of the party’s signature, or the addition of words to the
35 instrument indicating discharge, or (ii) by agreeing not to sue or otherwise renouncing rights
36 against the party by a signed record. The obligation of a party to pay a check is not discharged

1 solely by the destruction of the check in connection with a process in which, initially,
2 information is extracted from the check and an image of the check is made and, subsequently, the
3 information and image are transmitted for payment.

4 (b) Cancellation or striking out of an indorsement pursuant to subsection (a) does not
5 affect the status and rights of a party derived from the indorsement.

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

9 **Official Comment**

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

11
12 1. The destruction of a check in connection with a truncation process in which
13 information is extracted from the check and an image of the check is made, and then such
14 information and image are transmitted for payment is not within the scope of this section and
15 does not by itself discharge the obligation of a party to pay the instrument. The destruction of the
16 check also does not affect whether the check has been issued. See Section 3-105(a) and comment
17 1.

18
19 * * *

20 **ARTICLE 4**

21 **BANK DEPOSITS AND COLLECTIONS**

22 * * *

23 **Section 4-207. Transfer Warranties.**

24 * * *

25 **Official Comment**

26 1. Except for subsection (b), this section conforms to Section 3–416 and extends its
27 coverage to items. The substance of this section is discussed in the Comment to Section 3–416.
28 Subsection (b) provides that customers or collecting banks that transfer items, whether by
29 indorsement or not, undertake to pay the item if the item is dishonored. This obligation cannot be
30 disclaimed by a “without recourse” indorsement or otherwise. With respect to checks, Regulation
31 CC Section 229.34 states the warranties made by paying and returning banks.

2. For an explanation of subsection (a)(6), see comment 8 to Section 3-416.

3. The warranties provided for in this Section and in Sections 4-208 and 4-209 are supplemented by warranties created under federal law. For example, under Section 4-209(b), a person who undertakes to retain an item in connection with an agreement for electronic presentment makes a warranty that retention and presentment comply with the agreement. Under federal law, a person might also make a warranty that [no][a] person will [not] be asked to make payment based on a check already paid. See 12 C.F.R. § 229.34(a).

* * *

ARTICLE 4A

FUNDS TRANSFERS

Section 4A-103. Payment Order – Definitions.

(a) In this Article:

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

(i) the instruction does not state a condition to payment to the beneficiary other than time of payment,

(ii) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and

(iii) the instruction is transmitted by the sender directly to the receiving bank or to an agent, funds-transfer system, or communication system for transmittal to the receiving bank.

* * *

Official Comment

This section is discussed in the Comment following Section 4A-104.

Section 4A-104. Funds Transfer – Definitions.

* * *

Official Comment

* * *

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

For example, **Example:** a New York bank may have issued a letter of credit in favor of X, a California seller of goods to be shipped to the New York bank's customer in New York. The terms of the letter of credit provide for payment to X if documents are presented to prove shipment of the goods. Instead of providing for presentment of the documents to the New York bank, the letter of credit states that they may be presented to a California bank that acts as an agent for payment. The New York bank sends an instruction to the California bank to pay X upon presentation of the required documents. The instruction is not covered by Article 4A because payment to the beneficiary is conditional upon receipt of shipping documents. The function of banks in a funds transfer under Article 4A is comparable to the role of banks in the collection and payment of checks in that it is essentially mechanical in nature. The low price and high speed that characterize funds transfers reflect this fact. Conditions to payment by the California bank other than time of payment impose responsibilities on that bank that go beyond those in Article 4A funds transfers. Although the payment by the New York bank to X under the letter of credit is not covered by Article 4A, if X is paid by the California bank, payment of the obligation of the New York bank to reimburse the California bank could be made by an Article 4A funds transfer. In such a case there is a distinction between the payment by the New York bank to X under the letter of credit and the payment by the New York bank to the California bank. For example, if the New York bank pays its reimbursement obligation to the California bank by a Fedwire naming the California bank as beneficiary (see Comment 1 to Section 4A-107), payment is made to the California bank rather than to X. That payment is governed by Article 4A and it could be made either before or after payment by the California bank to X. The payment by the New York bank to X under the letter of credit is not governed by Article 4A and it occurs when the California bank, as agent of the New York bank, pays X. No payment order was involved in that transaction. In this example, if the New York bank had erroneously sent an instruction to the California bank unconditionally instructing payment to X, the instruction would have been an Article 4A payment order. If the payment order was accepted (Section 4A-209(b)) by the California bank, a payment by the New York bank to X would have resulted (Section 4A-406(a)). But Article 4A would not prevent recovery of funds from X on the basis that X was not entitled to retain the funds under the law of mistake and restitution, letter of credit law or other applicable law.

An instruction to pay might be a component of a computer program or a transaction

1 protocol intended to execute automatically under specified circumstances. The fact that the
2 program or protocol itself is subject to a condition does not necessarily mean that an instruction
3 to pay issued pursuant to that program or protocol “state[s] a condition to payment of the
4 beneficiary” within the meaning of Section 4A-103(a)(1)(i). Whether the instruction does state
5 such a condition depends on what the instruction says when it is received by the receiving bank.
6 An instruction that neither grants discretion nor imposes a limitation on payment by the receiving
7 bank does not state a condition to payment. What distinguishes the prior example is that the New
8 York bank’s instruction to the California bank did state a condition when the California bank
9 received it.

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

16
17 * * *

18 **Section 4A-201. Security Procedure.** “Security procedure” means a procedure
19 established by agreement of a customer and a receiving bank for the purpose of (i) verifying that
20 a payment order or communication amending or cancelling a payment order is that of the
21 customer, or (ii) detecting error in the transmission or the content of the payment order or
22 communication. A security procedure may impose an obligation on the receiving bank or the
23 customer and may require the use of algorithms or other codes, identifying words, ~~or~~ numbers,
24 symbols, sounds or biometrics, encryption, callback procedures, or similar security devices.
25 Comparison of a signature on a payment order or communication with an authorized specimen
26 signature of the customer or requiring that a payment order be sent from a known email address,
27 IP address or phone number is not by itself a security procedure.

28 **Official Comment**

29
30 A large percentage of payment orders and communications amending or cancelling
31 payment orders are transmitted electronically and it is standard practice to use security
32 procedures that are designed to assure the authenticity of the message through steps designed to
33 assure the identity of the sender, the integrity of the message, or both. Security procedures can
34 also be used to detect error in the content of messages or to detect payment orders that are
35 transmitted by mistake as in the case of multiple transmission of the same payment order.

1 Security procedures might also apply to communications that are transmitted by telephone or in
2 ~~writing~~ a record. Section 4A-201 defines these security procedures. The second sentence of the
3 definition provides several examples of a security procedure, but this list is not exhaustive. The
4 inclusion of the phrase “or similar security devices” means that, as new technologies emerge,
5 what can be a security procedure will change. The definition of security procedure limits the
6 term to a procedure “established by agreement of a customer and a receiving bank.” The term
7 does not apply to procedures that the receiving bank may follow unilaterally in processing
8 payment orders. The question of whether loss that may result from the transmission of a spurious
9 or erroneous payment order will be borne by the receiving bank or the sender or purported sender
10 is affected by whether a security procedure was or was not in effect and whether there was or
11 was not compliance with the procedure. Security procedures are referred to in Sections 4A-202
12 and 4A-203, which deal with authorized and verified payment orders, and Section 4A-205,
13 which deals with erroneous payment orders.
14

15 Requiring that a payment order be sent from a known email, IP address or phone number
16 is not by itself a “security procedure” within the meaning of this section because it is possible to
17 make a payment order with a different origin appear to have been sent from such an address or
18 phone number. However, requiring that a payment order have such an apparent origin in
19 combination with other security protocols might be a security procedure.
20

21 **Section 4A-202. Authorized and Verified Payment Orders.**

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

25 (b) If a bank and its customer have agreed that the authenticity of payment orders issued
26 to the bank in the name of the customer as sender will be verified pursuant to a security
27 procedure, a payment order received by the receiving bank is effective as the order of the
28 customer, whether or not authorized, if (i) the security procedure is a commercially reasonable
29 method of providing security against unauthorized payment orders, and (ii) the bank proves that
30 it accepted the payment order in good faith and in compliance with the bank’s obligations under
31 the security procedure and any ~~written~~ agreement or instruction of the customer, evidenced by a
32 record, restricting acceptance of payment orders issued in the name of the customer. The bank is
33 not required to follow an instruction that violates ~~a written~~ an agreement evidenced by a record

1 with the customer or notice of which is not received at a time and in a manner affording the bank
2 a reasonable opportunity to act on it before the payment order is accepted.

3 (c) Commercial reasonableness of a security procedure is a question of law to be
4 determined by considering the wishes of the customer expressed to the bank, the circumstances
5 of the customer known to the bank, including the size, type, and frequency of payment orders
6 normally issued by the customer to the bank, alternative security procedures offered to the
7 customer, and security procedures in general use by customers and receiving banks similarly
8 situated. A security procedure is deemed to be commercially reasonable if (i) the security
9 procedure was chosen by the customer after the bank offered, and the customer refused, a
10 security procedure that was commercially reasonable for that customer, and (ii) the customer
11 expressly agreed in ~~writing~~ a record to be bound by any payment order, whether or not
12 authorized, issued in its name and accepted by the bank in compliance with the bank's
13 obligations under the security procedure chosen by the customer.

14 * * *

15 **Official Comment**

16 This section is discussed in the Comment following Section 4A-203.

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

18 (a) If an accepted payment order is not, under Section 4A-202(a), an authorized order of a
19 customer identified as sender, but is effective as an order of the customer pursuant to Section
20 4A-202(b), the following rules apply:

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

23 (2) The receiving bank is not entitled to enforce or retain payment of the payment

order if the customer proves that the order was not caused, directly or indirectly, by a person (i) entrusted at any time with duties to act for the customer with respect to payment orders or the security procedure, or (ii) who obtained access to transmitting facilities of the customer or who obtained, from a source controlled by the customer and without authority of the receiving bank, information facilitating breach of the security procedure, regardless of how the information was obtained or whether the customer was at fault. Information includes any access device, computer software, or the like.

(b) This section applies to amendments of payment orders to the same extent it applies to payment orders.

Official Comment

* * *

3. Subsection (b) of Section 4A-202 is based on the assumption that losses due to fraudulent payment orders can best be avoided by the use of commercially reasonable security procedures, and that the use of such procedures should be encouraged. The subsection is designed to protect both the customer and the receiving bank. A receiving bank needs to be able to rely on objective criteria to determine whether it can safely act on a payment order. Employees of the bank can be trained to “test” a payment order according to the various steps specified in the security procedure. The bank is responsible for the acts of these employees. Subsection (b)(ii) requires the bank to prove that it accepted the payment order in good faith and “in compliance with the bank’s obligations under the security procedure.” If the fraud was not detected because the bank’s employee did not perform the acts required by the security procedure, the bank has not complied. Subsection (b)(ii) also requires the bank to prove that it complied with any agreement or instruction that restricts acceptance of payment orders issued in the name of the customer. If an agreement establishing a security procedure places obligations on both the sender and the receiving bank, the receiving bank need prove only that it complied with the obligations placed on the receiving bank. A customer may want to protect itself by imposing limitations on acceptance of payment orders by the bank. For example, the customer may prohibit the bank from accepting a payment order that is not payable from an authorized account, that exceeds the credit balance in specified accounts of the customer, or that exceeds some other amount. Another limitation may relate to the beneficiary. The customer may provide the bank with a list of authorized beneficiaries and prohibit acceptance of any payment order to a beneficiary not appearing on the list. Such limitations may be incorporated into the security procedure itself or they may be covered by a separate agreement or instruction. In either case, the bank must comply with the limitations if the conditions stated in subsection (b) are met. Normally limitations on acceptance would be incorporated into an agreement between the

1 customer and the receiving bank, but in some cases the instruction might be unilaterally given by
2 the customer. If standing instructions or an agreement state limitations on the ability of the
3 receiving bank to act, provision must be made for later modification of the limitations. Normally
4 this would be done by an agreement that specifies particular procedures to be followed. . Thus,
5 subsection (b) states that the receiving bank is not required to follow an instruction that violates a
6 ~~written~~ an agreement evidenced by a record. The receiving bank is not bound by an instruction
7 unless it has adequate notice of it. Subsections (25), (26), and (27) of Section 1-201 apply.

8
9 Subsection (b)(i) assures that the interests of the customer will be protected by providing
10 an incentive to a bank to make available to the customer a security procedure that is
11 commercially reasonable. If a commercially reasonable security procedure is not made available
12 to the customer, subsection (b) does not apply. The result is that subsection (a) applies and the
13 bank acts at its peril in accepting a payment order that may be unauthorized. Prudent banking
14 practice may require that security procedures be utilized in virtually all cases except for those in
15 which personal contact between the customer and the bank eliminates the possibility of an
16 unauthorized order. The burden of making available commercially reasonable security
17 procedures is imposed on receiving banks because they generally determine what security
18 procedures can be used and are in the best position to evaluate the efficacy of procedures offered
19 to customers to combat fraud. The burden on the customer is to supervise its employees to assure
20 compliance with the security procedure and to safeguard confidential security information and
21 access to transmitting facilities so that the security procedure cannot be breached.

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

44
45 The issue of whether a particular security procedure is commercially reasonable is a
46 question of law. Whether the receiving bank complied with the procedure is a question of fact. It

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

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

1 been remediated, thereafter accepts a payment order.

2
3 ~~5.6.~~ The effect of Section 4A-202(b) is to place the risk of loss on the customer if an
4 unauthorized payment order is accepted by the receiving bank after verification by the bank in
5 compliance with a commercially reasonable security procedure. An exception to this result is
6 provided by Section 4A-203(a)(2). The customer may avoid the loss resulting from such a
7 payment order if the customer can prove that the fraud was not committed by a person described
8 in that subsection. Breach of a commercially reasonable security procedure requires that the
9 person committing the fraud have knowledge of how the procedure works and knowledge of
10 codes, identifying devices, and the like. That person may also need access to transmitting
11 facilities through an access device or other software in order to breach the security procedure.
12 This confidential information must be obtained either from a source controlled by the customer
13 or from a source controlled by the receiving bank. If the customer can prove that the person
14 committing the fraud did not obtain the confidential information from an agent or former agent
15 of the customer or from a source controlled by the customer, the loss is shifted to the bank.
16 “Prove” is defined in Section 4A-105(a)(7). Because of bank regulation requirements, in this
17 kind of case there will always be a criminal investigation as well as an internal investigation of
18 the bank to determine the probable explanation for the breach of security. Because a funds
19 transfer fraud usually will involve a very large amount of money, both the criminal investigation
20 and the internal investigation are likely to be thorough. In some cases, there may be an
21 investigation by bank examiners as well. Frequently, these investigations will develop evidence
22 of who is at fault and the cause of the loss. The customer will have access to evidence developed
23 in these investigations and that evidence can be used by the customer in meeting its burden of
24 proof.
25

26 ~~6.7.~~ The effect of Section 4A-202(b) may also be changed by an agreement meeting the
27 requirements of Section 4A-203(a)(1). Some customers may be unwilling to take all or part of
28 the risk of loss with respect to unauthorized payment orders even if all of the requirements of
29 Section 4A-202(b) are met. By virtue of Section 4A-203(a)(1), a receiving bank may assume all
30 of the risk of loss with respect to unauthorized payment orders or the customer and bank may
31 agree that losses from unauthorized payment orders are to be divided as provided in the
32 agreement.
33

34 ~~7.8.~~ In a large majority of cases the sender of a payment order is a bank. In many cases in
35 which there is a bank sender, both the sender and the receiving bank will be members of a funds
36 transfer system over which the payment order is transmitted. Since Section 4A-202(f) does not
37 prohibit a funds transfer system rule from varying rights and obligations under Section 4A-202, a
38 rule of the funds transfer system can determine how loss due to an unauthorized payment order
39 from a participating bank to another participating bank is to be allocated. A funds transfer system
40 rule, however, cannot change the rights of a customer that is not a participating bank. § 4A-
41 501(b). Section 4A-202(f) also prevents variation by agreement except to the extent stated.
42

43 * * *

44
45 **Section 4A-206. Transmission of Payment Order Through Funds-Transfer or**
46 **Other Communication System.**

1 * * *

2 **Official Comment**

3 1. A payment order may be issued to a receiving bank directly by delivery of a ~~writing or~~
4 ~~electronic device~~ record or by an oral ~~or electronic~~ communication. If an agent of the sender is
5 employed to transmit orders on behalf of the sender, the sender is bound by the order transmitted
6 by the agent on the basis of agency law. Section 4A-206 is an application of that principle to
7 cases in which a funds transfer or communication system acts as an intermediary in transmitting
8 the sender's order to the receiving bank. The intermediary is deemed to be an agent of the sender
9 for the purpose of transmitting payment orders and related messages for the sender. Section
10 4A-206 deals with error by the intermediary.

11 * * *

12
13
14 **Section 4A-207. Misdescription of Beneficiary.**

15 * * *

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

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

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

1 * * *

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

5 * * *

6 **Section 4A-208. Misdescription of Intermediary Bank or Beneficiary’s Bank.**

7 * * *

8 (b) This subsection applies to a payment order identifying an intermediary bank or the
9 beneficiary’s bank both by name and an identifying number if the name and number identify
10 different persons.

11 (1) If the sender is a bank, the receiving bank may rely on the number as the
12 proper identification of the intermediary or beneficiary’s bank if the receiving bank, when it
13 executes the sender’s order, does not know that the name and number identify different persons.
14 The receiving bank need not determine whether the name and number refer to the same person or
15 whether the number refers to a bank. The sender is obliged to compensate the receiving bank for
16 any loss and expenses incurred by the receiving bank as a result of its reliance on the number in
17 executing or attempting to execute the order.

18 (2) If the sender is not a bank and the receiving bank proves that the sender,
19 before the payment order was accepted, had notice that the receiving bank might rely on the
20 number as the proper identification of the intermediary or beneficiary’s bank even if it identifies
21 a person different from the bank identified by name, the rights and obligations of the sender and
22 the receiving bank are governed by subsection (b)(1), as though the sender were a bank. Proof of
23 notice may be made by any admissible evidence. The receiving bank satisfies the burden of proof

1 if it proves that the sender, before the payment order was accepted, signed a ~~writing~~ record
2 stating the information to which the notice relates.

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

6 * * *

7 **Section 4A-210. Rejection of Payment Order.**

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

18 * * *

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

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

1 security procedure or the bank agrees to the cancellation or amendment.

2 * * *

3 **Official Comment**

4 * * *

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

16
17 * * *

18 **ARTICLE 5**

19 **LETTERS OF CREDIT**

20 **Section 5-102. Definitions.**

21 (a) In this article:

22 * * *

23 (14A) “Signed,” with respect to a record that is not a writing, includes the
24 attachment to or logical association with the record an electronic sound, symbol, or process with
25 present intent to adopt or accept the record.

26 * * *

27 **Reporter’s Note**

28
29 1. “*Signed.*” The definition of “signed” contained in Section 5-102(a)(14A) is copied
30 from Section 3-604(c). It would accommodate the use of electronic signatures under Sections 5-
31 104(i), 5-108(i)(5), 5-113(a), (b), (c) and (d), and 5-116(a) without invalidating the use of
32 traditional, non-electronic signatures on paper documents in letter-of-credit transactions. A

1 biometric measurement or calculation would be an “electronic . . . process” and that technology
2 would be covered by the proposed new definition.

3
4 2. The Drafting Committee plans to consider more generally the definition and use of
5 “signed,” which also is defined in Section 1-201(b)(37), throughout the Uniform Commercial
6 Code.

7
8 * * *

9 **Section 5-116. Choice of Law and Forum.**

10 (a) The liability of an issuer, nominated person, or adviser for action or omission is
11 governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or
12 otherwise authenticated by the affected parties in the manner provided in Section 5-104 or by a
13 provision in the person’s letter of credit, confirmation, or other undertaking. The jurisdiction
14 whose law is chosen need not bear any relation to the transaction.

15 (b) Unless subsection (a) applies, the liability of an issuer, nominated person, or adviser
16 for action or omission is governed by the law of the jurisdiction in which the person is located.
17 The person is considered to be located at the address indicated in the person’s undertaking. If
18 more than one address is indicated, the person is considered to be located at the address from
19 which the person’s undertaking was issued.

20 (c) For the purpose of jurisdiction, choice of law, and recognition of interbranch letters of
21 credit, but not enforcement of a judgment, all branches of a bank are considered separate
22 juridical entities and a bank is considered to be located at the place where its relevant branch is
23 considered to be located under ~~this~~ subsection (d).

24 (d) A branch of a bank is considered to be located at the address indicated in the branch’s
25 undertaking. If more than one address is indicated, the branch is considered to be located at the
26 address from which the undertaking was issued.

27 ~~(e)~~(e) Except as otherwise provided in this subsection, the liability of an issuer,

1 nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform
2 Customs and Practice for Documentary Credits, to which the letter of credit, confirmation, or
3 other undertaking is expressly made subject. If (i) this article would govern the liability of an
4 issuer, nominated person, or adviser under subsection (a) or (b), (ii) the relevant undertaking
5 incorporates rules of custom or practice, and (iii) there is conflict between this article and those
6 rules as applied to that undertaking, those rules govern except to the extent of any conflict with
7 the nonvariable provisions specified in Section 5-103(c).

8 ~~(d)~~(f) If there is conflict between this article and Article 3, 4, 4A, or 9, this article
9 governs.

10 ~~(e)~~(g) The forum for settling disputes arising out of an undertaking within this article may
11 be chosen in the manner and with the binding effect that governing law may be chosen in
12 accordance with subsection (a).

13 **Reporter's Note**

14
15 *Clarification of ambiguity as to separateness of bank branches.* The last sentence of
16 existing subsection (b) is placed in a new subsection (c) and a new subsection (d) is added. These
17 revisions are necessary to eliminate a potential ambiguity arising from the first sentence of
18 subsection (b). The first sentence has been construed incorrectly as meaning that the last
19 sentence, which recognizes the separateness of bank branches for the specified purposes, is
20 inapplicable when a governing law has been chosen pursuant to subsection (a). These
21 amendments would reject that construction and override cases such as *Zeeco, Inc. v. JPMorgan*
22 *Chase Bank*, Case No. 17 -CV-384-JED-FHM, 2018 WL 1414119 (N.D. Okla. Mar. 21, 2018),
23 *amending opinion dated March 20, 2018, both opinions vacated*, 2019 WL 3543081, 2019 U.S.
24 Dist. LEXIS 133756 (Feb. 8, 2019).

25 * * *
26

27 **ARTICLE 7**

28 **DOCUMENTS OF TITLE**

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

30 (a) **General rule.** A person has control of an electronic document of title if a system

1 employed for evidencing the transfer of interests in the electronic document reliably establishes
2 that person as the person to which the electronic document was issued or transferred.

3 (b) **[Single authoritative copy.]** A system satisfies subsection (a), and a person is
4 ~~deemed to have~~ has control of an electronic document of title, if the document is created, stored,
5 and ~~assigned~~ transferred in such a manner that:

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

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

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

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

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

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

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

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

20 (c) **[One or more authoritative electronic copies.]** A system satisfies subsection (a) and
21 a person has control of an electronic document of title if an electronic copy of the document, a
22 record attached to or logically associated with the electronic copy, or a system in which the
23 electronic copy is recorded:

1 (1) enables the person to readily identify each electronic copy as an authoritative
2 copy or nonauthoritative copy;

3 (2) enables the person readily to identify itself in any way, including by name,
4 identifying number, cryptographic key, office, or account number, as the person to which each
5 authoritative electronic copy was issued or transferred; and

6 (3) gives the person exclusive power, subject to subsection(e), to:

7 (A) prevent others from [adding to or changing][altering] the person to
8 which each authoritative electronic copy has been issued or transferred; and

9 (B) transfer control of the authoritative copy.

10 (d) [Obtaining control through another person.] A person has control of an electronic
11 document of title if another person, other than the transferor of an interest in the document:

12 (1) has control of the document and acknowledges that it has control on behalf of
13 the person, or

14 (2) obtains control of the document after having acknowledged that it will obtain
15 control of the document on behalf of the person.

16 (e) [Meaning of exclusive.] A power is exclusive under subsection (c)(3), even if:

17 (1) the authoritative electronic copy or a system in which the electronic copy is
18 recorded limits the use of the document or has a protocol that is programmed to transfer control;
19 or

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

21 **Reporter's Note**

22 1. *Background of revisions.* Draft § 7-106 on control of electronic documents of title
23 preserves the existing subsection (a) general rule and the existing subsection (b) “safe harbor.”
24 The minor stylistic revisions are not substantive. The other proposed revisions add an additional
25 “safe harbor” in subsection (c), along the lines of the proposed revisions to draft § 9-105 on

1 control of chattel paper evidenced by electronic records, and subsection (d) on control through
2 another person.

3
4 2. *Control of documents of title evidenced by an electronic record.* Draft § 7-106(c),
5 supplemented by subsections (e) and (f), generally follows draft § 9-105 on control of an
6 authoritative electronic copy of a record evidencing chattel paper. Subsection (c) differs from
7 subsection (b), which is based on a “single authoritative copy” of an electronic document of title.
8 *See generally* draft § 9-105 and Reporter’s Note.

9
10 3. *Control through another person.* Subsection (d) provides for a person to obtain control
11 through the control of another person. It follows the corresponding provisions for control of
12 deposit accounts (draft § 9-104), authoritative electronic copies of records evidencing chattel
13 paper (draft § 9-105), control of electronic money (draft § 9-105A), and control of controllable
14 electronic records (draft § 12-105). For a brief discussion, see draft § 12-105, Reporter’s Note 7.

15 16 ARTICLE 8

17 INVESTMENT SECURITIES

18 Reporter’s Prefatory Note to Article 8 Amendments

19 Proposed amendments to the official comments to Section 8-102 primarily serve to make
20 clear that a controllable electronic record may be a financial asset credited to a securities
21 account under Article 8. *See also* draft § 12-102, Reporter’s Note 1. The proposed amendment
22 to Section 8-106(d) on control through another person conforms that provision to proposed
23 amendments to Section 7-106 (control of electronic documents of title) and Section 9-105
24 (control of authoritative electronic copies of records evidencing chattel paper) and to draft §§ 9-
25 105A (control of electronic money) and 12-105 (control of controllable electronic records). The
26 proposed amendment to Section 8-303 conforms the text on the rights of a protected purchaser
27 to the corresponding provision for a qualifying purchaser under Article 12. The proposed
28 revision of Section 8-501 addresses the specified financial assets as to which both a securities
29 intermediary and its customer have control. These financial assets would be treated as being
30 held directly by the customer and would not be included in a security entitlement.

31 32 Section 8-102. Definitions and Index of Definitions.

33 * * *

34
35 (b) Other definitions applying to this Article and the sections in which they appear are:

36
37 “Appropriate person”. Section 8-107.

38 “Control”. Section 8-106.

39 [“Chattel paper”. Section 9-102.]

40 “Controllable account”. Section 9-102.

41 “Controllable electronic record”. Section 12-102.

42 “Controllable payment intangible”. Section 9-102.

“Delivery”. Section 8-301.

“Electronic money”. Section 9-102.

“Investment company security”. Section 8-103.

“Issuer”. Section 8-201.

“Overissue”. Section 8-210.

“Protected purchaser”. Section 8-303.

“Securities account”. Section 8-501.

Official Comment

* * *

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

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

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

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

1 to the entitlement holder's security entitlement related to the financial asset. If the financial asset
2 itself is a controllable electronic record, however, then the rules in Article 12 would apply to the
3 securities intermediary's rights with respect to the controllable electronic record.
4

5 The term financial asset is used to refer both to the underlying asset and the particular
6 means by which ownership of that asset is evidenced. Thus, with respect to a certificated
7 security, the term financial asset may, as context requires, refer either to the interest or obligation
8 of the issuer or to the security certificate representing that interest or obligation. Similarly, if a
9 person holds a security or other financial asset through a securities account, the term financial
10 asset may, as context requires, refer either to the underlying asset or to the person's security
11 entitlement.
12

13 * * *

14 14. "Securities intermediary." A "securities intermediary" is a person that in the ordinary
15 course of its business maintains securities accounts for others and is acting in that capacity. The
16 most common examples of securities intermediaries would be clearing corporations holding
17 securities for their participants, banks acting as securities custodians, and brokers holding
18 securities on behalf of their customers. However, a person need not be such an entity in order to
19 be a securities intermediary. Because a "securities account" is an account to which a financial
20 asset is or may be credited under Section 8-501(a) and the definition of "financial asset" is not
21 limited to securities, a person may be a "securities intermediary" even if that person does not
22 credit "securities" (as defined in Article 8) to the account. Rather, the securities accounts that a
23 securities intermediary maintains may consist exclusively of financial assets described in Section
24 8-102(a)(9)(ii) and (iii). Clearing corporations are listed separately as a category of securities
25 intermediary in subparagraph (i) even though in most circumstances they would fall within the
26 general definition in subparagraph (ii). The reason is to simplify the analysis of arrangements
27 such as the NSCC-DTC system in which NSCC performs the comparison, clearance, and netting
28 function, while DTC acts as the depository. Because NSCC is a registered clearing agency under
29 the federal securities laws, it is a clearing corporation and hence a securities intermediary under
30 Article 8, regardless of whether it is at any particular time or in any particular aspect of its
31 operations holding securities on behalf of its participants.
32

33 The terms securities intermediary and broker have different meanings. Broker means a
34 person engaged in the business of buying and selling securities, as agent for others or as
35 principal. Securities intermediary means a person maintaining securities accounts for others. A
36 stockbroker, in the colloquial sense, may or may not be acting as a securities intermediary.
37

38 The definition of securities intermediary includes the requirement that the person in
39 question is "acting in the capacity" of maintaining securities accounts for others. This is to take
40 account of the fact that a particular entity, such as a bank, may act in many different capacities in
41 securities transactions. A bank may act as a transfer agent for issuers, as a securities custodian
42 for institutional investors and private investors, as a dealer in government securities, as a lender
43 taking securities as collateral, and as a provider of general payment and collection services that
44 might be used in connection with securities transactions. A bank that maintains securities
45 accounts for its customers would be a securities intermediary with respect to those accounts; but

1 if it takes a pledge of securities from a borrower to secure a loan, it is not thereby acting as a
2 securities intermediary with respect to the pledged securities, since it holds them for its own
3 account rather than for a customer. In other circumstances, those two functions might be
4 combined. For example, if the bank is a government securities dealer it may maintain securities
5 accounts for customers and also provide the customers with margin credit to purchase or carry
6 the securities, in much the same way that brokers provide margin loans to their customers.

7
8 The definition of securities intermediary includes the requirement that the person in
9 question “in the ordinary course of its business maintain securities accounts for others”. This
10 “ordinary course” requirement does not have a fixed quantitative requirement and is determined
11 by the facts of each case. Thus, a person need not necessarily satisfy a specified threshold of
12 activity or necessarily have a minimum number of customers.

13 14 **Reporter’s Note**

15
16 *Relationship between Articles 8 and 12.* These draft amendments to the Official
17 Comments to Article 8 are intended to make clear that a controllable electronic record may be a
18 financial asset credited to a securities account under Article 8 and to identify several significant
19 aspects of the relationship between Articles 8 and 12. *See also* draft § 12-102, Reporter’s Note 1
20 (second paragraph).

21
22 * * *

23 **Section 8-106. Control.**

24 (d) A purchaser has “control” of a security entitlement if:

25 * * *

26 (3) another person, other than the transferor of an interest in the security
27 entitlement: has control of the security entitlement on behalf of the purchaser or, having
28 previously acquired control of the security entitlement, acknowledges that it has control on
29 behalf of the purchaser.

30 (A) has control of the security entitlement and acknowledges that it has
31 control on behalf of the purchaser, or

32 (B) obtains control of the security entitlement after having acknowledged
33 that it will obtain control of the security entitlement on behalf of the purchaser.

34 **Reporter’s Note**

1 The proposed amendment to subsection (d)(3) would conform that provision for control
2 through another person to the corresponding provisions for control of other assets. *See* Reporter's
3 Prefatory Note to Article 8 Amendments and draft § 12-105, Reporter's Note 7.

4
5 * * *

6 **Section 8-303. Protected Purchaser.**

7 (a) "Protected purchaser" means a purchaser of a certificated or uncertificated security, or
8 of an interest therein, who:

9 (1) gives value;

10 (2) does not have notice of any adverse claim to the security; and

11 (3) obtains control of the certificated or uncertificated security.

12 (b) ~~In addition to acquiring the rights of a purchaser, a~~ A protected purchaser acquires its
13 interest in the security free of any adverse claim.

14 **Reporter's Note**

15 The proposed change conforms subsection (b) to draft § 12-104(d) on the rights of a
16 qualifying purchaser of a controllable electronic record, controllable account, or controllable
17 payment intangible. A protected purchaser acquires the rights of a purchaser under Section 8-
18 302. Consequently, the deletion of the reference in the current text to the rights of a purchaser
19 does not diminish the rights of a protected purchaser under this section.

20
21 * * *

22
23 **Section 8-501. Securities Account; Acquisition of Security Entitlement from**
24 **Securities Intermediary.**

25 * * *

26 (d) ~~If a securities intermediary holds a financial asset for another person, and the~~ A
27 person is treated as holding a financial asset directly rather than as having a security entitlement
28 with respect to the financial asset if:

29 (1) the financial asset is registered in the name of, payable to the order of, or

1 specially indorsed to the ~~other~~ person, and has not been indorsed to the securities intermediary or
2 in blank, ~~the other person is treated as holding the financial asset directly rather than as having a~~
3 ~~security entitlement with respect to the financial asset;~~ or

4 (2) the financial asset is a controllable account, controllable electronic record,
5 controllable payment intangible, [electronic document of title,] [or] electronic money[, or an
6 electronic copy of a record evidencing chattel paper] and both the securities intermediary and the
7 person each have control of the financial asset under Section 7-106, 9-105, 9-105A, 9-107A, or
8 12-105.

9 * * *

10 Reporter's Note

11 1. *Financial assets held for a person other than an entitlement holder.* The proposed
12 amendment of subsection (d) would address assets subject to control that might be held by a
13 securities intermediary for a person other than an entitlement holder. Subsection (d) generally
14 applies to “customer name securities” (see 15 U.S. Code § 7811l(3)) that are held directly by a
15 securities intermediary’s customer. However, subsection (d) uses terminology applicable to
16 conventional securities (e.g., “indorsed”). The proposed amendment would treat situations of
17 shared control between a securities intermediary and its customer as analogous to such customer
18 name securities.

19
20 2. As indicated by the terms placed in square brackets in subsection (d)(2), the Drafting
21 Committee should consider which assets that are subject to control under the Uniform
22 Commercial Code should be covered by the new provision.

23 ARTICLE 9

24 SECURED TRANSACTIONS

25 Reporter's Prefatory Note to Article 9 Amendments

26
27 1. *General.* This draft proposes extensive amendments to Article 9. Many of the
28 amendments are necessary to conform Article 9 to new Article 12, which, along with its
29 Reporter's Notes, should be read along with the Article 9 amendments and Reporter's Notes.
30 Other material amendments relate to chattel paper and money.

31
32 2. *Article 12-related conforming amendments.* Article 12-related conforming
33 amendments to Article 9 include the addition of two new types of collateral: controllable

1 accounts (a subset of accounts) and controllable payment intangibles (a subset of payment
2 intangibles, which is a subset of general intangibles). Perfection of a security interest in a
3 controllable electronic record, controllable account, or controllable payment intangible may be
4 by control or by filing a financing statement. Control of a controllable electronic record is
5 determined under draft § 12-105. Control of a controllable account or controllable payment
6 intangible is achieved by obtaining control of the controllable electronic record that evidences
7 the account or payment intangible. Draft § 9-107A. The rights of a secured party that takes free
8 of competing property interests as a qualifying purchaser of a controllable account, controllable
9 electronic record, or controllable payment intangible are respected under Article 9. Draft § 9-
10 331.

11
12 The law of the controllable record's jurisdiction under draft 12-107 governs perfection
13 by control and priority of a security interest in a controllable account, controllable electronic
14 record, or controllable payment intangible. The law of the jurisdiction in which a debtor is
15 located governs perfection by filing for such collateral. Draft § 9-306A.

16
17 The draft also contains several other Article 12-related conforming amendments to
18 Article 9.

19
20 3. *Chattel paper-related amendments.* These amendments primarily address two issues
21 that have arisen with respect to transactions in chattel paper.

22
23 First, the definition of "chattel paper" creates uncertainty in "bundled" transactions in
24 which monetary obligations exist not only under a lease of goods but also with respect to
25 software and services relating to the leased goods. Frequently, the value of the non-goods aspect
26 of a transaction is substantially greater than the value of the lessee's rights under the lease of
27 goods. Those who finance chattel paper and other rights to payment have become uncertain as to
28 whether these transactions give rise to chattel paper. The draft resolves this issue by treating only
29 those transactions whose predominant purpose was to give the obligor (lessee) the right to
30 possession and use of the goods as giving rise to "chattel paper."

31
32 Second, the statutory distinction between "tangible chattel paper" and "electronic chattel
33 paper" causes practical problems. As to tangible chattel paper (i.e., evidenced by writings),
34 problems arose in the case of multiple originals of writings and situations in which separate
35 writings covered different components of chattel paper. Official comments issued in connection
36 with the 1999 amendments to Article 9 addressed these issues. As to electronic chattel paper, the
37 safe harbor for control is based on a "single authoritative copy" of the chattel paper. Moreover,
38 in some situations tangible chattel paper is converted to electronic form and electronic chattel
39 paper is converted to tangible form. Additional uncertainty exists when one or more records
40 referred to in the current definition comprise one or more tangible authoritative copies of the
41 records that evidence the right to payment and rights in related property and one or more
42 electronic authoritative copies of those records also exist.

43
44 The draft provides a single rule, under which a security interest in chattel paper can be
45 perfected by taking possession of the tangible authoritative copies, if any, and obtaining control
46 of the electronic authoritative copies, if any. This single rule would address cases where some

1 records evidencing chattel paper are electronic and some are tangible or where a record in one
2 medium is replaced by a record in another.

3
4 The draft also defines chattel paper more accurately, as the right to payment of a
5 monetary obligation that is secured by a security interest in specific goods or owed under a lease
6 of specific goods, if the right to payment and interest in the goods are evidenced by a record.

7 8 4. Money-related amendments 9

10 Section 1-201(b)(24) defines “money” as including “a medium of exchange currently
11 authorized or adopted by a domestic or foreign government” There is no way of knowing
12 how money in an intangible form might develop, but there are indications that some countries
13 might authorize or adopt intangible tokens as a medium of exchange and others might authorize
14 or adopt deposit accounts with a central bank as money.¹ For many purposes, there is no need
15 for the UCC to distinguish among types of money. For Article 9 purposes, however, distinctions
16 must be drawn. Only tangible money is susceptible of perfection by possession. And the steps
17 needed for perfection by control with respect to intangible tokens, such as controllable electronic
18 records, will not work for deposit accounts with a central bank, and vice versa. For this reason,
19 the draft provides a new definition of “money” for purposes of Article 9 that expressly excludes
20 deposit accounts. Thus, “electronic money,” defined in draft § 9-102 as “money in an electronic
21 form,” would not include deposit accounts.

22
23 The existing Article 9 provisions governing “deposit accounts” would remain suitable for
24 accounts with a central bank, even if a government has adopted these accounts as money. The
25 draft makes no changes with respect to Article 9’s treatment of these accounts, aside from
26 distinguishing them from “money” and therefore from “electronic money.” Under the draft, a
27 security interest in electronic money as original collateral can be perfected only by control. The
28 requirements for obtaining control of electronic money are the same as those for obtaining
29 control of a controllable electronic record under draft Article 12.

30
31 The draft also makes changes to the take-free rules for transferees of money, including
32 the addition of a new rule applicable to electronic money, and transferees of funds from deposit
33 accounts.

34 35 **Section 9-102. Definitions and Index of Definitions.**

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

37 * * *

38 (2) “Account”, except as used in “account for”, “on account of”, and paragraph
39 (29), means a right to payment of a monetary obligation, whether or not earned by performance,

¹ These accounts sometimes are referred to as central bank digital currency or CBDC.

(i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of,
(ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued,
(iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be
provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of
the use of a credit or charge card or information contained on or for use with the card, or (viii) as
winnings in a lottery or other game of chance operated or sponsored by a State, governmental
unit of a State, or person licensed or authorized to operate the game by a State or governmental
unit of a State. The term includes controllable accounts and health-care-insurance receivables.
The term does not include (i) ~~rights to payment evidenced by chattel paper or an instrument,~~
chattel paper, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v)
letter-of-credit rights or letters of credit, ~~or~~ (vi) rights to payment for money or funds advanced
or sold, other than rights arising out of the use of a credit or charge card or information contained
on or for use with the ~~card~~ card, or (vii) rights to payment evidenced by an instrument.

* * *

(6A) “Assignee” means a person:

(A) in whose favor a security interest that secures an obligation is created
or provided for under a security agreement, whether or not an obligation to be secured is
outstanding; or

(B) to which an account, chattel paper, payment intangible, or promissory
note has been sold.

(6B) “Assignor” means a person that:

(A) under a security agreement creates or provides for a security interest
that secures an obligation; or

1 (B) sells an account, chattel paper, payment intangible, or promissory
2 note.

3 * * *

4 (11) “Chattel paper” ~~means a record or records that evidence both a monetary~~
5 ~~obligation and a security interest in specific goods, a security interest in specific goods and~~
6 ~~software used in the goods, a security interest in specific goods and license of software used in~~
7 ~~the goods, a lease of specific goods, or a lease of specific goods and license of software used in~~
8 ~~the goods. In this paragraph, “monetary obligation” means a monetary obligation secured by the~~
9 ~~goods or owed under a lease of the goods and includes a monetary obligation with respect to~~
10 ~~software used in the goods. means:~~

11 (A) a right to payment of a monetary obligation secured [under a security
12 agreement] by specific goods, if the right to payment and security agreement are evidenced by a
13 record; or

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

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

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

21 ~~The term does not include (i) charters or other contracts involving the use or hire of a vessel or~~
22 ~~(ii) records that evidence a right to payment arising out of the use of a credit or charge card or~~
23 ~~information contained on or for use with the card. If a transaction is evidenced by records that~~

1 ~~include an instrument or series of instruments, the group of records taken together constitutes~~
2 ~~chattel paper.~~

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

6 * * *

7 (27A) “Controllable account” means an account evidenced by a controllable
8 electronic record that provides that the account debtor undertakes to pay the person that under
9 Section 12-105 has control of the controllable electronic record.

10 (27B) “Controllable payment intangible” means a payment intangible evidenced
11 by a controllable electronic record that provides that the account debtor undertakes to pay the
12 person that under Section 12-105 has control of the controllable electronic record.

13 * * *

14 (29) “Deposit account” means a demand, time, savings, passbook, or similar
15 account maintained with a bank. The term does not include investment property or accounts
16 evidenced by an instrument.

17 * * *

18 (31A) “Electronic money” means money in an electronic form.

19 * * *

20 (47) “Instrument” means a negotiable instrument or any other writing that
21 evidences a right to the payment of a monetary obligation, is not itself a security agreement or
22 lease, and is of a type that in ordinary course of business is transferred by delivery with any
23 necessary indorsement or assignment. The term does not include (i) investment property, (ii)

1 letters of credit, ~~or~~ (iii) writings that evidence a right to payment arising out of the use of a credit
2 or charge card or information contained on or for use with the card, or (iv) writings that evidence
3 chattel paper.

4 * * *

5 (54A) “Money” has the meaning provided in Section 1-201(24), but does not
6 include a deposit account.

7 * * *

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

11 * * *

12 (64) “Proceeds”, except as used in Section 9-609(b), means the following
13 property:

14 (A) whatever is acquired upon the sale, lease, license, exchange, or other
15 disposition of collateral;

16 (B) whatever is collected on, or distributed on account of, collateral;

17 (C) rights arising out of collateral;

18 (D) to the extent of the value of collateral, claims arising out of the loss,
19 nonconformity, or interference with the use of, defects or infringement of rights in, or damage to,
20 the collateral; or

21 (E) to the extent of the value of collateral and to the extent payable to the
22 debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects
23 or infringement of rights in, or damage to, the collateral.

1 * * *

2 (79A) “Tangible money” means money in a tangible form.

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

5 * * *

6 “Controllable electronic record” Section 12-102.

7 * * *

8 “Qualifying purchaser” Section 12-102.

9 * * *

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

12
13 **Official Comment**

14 * * *

15 **5. Receivables-related Definitions.**

16 * * *

17 b. ~~“Chattel Paper”; “Electronic Chattel Paper”; “Tangible Chattel Paper.”~~ “Chattel
18 paper” consists of a monetary obligation together with a security interest in or a lease of specific
19 goods if the obligation and security interest or lease are evidenced by “a record or records.” The
20 definition has been expanded from that found in former Article 9 to include records that evidence
21 a monetary obligation and a security interest in specific goods and software used in the goods, a
22 security interest in specific goods and license of software used in the goods, or a lease of specific
23 goods and license of software used in the goods. The expanded definition covers transactions in
24 which the debtor’s or lessee’s monetary obligation includes amounts owed with respect to
25 software used in the goods. The monetary obligation with respect to the software need not be
26 owed under a license from the secured party or lessor, and the secured party or lessor need not be
27 a party to the license transaction itself. Among the types of monetary obligations that are
28 included in “chattel paper” are amounts that have been advanced by the secured party or lessor to
29 enable the debtor or lessee to acquire or obtain financing for a license of the software used in the
30 goods. The definition also makes clear that rights to payment arising out of credit-card
31 transactions are not chattel paper. “Chattel paper” consists of a monetary obligation that is either
32 secured by specific goods or arises in connection with a lease of specific goods. The term also
33 includes a monetary obligation and a security interest in specific goods and software used in the

1 goods, a security interest in specific goods and license of software used in the goods, or a lease
2 of specific goods and license of software used in the goods. The term covers transactions in
3 which the debtor's or lessee's monetary obligation includes amounts owed with respect to
4 software used in the goods. The monetary obligation with respect to the software need not be
5 owed under a license from the secured party or lessor, and the secured party or lessor need not be
6 a party to the license transaction itself. The monetary obligation itself need not relate to the
7 goods. For example, a loan secured by specific goods and evidenced by one or more records
8 creates chattel paper regardless of the purpose of the loan.

9
10 What distinguishes chattel paper from other rights to payment is the fact that creditor has
11 an interest in specific goods to enforce the right to payment. The fact that the creditor also has an
12 interest in other property does not prevent the right to payment from being chattel paper.

13
14 **Example 8.** To secure a loan, Borrower grants Lender a security interest in a specified
15 item of equipment and a deposit account. The loan and the security interest are evidenced
16 by one or more records. The right to payment is chattel paper.

17
18 On the other hand, to be chattel paper, a right to payment must be accompanied by a security
19 interest in *specific* goods or a lease of *specific* goods. A right to payment secured by a security
20 interest in rotating collateral is not chattel paper.

21
22 **Example 9.** To secure a loan, Borrower grants Lender a security interest in all of
23 Borrower's existing and after-acquired inventory. The loan and the security interest are
24 evidenced by one or more records. The right to payment is not chattel paper.

25
26 A right to payment arising from a lease of specific goods gives rise to chattel paper only
27 if the predominant purpose of the transaction is to provide the lessee the right to possession and
28 use of the goods. Therefore, under paragraph (11)(B)(ii), when a lease of specific goods is
29 combined with an obligation to provide or right to receive other property or services, the
30 resulting right to payment will be chattel paper only if the goods aspect of the transaction
31 predominates.

32
33 **Example 10.** In one or more authenticated records, Customer and Car Dealer enter into a
34 transaction pursuant to which, in exchange for a payment of \$2,000 per month:
35 (i) Customer is entitled to possession of a specific vehicle for 36 months; (ii) Car Dealer
36 will provide round-the-clock monitoring of the vehicle's location and condition, and alert
37 authorities to provide road-side assistance in the event of a malfunction or accident; and
38 (iii) Car Dealer will, from time to time, remotely update the vehicle's automobile's
39 operating system. The value of the right to possess and use the vehicle is significantly
40 greater than the value of the monitoring service and updates. Because the goods aspect of
41 the transaction predominates, Customer's monetary obligation, including the portion
42 attributable to Car Dealer's obligation to provide monitoring and updates, constitutes
43 chattel paper.

44
45 **Example 11.** In one or more authenticated records, Customer and Cableco enter into a
46 transaction pursuant to which, in exchange for a payment of \$200 per month, Cableco

1 will provide Customer with specified television programming and a device needed to
2 access the programming (a “lease” of the device). If the components of the transaction
3 were priced separately, the price for the programming would be nine times the price for
4 possession and use of the device. Because the goods aspect of this transaction does not
5 predominate, Customer’s monetary obligation does not constitute chattel paper.
6

7 Charters of vessels are expressly excluded from the definition of chattel paper; they are
8 accounts. The term “charter” as used in this section includes bareboat charters, time charters,
9 successive voyage charters, contracts of affreightment, contracts of carriage, and all other
10 arrangements for the use of vessels.
11

12 ~~Under former Section 9-105, only if the evidence of an obligation consisted of “a writing~~
13 ~~or writings” could an obligation qualify as chattel paper. In this Article, traditional, written~~
14 ~~chattel paper is included in the definition of “tangible chattel paper.” “Electronic chattel paper”~~
15 ~~is chattel paper that is stored in an electronic medium instead of in tangible form. The concept of~~
16 ~~an electronic medium should be construed liberally to include electrical, digital, magnetic,~~
17 ~~optical, electromagnetic, or any other current or similar emerging technologies.~~
18

19 The latest revision to the definition of “chattel paper” changed the language from “a
20 record or records that evidence a monetary obligation” to “a right to payment of a monetary
21 obligation . . . evidenced by a record.” This semantic change was for clarification purposes only;
22 it does not imply a change in meaning. Chattel paper is and has always been a right to payment
23 of a monetary obligation. Because the revised definition is based on the obligation, rather than
24 the record, the definition no longer includes the following statement, which was previously part
25 of the definition: “If a transaction is evidenced by records that include an instrument or series of
26 instruments, the group of records taken together constitutes chattel paper.” The omission of that
27 statement also does not imply a change in meaning, except that records (writings) evidencing
28 chattel paper are excluded from the definition of “instrument” under draft § 9-102(a)(47).
29 Although the definition refers to “a record,” chattel paper can be evidenced by one or more
30 records because, under Section 1-106, unless the statutory context otherwise requires, words in
31 the singular number include the plural.
32

33 **Reporter’s Note**

34

35 1. “*Account*.” The draft redefines “chattel paper” to mean a right to payment rather than
36 a record evidencing a right to payment. The amendments to the definition of “account” reflect
37 the redefinition. The definition also includes a new exception for the use of the term in the
38 definition of “deposit account.”
39

40 2. “*Assignor*”; “*assignee*”. Instead of referring to a “debtor,” “secured party,” and
41 “security interest,” all of which terms are defined in the UCC, several provisions of Article 9,
42 including Part 4, refer to an “assignor,” “assignee,” and “assignment,” or sometimes an
43 “assigned contract,” none of which terms are defined in the UCC. Some courts read the
44 undefined terms in an unduly narrow way. In 2020, the Permanent Editorial Board for the UCC
45 issued a Commentary clarifying the meanings of these terms and amended the official comments
46 accordingly. *PEB Commentary No. 21, Use of the Term “Assignment” in Article 9 of the*

1 *Uniform Commercial Code* (Mar. 11, 2020). New subsections (6A) and (6B) incorporate the
2 essence of the Commentary into the statutory text.

3
4 3. “*Chattel paper*.” Under the revised definition, “chattel paper” is a right to payment
5 rather than a record evidencing a right to payment. Records evidencing chattel paper remain
6 relevant to perfection of a security interest in chattel paper. *See* draft § 9-314A.

7
8 The right to payment that constitutes “chattel paper” under subsection (a)(11)(B) may
9 include the right to payment of a variety of “bundled” monetary obligations owed by a lessee of
10 specific goods. These obligations may include obligations arising in connection with the
11 transaction giving rise to the lease, such as obligations for software or services. However, to
12 constitute “chattel paper,” these obligations must include the right to payment of a monetary
13 obligation owed by the lessee under the lease agreement.

14
15 A right to payment is not “chattel paper” under subsection (a)(11)(B) unless the
16 predominant purpose of the transaction giving rise to the lease was to give the lessee the right to
17 possession and use of the goods. The draft official comment explains the predominant-purpose
18 test and gives examples of its application.

19
20 4. “*Controllable account*”; “*controllable payment intangible*.” The draft affords special
21 treatment to security interests in controllable accounts and controllable payment intangibles, *i.e.*,
22 those accounts and payment intangibles that are evidenced by a controllable electronic record
23 that provides that the account debtor (obligor) undertakes to pay the person having control of the
24 controllable electronic record. (Of course, a person would be an account debtor only if it were
25 actually obligated on the underlying account or payment intangible.) An undertaking to pay the
26 “person that has control” means an undertaking to pay the person that has control at the time
27 payment is made. An undertaking to pay Smith, who happens to have control of the relevant
28 controllable electronic record at the time the undertaking was made, is not an undertaking to pay
29 the person that has control.

30
31 This special treatment includes the following:

- 32
- 33 • Perfection of a security interest in a controllable account or controllable payment
34 intangible can be achieved by filing a financing statement or obtaining control of the
35 controllable electronic record that evidences the controllable account or controllable
36 payment intangible. Draft §§ 9-312(a); 9-314(a); 9-107A(b).
 - 37
 - 38 • A security interest in a controllable electronic record, controllable account, or
39 controllable payment intangible that is perfected by control has priority over a
40 conflicting security interest that is perfected by another method. Draft § 9-326A.
 - 41
 - 42 • The benefit of the take-free and no-action rules for qualifying purchasers (including
43 secured parties) of controllable electronic records also extends to qualifying
44 purchasers of controllable accounts and controllable payment intangibles, whether or
45 not the qualifying purchaser also purchases the related controllable electronic record.
46 *See* draft § 12-104(a) and Reporter’s Notes 6 and 7.

1 5. “*Deposit account.*” This definition is not changed and is provided here for
2 convenience of reference.

3
4 6. “*Electronic money*” and “*tangible money.*” As the Reporter’s Prefatory Note to
5 Article 9 Amendments observes, some countries may authorize or adopt intangible tokens as a
6 medium of exchange that would be “money” as defined (and as proposed to be defined) in both
7 Article 1 and Article 9. Such intangible tokens would be “electronic money” as defined in draft §
8 9-102(a)(31A). Under the draft, a security interest in electronic money as original collateral can
9 be perfected only by control. Draft §§ 9-105A; 9-312(b)(4). The requirements for obtaining
10 control of electronic money are essentially the same as those for obtaining control of a
11 controllable electronic record under draft Article 12. The definition of “tangible money” uses the
12 word “tangible” with its normal meaning (as something that does have physical or corporeal
13 existence, such as goods).

14
15 7. “*Instrument.*” The change to the definition of “instrument” makes it clear that the
16 definition excludes an instrument that is a record included in the definition of “chattel paper.”
17 Note that while in many places in the UCC the term “writing” has been and is proposed to be
18 replaced by the technology neutral term, “record,” instruments (under both Articles 3 and 9)
19 must be “written” and in “writing.”

20
21 8. *Money and deposit accounts under Article 9.* As observed in the Reporter’s Prefatory
22 Note to Article 9 Amendments, some countries may authorize or adopt deposit accounts with a
23 central bank as a form of “money,” as defined in Section 1-201(b)(24) (and as that definition is
24 proposed to be revised in the draft). However, the existing Article 9 provisions governing
25 “deposit accounts” would remain suitable for such accounts with a central bank, even if a
26 government has adopted these accounts as money. The draft makes no changes with respect to
27 Article 9’s treatment of deposit accounts. However, *for purposes of Article 9* and in the interest
28 of clarity, the definition of “money” in draft § 9-102(a)(31A) excludes deposit accounts. Under
29 this definition, deposit accounts would not be money for Article 9 purposes even if they were to
30 become money under the Article 1 definition.

31
32 The principal function of the Article 9 definition of “money” is to ensure that even if
33 some deposit accounts were to become “money” as defined in Article 1, the provisions relating
34 to perfection and priority for security interests in deposit accounts, and not those for money, will
35 apply. It will be necessary to ensure that this definitional strategy does not cause any difficulties
36 for other provisions of Article 9, such as references to the cognate term “monetary.” The current
37 thinking is that this will not be problematic.

38
39 9. *Proceeds.*

40
41 a. *No change to definition of proceeds.* No change to the definition of “proceeds” is
42 proposed and the definition is provided here for convenience of reference.

43
44 b. “*Fork*” involving controllable electronic record. Sometimes there occurs a change in
45 the software (code) of a system (sometimes referred to as a “protocol” or “platform”) in which a
46 controllable electronic record is recorded. When such a change occurs in a blockchain platform,

1 the blockchain may remain intact, no new blockchain may result, and the change sometimes is
2 colloquially referred to as a “soft fork.” If such a change results in a new, separate blockchain
3 that exists alongside the original blockchain and a new controllable electronic record is created,
4 the change is sometimes referred to as a “hard fork.” But the terms “fork,” “soft fork,” and “hard
5 fork” are ambiguous and not used consistently. Even in a hard fork situation the pre-fork
6 controllable electronic record typically would remain intact (although its value might be
7 affected). However, a person in control of the original record may not automatically obtain
8 control of a new record. Additional steps may be required for the person in control to claim and
9 obtain control of the new record.

10
11 *c. New controllable electronic record as proceeds.* Depending on the nature and structure
12 of the fork, a new controllable electronic record arising under a hard fork may be property
13 “distributed on account of” the original record or “rights arising out of” the original record,
14 thereby constituting proceeds of the original record under subparagraph (B) or (C), or both, of
15 the definition of “proceeds.” If the new record is “proceeds,” then the rules on attachment,
16 perfection, priority under Sections 9-203(f), 9-315, and 9-322 would apply. If a security interest
17 in the original record is perfected by control, the creation of the new record in connection with a
18 hard fork typically results in the secured party obtaining control (or having the opportunity to
19 obtain control) of the new record. If that is not the case and perfection of the security interest in
20 the original record is only by control, however, then perfection would continue in the new record
21 only until the 21st day after the security interest attaches to the new record, unless one of the
22 exceptions under subsection (d) applies. Section 9-315(c), (d). For this reason, a secured party
23 may wish to perfect its security interest by filing so that the perfection would continue thereafter
24 in any proceeds under Section 9-315(d)(1). A secured party that does so may, to ensure the
25 priority of its perfected security interest, also wish to consider obtaining a release or
26 subordination from any earlier filed secured party whose financing statement covers the same
27 type of property. Even if that is achieved, a security interest in the record that is later perfected
28 by control would have priority over a security interest perfected by filing. Draft § 9-326A.

29
30 *d. “Airdrops” of controllable electronic records.* New controllable electronic records also
31 may be provided to persons in control of existing records by way of an “airdrop” that does not
32 involve a fork in an existing blockchain. Depending on the circumstances, these new records
33 may or may not be proceeds of the existing, original record.

34
35 *e. New controllable electronic record as financial asset credited to securities account.* If
36 the original record were a financial asset credited to a securities account, the new record might
37 become proceeds of a security entitlement for the reasons described in Note 9.c. Because the
38 securities intermediary (and not the entitlement holder) in such a situation presumably would
39 have control of the original record, the question sometimes arises as to whether the intermediary
40 has any duty to obtain or maintain control of the new record for the benefit of its entitlement
41 holder (and indirectly for the benefit of the holder of a security interest in the security
42 entitlement). The Drafting Committee has not yet considered that issue.

43 * * *

44 45 **Section 9-104. Control of Deposit Account.**

1 (a) **[Requirements for control.]** A secured party has control of a deposit account if:

2 (1) the secured party is the bank with which the deposit account is maintained;

3 (2) the debtor, secured party, and bank have agreed in an authenticated record that
4 the bank will comply with instructions originated by the secured party directing disposition of
5 the funds in the deposit account without further consent by the debtor; ~~or~~

6 (3) the secured party becomes the bank's customer with respect to the deposit
7 account; or

8 (4) another person, other than the debtor:

9 (A) has control of the deposit account and acknowledges that it has control
10 on behalf of the secured party; or

11 (B) obtains control of the deposit account after having acknowledged that
12 it will obtain control of the deposit account on behalf of the secured party.

13 (b) **[Debtor's right to direct disposition.]** A secured party that has satisfied subsection

14 (a) has control, even if the debtor retains the right to direct the disposition of funds from the
15 deposit account.

16 **Reporter's Note**

17 *Control on behalf of another person.* Draft subsection (a)(4) provides for a secured party
18 to obtain control of a deposit account by virtue of the acknowledgment by another person, other
19 than the debtor, in control of the deposit account. It follows the corresponding provisions for
20 control of electronic documents of title (draft § 7-106), control of an electronic copy of a record
21 evidencing chattel paper (draft § 9-105), control of electronic money (draft § 9-105A), and
22 control of controllable electronic records (draft § 12-105). For a brief discussion, see draft § 12-
23 105, Reporter's Note 7.

24 **~~Section 9-105. Control of Electronic Chattel Paper.~~**

25 ~~(a) **[General rule: control of electronic chattel paper.]** A secured party has control of~~
26 ~~electronic chattel paper if a system employed for evidencing the transfer of interests in the~~
27

1 chattel paper reliably establishes the secured party as the person to which the chattel paper was
2 assigned.

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

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

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

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

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

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

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

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

18 **[(a) [General rule: control of electronic copy of record evidencing chattel paper.] A**
19 **purchaser has control of each authoritative electronic copy of a record evidencing chattel paper if**
20 **a system employed for evidencing the [transfer][assignment] of interests in the chattel paper**
21 **reliably establishes the purchaser as the person to which the chattel paper was**
22 **[transferred][assigned.]**

23 **(b) [Specific facts giving control.] A purchaser has control of an electronic copy of a**

1 record evidencing chattel paper if:

2 (1) the electronic copy, a record attached to or logically associated with the
3 electronic copy, or a system in which the electronic copy is recorded:

4 (A) enables the purchaser readily to identify each electronic copy as an
5 authoritative copy or nonauthoritative copy;

6 (B) enables the purchaser readily to identify itself in any way, including
7 by name, identifying number, cryptographic key, office, or account number, as the assignee of
8 each authoritative electronic copy; and

9 (C) gives the purchaser exclusive power, subject to subsections (c) and
10 (d), to:

11 (i) prevent others from [adding to or changing] [altering] an
12 identified assignee of each authoritative electronic copy; and

13 (ii) transfer control of the authoritative electronic copy; or

14 (2) another person, other than the debtor:

15 (A) has control of the electronic copy and acknowledges that it has control
16 on behalf of the purchaser; or

17 (B) obtains control of the electronic copy after having acknowledged that
18 it will obtain control of the electronic copy on behalf of the purchaser.

19 **(c) [Exception for single authoritative electronic copy of record evidencing chattel**
20 **paper.]** This subsection applies if a single, unique, and identifiable authoritative electronic copy
21 of a record evidencing chattel paper exists. The requirements of subsection (b)(1)(C) are satisfied
22 if the [addition to or change] [alteration] of an identified assignee of the authoritative electronic
23 copy [can] [may] be made only with the consent of the secured party.

(d) [Meaning of exclusive.] A power is exclusive under subsection (b)(1)(C), even if:

(1) the electronic copy or a system in which the electronic copy is recorded limits

the use of the electronic record or has a protocol programmed to transfer control; or

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

Reporter's Note

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

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

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

To show that it has possession of all tangible authoritative copies of a record evidencing chattel paper, a secured party can produce the copies in its possession and provide evidence that these are authoritative copies. The secured party need not prove that no other tangible authoritative copies exist. *See* draft § 12-105, Reporter’s Note 8. (The Reporter’s Note to draft § 9-314A explains the meaning of “authoritative copy.”) The secured party’s possession of the tangible authoritative copies gives the secured party the power to prevent others from taking possession of the copies and to transfer possession of the copies.

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

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

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

4
5 4. *Control on behalf of another person.* Draft subsection (b)(2) provides for a secured
6 party to obtain control of an electronic copy by virtue of the acknowledgment by another person
7 in control of the electronic copy. It follows the corresponding provisions for control of electronic
8 documents of title (draft § 7-106), control of electronic money (draft § 9-105A), and control of
9 controllable electronic records (draft § 12-105). For a brief discussion, see draft § 12-105,
10 Reporter’s Note 7.

11
12 5. *Accommodation of systems for control under existing Section 9-105.* Subsections (a)
13 and (c) are intended to ensure that systems for control of electronic chattel paper under existing
14 Section 9-105 will also provide for control under the draft subsection (b). Subsection (a) appears
15 in square brackets to indicate that it may not be necessary. It appears that existing systems rely
16 on the “safe harbor” of existing subsection (b) and not on the general rule under subsection (a).
17 With one potential exception, control of electronic chattel paper under an existing system that
18 complies with existing subsection (b) would also satisfy the requirements for control under the
19 draft subsection (b). Subsection (c) provides for this exception.

20
21 6. *Application of section to “purchaser.”* References to a “secured party” in this section
22 have been changed to refer to a “purchaser.” This conforms the terminology to Section 9-330,
23 which conditions non-temporal priority on a “purchaser” obtaining control under this section.
24 This is not a substantive change. *See* Section 330(a), (b), (c), and (f).

25
26 * * *

27 **Section 9-105A. Control of Electronic Money.**

28 **(a) [General rule: control of electronic money.]** A person has control of electronic
29 money if:

30 (1) the electronic money or a system in which the electronic money is recorded
31 gives the person:

32 (A) the power to avail itself of substantially all the benefit from the
33 electronic money; and

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

35 (i) prevent others from availing themselves of substantially all the
36 benefit from the electronic money; and

(ii) transfer control of the electronic money to another person or
cause another person to obtain control of other electronic money as a result of the transfer of the
electronic money; and

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

(b) [Control through another person.] A person has control of electronic money if another person, other than the transferor of an interest in the electronic money:

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

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

(c) [Meaning of exclusive.] A power is exclusive under subsection (a)(1)(B), even if:

(1) the electronic money or a system in which the electronic money is recorded
limits the use of the electronic money or has a protocol programmed to transfer control; or

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

Reporter's Note

“*Control.*” A security interest in electronic money as original collateral may be perfected only by control as provided in this section. See draft § 9-312(b)(4). The requirements for obtaining control track those in draft § 12-105. See Reporter’s Note to draft § 12-105.

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

(a) [Control under Section 12-105.] A secured party has control of a controllable

1 electronic record as provided in Section 12-105.

2 **(b) [Control of controllable account and controllable payment intangible.]** A secured
3 party has control of a controllable account or controllable payment intangible if the secured party
4 has control of the controllable electronic record that evidences the controllable account or
5 controllable payment intangible.

6 **Reporter's Note**

7
8 1. *Control of controllable electronic records.* This draft provides for perfection by filing
9 and perfection by control as alternative methods of perfection with respect to a controllable
10 electronic record. See draft §§ 9-312 and 9-314. Under draft § 9-107A(a), a secured party has
11 control of a controllable electronic record as provided in draft § 12-105. Under draft § 9-326A, a
12 security interest in a controllable electronic record that is perfected by control has priority over a
13 security interest perfected by another method.

14
15 2. *Control of controllable account or controllable payment intangible.* This draft
16 provides for perfection by filing and perfection by control as alternative methods of perfection
17 with respect to a controllable account or controllable payment intangible. See draft §§ 9-312, 9-
18 314. Under draft § 9-107A(a), a secured party would obtain control of a controllable account or
19 controllable payment intangible by obtaining control of the related controllable electronic record.
20 Under draft § 9-326A, a security interest in a controllable account or controllable payment
21 intangible that is perfected by control would have priority over a security interest perfected by
22 another method.

23
24 By definition, a controllable account would be an Article 9 “account,” and a controllable
25 payment intangible would be an Article 9 “payment intangible.” Draft § 9-102. The fact that an
26 account or payment intangible is a controllable account or controllable payment intangible does
27 not affect a secured party’s alternative method of perfection, *i.e.*, filing. Moreover, that fact does
28 not affect the applicability of other provisions of Article 9, including the provisions governing an
29 account debtor’s agreement not to assert defenses (Section 9-403) and the statutory overrides of
30 legal and contractual restrictions on the assignability of accounts and payment intangibles
31 (Sections 9-406 and 9-408).

32 * * *

33
34
35 **Section 9-203. Attachment and Enforceability of Security Interest; Proceeds;**
36 **Supporting Obligations; Formal Requisites.**

37 * * *

38 **(b) [Enforceability.]** Except as otherwise provided in subsections (c) through (i), a

1 security interest is enforceable against the debtor and third parties with respect to the collateral
2 only if:

3 (1) value has been given;

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

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

7 * * *

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

11 (D) the collateral is controllable accounts, controllable electronic records,
12 controllable payment intangibles, deposit accounts, ~~electronic chattel paper,~~ electronic
13 documents, electronic money, investment property, or letter-of-credit rights, ~~or electronic~~
14 ~~documents,~~ and the secured party has control under Section 7-106, 9-104, 9-105A, 9-106, ~~or 9-~~
15 107, or 9-107A pursuant to the debtor's security agreement; or

16 (E) the collateral is chattel paper and the secured party has possession and
17 control under Section 9-314A pursuant to the debtor's security agreement.

18 **Reporter's Note**

19 . *Substitute for authenticated security agreement.* Under existing subparagraphs (b)(3)(B)
20 and (b)(3)(D), possession of tangible collateral and control of intangible collateral may substitute
21 for an authenticated security agreement that provides a description of the collateral. With respect
22 to chattel paper, some of the authoritative records that evidence the right to payment may be
23 tangible and some electronic. Accordingly, new subparagraph (b)(3)(E) would provide that
24 possession of the tangible authoritative records, if any, and control of the electronic records, if
25 any, may substitute for an authenticated security agreement.

26 **Section 9-204. After-Acquired Property; Future Advances.**

1 (a) **[After-acquired collateral.]** Except as otherwise provided in subsection (b), a
2 security agreement may create or provide for a security interest in after-acquired collateral.

3 (b) **[When after-acquired property clause not effective.]** A security interest does not
4 attach under a term constituting an after-acquired property clause to:

5 (1) consumer goods, other than an accession when given as additional security,
6 unless the debtor acquires rights in them within 10 days after the secured party gives value; or

7 (2) a commercial tort claim.

8 **(c) [Limitation on subsection (b).]** Subsection (b) does not prevent a security interest
9 from attaching:

10 (1) to consumer goods under Section 9-315(a) or Section 9-336(c);

11 (2) to a commercial tort claim under Section 9-315(a); or

12 (3) under an after-acquired property clause to property that is proceeds of
13 consumer goods or a commercial tort claim.

14 ~~(e)~~(d) **[Future advances and other value.]** A security agreement may provide that
15 collateral secures, or that accounts, chattel paper, payment intangibles, or promissory notes are
16 sold in connection with, future advances or other value, whether or not the advances or value are
17 given pursuant to commitment.

18 **Reporter's Note**

19 The proposed revision would clarify the appropriate result when a debtor acquires
20 consumer goods or a commercial tort claim as proceeds of collateral and when a consumer
21 acquires an interest in commingled goods. This clarification would override the erroneous
22 holdings of several cases addressing commercial tort claims that are proceeds.

23
24 * * *

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

1 the debtor or its designated custodian;

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

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

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

13 * * *

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

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

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

22 ~~(C) take appropriate action to enable the debtor or its designated custodian~~
23 ~~to make copies of or revisions to the authoritative copy which add or change an identified~~

1 ~~assignee of the authoritative copy without the consent of the secured party;~~

2 (6) a secured party having control under Section 7-106 of an authoritative copy of
3 an electronic document of title shall transfer control of the authoritative copy to the debtor or a
4 person designated by the debtor;

5 (7) a secured party having control under Section 9-105A of electronic money shall
6 transfer control of the electronic money to the debtor or a person designated by the debtor; and.

7 (8) a secured party having control under Section 12-105 of a controllable
8 electronic record shall transfer control of the controllable electronic record to the debtor or a
9 person designated by the debtor.

10 **Reporter's Note**

11 *New methods of control.* Provisions have been modified or added to take account of the
12 new methods of "control" for chattel paper, electronic documents, electronic money, and
13 controllable electronic records.

14 * * *

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

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

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

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

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

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

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

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

* * *

(5) While an authoritative tangible copy of a record evidencing chattel paper is located in a jurisdiction, the local law of that jurisdiction governs:

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

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

Reporter's Note

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

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

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

This approach is modeled on paragraph (3), which is designed to reduce the confusion that might arise when the choice-of-law rules of a given jurisdiction result in each of two

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

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

* * *

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

* * *

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

* * *

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

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

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

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

Reporter's Note

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

* * *

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

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

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

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

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

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

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

(4) a security interest in electronic money may be perfected only by control under

Section 9-314.

Reporter's Note

Perfection for controllable accounts, controllable electronic records, controllable payment intangibles, tangible money, and electronic money. Perfection for controllable accounts, controllable electronic records, and controllable payment intangibles may be by filing, for tangible money may be only by possession, and for electronic money may be only by control.

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

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

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

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.

copies are authoritative and which are not.

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

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

* * *

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

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

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

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

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

* * *

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

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

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

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

* * *

Reporter's Note

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

Section 9-317. Interests That Take Priority Over or Take Free of Security

Interest or Agricultural Lien.

* * *

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

* * *

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

* * *

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

Reporter's Note

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

* * *

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

* * *

Reporter's Note

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

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

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

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

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

Reporter's Note

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

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

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

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

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

Reporter's Note

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

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

3. *Meaning of “transfer”.* A “transfer” of property occurs when the transferee has obtained a property interest in the relevant property. *See* Section 9-102, Comment 26 (“In numerous provisions, this Article refers to the “assignment” or the “transfer” of *property* 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 * * *

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

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

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

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

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

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

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

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

Reporter's Note

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

* * *

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 • The electronic record must have some “use” that one person can enjoy to the
22 exclusion of all others, *e.g.*, the power to “spend” a bitcoin (or, more precisely,
23 the power to include an unspent transaction output (a UTXO) in a message that
24 the Bitcoin protocol will record to its blockchain).
25
- 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
- 30 • A person must be able to demonstrate to others that the person has the power to
31 “use” the electronic record.
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
 - Just as a buyer of goods can obtain possession from a seller that has no rights in
7 the goods, *B* can obtain control of the bitcoin, even if *S* “stole” it from the owner.
 - If *B* obtains control of the bitcoin for value, in good faith, and without notice of
8 any claim of a property interest, *B* would be a *qualifying purchaser*.
 - Even if *B* would not have acquired any rights in the bitcoin under non-Article 12
9 law, as an Article 12 qualifying purchaser, *B* would acquire the bitcoin free of all
10 claims of a property interest in the bitcoin. In the unlikely event that *O* could
11 locate *B*, *B* would defeat *O*’s claim of ownership and own the bitcoin free and
12 clear. (The same result would obtain if *B* bought a negotiable instrument from a
13 thief under circumstances where *B* became a holder in due course.)

14
15
16
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.

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 17 **Section 12-102. Definitions.**

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

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

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

27 (3) “Transferable record” means:

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

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

Transactions Act Section 16(a)].

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

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

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

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

Reporter’s Note

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

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

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

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

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

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

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

Reporter's Note

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Reporter's Note

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

2. *The basic rules.* This section applies only to an account debtor that has undertaken to pay the person that has control of the controllable electronic record that evidences the obligation to pay. See 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.

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

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

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

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

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

* * *

Reporter's Note

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

2. *Practical limitations on determination of governing law.* This section relating to the law governing the matters covered by Article 12 must confront substantial practical limitations. 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.