Uniform Commercial Code and Emerging Technologies

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# Uniform Commercial Code and Emerging Technologies

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Background

The Uniform Commercial Code (the UCC) has been enacted in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Since its widespread enactment in the 1960s, the UCC has been periodically revised to address changes in commercial practices. In 2019, the Uniform Law Commission and The American Law Institute (the Sponsors) appointed a Joint Committee to consider whether changes to the UCC are advisable to accommodate emerging technologies, such as artificial intelligence, distributed ledger technology, and virtual currency. At the time when the Joint Committee was formed, invitations were sent to large groups of potential stakeholders including trade organizations, financial institutions, technology companies, government agencies, academicians, and consumer groups. The Joint Committee currently has over 250 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.

The 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 July 31, September 2, and December 1, 2020, and on February 1, March 9, April 27 and 29, and May 3 and 10, 2021.

In addition, several small working groups met remotely to discuss specific topics and to hear the views of various stakeholder groups. Also, the Committee held informal sessions with Commissioners on June 15 and 16, 2021, on the draft of proposed amendments to the UCC.

The work of the Committee is currently in the following areas concerning the UCC: digital assets (controllable electronic records), intangible 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), payment systems, miscellaneous UCC amendments, and consumer issues.
The Committee expects to hold three full meetings, in-person with Zoom meeting attendance available to those who do not attend in-person, in the nine-month period following the 2021 annual meeting 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 Committee will continue to reach out to industry groups and other stakeholders and are already planning CLE presentations to educate members of the bar and others.

Organization of the draft

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

A. **Controllable electronic records.** The draft includes a new UCC Article 12 that would govern the transfer of property rights in intangible assets (“controllable electronic records”) that have been or may be created using new technologies. These assets include certain types of virtual currency and nonfungible tokens (NFTs). The draft also includes amendments to UCC Article 9 to govern security interests in controllable electronic records and in rights to payment that are embedded in (or tethered to) controllable electronic records.

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

C. **Chattel paper.** UCC Article 9 affords special treatment to “chattel paper” (e.g., installment sale contracts and personal property leases). The draft redefines “chattel paper” and updates the Article 9 provisions applicable to this type of collateral. The new definition resolves uncertainty that has arisen under the current definition and more accurately reflects the distinction between the seller’s or lessor’s right to payment and the record (e.g., installment sale contract or lease) evidencing that right. The new definition also resolves uncertainty that has arisen when goods are leased as part of a bundled transaction.

D. **Payments.** These amendments primarily concern payments made by check and wire transfer.

E. **Miscellaneous amendments.**

A. **Controllable Electronic Records**

**Prefatory Note**

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

Article 12 creates a legal regime that is meant to apply not only to electronic (intangible) assets that are created using existing technologies such a distributed ledger technology (DLT),
which powers transactions in Bitcoin and other digital assets, but also to electronic assets that may be created using technologies that have yet to be developed, or even imagined.¹

The adoption of distributed ledger technology (DLT) has underscored two important trends in electronic commerce. First, people are using the creation or transfer of electronic records to transfer rights to receive payment, rights to receive performance of other obligations (e.g., services or delivery of goods), and interests in personal and real property. Second, people have begun to assign economic value to some electronic records that bear no relationship to extrinsic rights and interests. For example, without any law or binding agreement, people around the world have agreed to treat Bitcoin (or, more precisely “transaction outputs” generated by the Bitcoin protocol) as a medium of exchange and store of value.

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

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

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

- The electronic record must have some “use” that one person can enjoy to the exclusion of all others, e.g., the power to “spend” a Bitcoin (or, more precisely, the power to include an unspent transaction output in a message that the Bitcoin protocol will record to its blockchain).

- A person must be able to transfer to another person this exclusive power to use the electronic record. To remain exclusive, the transfer must divest the transferor of the power to use the electronic record.

- A person must be able to demonstrate to others that the person has the power to “use” the electronic record.

As discussed in the Reporter’s Note to draft § 12-105, these functions form the basis of the Article 12 concept of control. To receive the benefits of negotiability and take free of third-party claims of a property interest in a controllable electronic record, a person must have control of the

¹ This draft was written before El Salvador adopted Bitcoin as legal tender. The Drafting Committee has not yet had an opportunity to consider how this action may affect future drafts.
controllable electronic record. In addition, control serves as a method of perfection of a security interest in a controllable electronic record. In this context, it may be useful to think of control as the rough functional equivalent of possession of tangible personal property such as goods.

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

What is the scope of draft Article 12?

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

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

The meaning of control in the UCC depends on the type of property involved.3 The Reporter’s Note accompanying draft § 12-105 explains the requirements for obtaining control of a controllable electronic record. For present purposes, it is sufficient to think of Bitcoin as the prototypical controllable electronic record.

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

What are the substantive provisions of Article 12?

The principal function of Article 12 is to specify the rights of a purchaser of a controllable electronic record. In addition, control serves as a method of perfection of a security interest in a controllable electronic record. In this context, it may be useful to think of control as the rough functional equivalent of possession of tangible personal property such as goods.

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

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2 See UCC § 1-201(b)(31).
3 E.g., UCC § 7-106 (electronic documents of title); § 8-106 (containing four definitions of “control,” one for each of four different types of investment property); § 9-104 (deposit accounts); § 9-105 (electronic chattel paper).
A purchaser is a person that acquires an interest in property by a voluntary transaction, such as a sale. Law other than Article 12 would determine whether a person acquires any rights in a controllable electronic record and so would be eligible to be a purchaser.

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

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

Consider the case in which B contracts to buy Bitcoin from S. Assume that S is the owner of the Bitcoin.

- Law other than Article 12 generally would determine whether S is the owner of the Bitcoin.
- Law other than Article 12 would resolve issues concerning the formation of the contract of sale between B and S and the obligations of the parties under the contract.
- Law other than Article 12 would determine what steps are necessary for B to acquire rights in the Bitcoin.
- By acquiring rights in the Bitcoin by sale, B would become a purchaser of the Bitcoin within the meaning of UCC Article 1.
- Article 12 provides that if B becomes a purchaser, B would acquire whatever rights S had or had power to transfer. As a general matter, law other than Article 12 would define these rights. B would acquire these rights regardless of whether B obtained

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4 “Purchase’ means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property.” UCC § 1-201(b)(29).
5 UCC § 2-403(1) provides, “A purchaser of goods acquires all title which his transferor had or had power to transfer . . . .” UCC § 8-302(a) provides, “a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer.” Other UCC provisions also reflect the shelter principle. See, e.g., UCC § 3-203(b) (concerning negotiable instruments); UCC § 7-504(a) (concerning documents of title).
6 Article 8 also provides for certain purchasers for value to take greater rights but does not contain a good-faith requirement. See UCC § 8-303.
7 Law other than Article 12 includes UCC Article 9. Thus, Article 9 would determine whether a security interest attaches to a controllable electronic record. More generally, Article 9 governs any conflict between Article 9 and Article 12. Draft § 12-102(b).
control of the Bitcoin.

Now assume that $S$ is a hacker, who acquired the Bitcoin illegally from the owner, $O$.

- Just as a buyer of goods can obtain possession from a seller that has no rights in 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 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 law, as an Article 12 qualifying purchaser, $B$ would acquire the Bitcoin free of all claims of a property interest in the Bitcoin. In the unlikely event that $O$ could locate $B$, $B$ would defeat $O$’s claim of ownership and own the Bitcoin free and clear. (The same result would obtain if $B$ bought a negotiable instrument from a thief under circumstances where $B$ became a holder in due course.)

How would Article 12 deal with rights or property that is linked to a controllable electronic record?

The general rules.

Recall that a controllable electronic record is a record, *i.e.*, information. Some records have what one might call “inherent value.” Bitcoin would be an example of such a record. Bitcoin can be exchanged (sold) for cash or other valuable assets. Or, the owner of Bitcoin can hold the Bitcoin as an investment.

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

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

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

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

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

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

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

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

The exceptions: controllable electronic records and controllable payment intangibles.

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

The draft provides an important exception to the general rule. The exception concerns
rights to payment (specifically, accounts and payment intangibles) that are evidenced by a
controllable electronic record that provides that the obligor (account debtor) undertakes to pay the
person that has control of the controllable electronic record. These rights to payment are referred
to as “controllable accounts” and “controllable payment intangibles.” Under amendments to UCC
Article 9, the attachment and perfection of a security interest in a controllable electronic record
would also be attachment of a security interest in controllable accounts and controllable payment
intangibles that are evidenced by the controllable electronic record. The draft provides a similar
rule with regard to perfection of a security interest in a controllable account or controllable
payment intangible. Under Article 12, a qualifying purchaser of the controllable electronic
record would acquire its rights in the controllable account or controllable payment intangible free
of any claim of a property interest.

The draft amends several other sections of Article 9 to deal with other aspects of security

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8 See draft § 9-102(b) (defining “controllable account” and “controllable payment intangible”).
9 Draft § 9-203(j).
10 Draft § 9-310(h).
11 Draft § 12-104.
interests in controllable accounts and controllable payment intangibles. The Reporter’s Notes to these sections discuss the amendments.

**Note on formatting**

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

Because Article 12 is a completely new UCC article, its provisions are not underscored.
Uniform Commercial Code and Emerging Technologies

ARTICLE 1

GENERAL PROVISIONS

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

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

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

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

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

Reporter’s Note

1. “Value.” The amendment to this section implements the policy choice described in Reporter’s Note 8 to draft § 12-104.

ARTICLE 12

CONTROLLABLE ELECTRONIC RECORDS

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

Section 12-102. Definitions.

(a) In this article, “controllable electronic record” means an electronic record that can be subjected to control under Section 12-105. The term does not include deposit accounts, electronic chattel paper, electronic documents of title, intangible money, investment property, or “transferable records”, as defined in the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7021(a)(1) or as defined in [cite to Uniform Electronic Transaction Act Section 16(a)].
(b) The definitions of “account debtor,” “authenticate,” “controllable account,”
“controllable payment intangible,” “deposit account,” “electronic chattel paper,” “intangible
money,” “investment property,” and “proceeds” in Article 9 apply to this article.

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

**Legislative Note:** In subsection (a), 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.” A “controllable electronic record” is an “electronic
record,” i.e., information that is stored in an electronic or other intangible medium and is
retrievable in perceivable form. To be within the scope of Article 12, the record must be
susceptible of control under Section 12-105. Unlike a “transferable record” under E-SIGN or
UETA, 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 are unsuitable for certain types of electronic records, and the
definition has been limited accordingly.

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

**Section 12-103. Scope.**

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

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

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

**Reporter’s Note**

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

2. Controllable accounts and controllable payment intangibles. As to controllable accounts and controllable payment intangibles, see Reporter’s Note 1 to draft § 9-102.

Section 12-104. Rights in Controllable Electronic Records, Controllable Accounts, and Controllable Payment Intangibles.

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

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

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

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

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

(f) Except as provided in subsection (e) or law other than [the Uniform Commercial Code], a qualifying purchaser takes a right to payment, right to performance, or interest in property evidenced by the controllable electronic record subject to a claim of a property right in the right to payment, right to performance, or interest in property.
The following rules apply to a purchaser of a controllable electronic record traceable to another controllable electronic record:

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

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

(A) the purchaser acquires its interest in and obtains control of the traceable controllable electronic record for value, in good faith, and without notice of a claim of a property right in the traceable controllable electronic record or a controllable account or controllable payment intangible evidenced by the traceable controllable electronic record; and

(B) the traceable controllable electronic record constitutes proceeds of the other controllable electronic record.

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

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

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

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

Subsection (e) derives from Section 3-306 (concerning the rights of a holder in due course).

Subsection (g) derives from Section 8-502 (protecting entitlement holders).

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

2. **Applicability of other law.** As a general matter, this section leaves to other law the resolution of questions concerning the transfer of rights in a controllable electronic record, 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 (h) 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 by either subsection (c) or (e), depending on whether *B* was a qualifying purchaser.

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

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

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

Because Debtor’s security agreement does not cover controllable electronic records, Secured Party would have no interest in the controllable electronic record. Accordingly, Secured Party would not be a purchaser of the controllable electronic record and would not benefit from the take-free rule in subsection (e) (discussed in Note 5). Secured Party’s security interest in Debtor’s controllable accounts and...
controllable payment intangibles would, however, have priority over a conflicting
security interest that was perfected by a method other than control. See draft § 9-
326A.

4. Conditions for, and consequences of, becoming a qualifying purchaser. The conditions
for, and consequences of, 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 Note 8 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.

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

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

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

As a general matter, law other than Article 12 would determine whether any particular
transaction creates a property interest in a controllable electronic record. See subsection (b). The
applicable law may provide that a hacker, who is essentially a thief, acquires no rights in a “stolen”
controllable electronic record. Even if this is the case, subsections (c) and (e) would enable a
purchaser that obtains control from a hacker and that otherwise meets the definition of “qualified
purchaser” (for value, in good faith, and without notice of property claims) to take the controllable
electronic record and any related controllable account or controllable payment intangible free of
property claims.

6. The no-action rule. The take-free rule in subsection (e) applies when both the person
having control and another person each claim a property interest in the same controllable electronic
record. The no-action rule in subsection (g) is meant to provide analogous protection when a
purchaser obtains control of a controllable electronic record that is not the same controllable
electronic record in which a third person claims a property interest but is traceable to that
controllable electronic record. To qualify for protection under subsection (g), a purchaser must
acquire its interest in, and obtain control of, the traceable controllable electronic record for value,
in good faith, and without notice of a claim of a property interest in the traceable controllable
electronic record or any related controllable account or controllable payment intangible.

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

7. “Tethered” assets. Certain controllable electronic records may carry with them rights to other assets, e.g., goods or rights to payment. By its terms, the take-free rule in subsection (e) applies to controllable electronic records, controllable accounts, and controllable payment intangibles. One might argue that the reference to controllable accounts and controllable payment intangibles is unnecessary. By taking a controllable electronic record free of property claims, wouldn’t a person take not only the controllable electronic record itself but also all rights that are “carried” in the controllable electronic record free and clear?

Subsection (f) defeats that argument and limits the application of the take-free rule in subsection (e) to controllable electronic records, controllable accounts, and controllable payment intangibles. Under subsection (f), a qualifying purchaser of a controllable electronic record takes other rights to payment, rights to performance, and interests in property that are evidenced by a controllable electronic record subject to third-party property claims, unless law other than the UCC provides to the contrary.

Example: O is the owner of a controllable electronic record. The controllable electronic record is a nonfungible token (NFT) that provides access to an electronic image file depicting LeBron James. The image file is not a controllable electronic record, and O does not own the copyright in the image of LeBron James. O granted to SP a security interest in all of O’s existing and after-acquired property. SP perfected the security interest. Thereafter, O sold the NFT to Buyer.

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

However, if Buyer is a qualifying purchaser, Buyer would acquire its interest in the NFT free of any claim of a property right in the NFT, including SP’s security interest. See draft § 12-104(e); UCC § 9-331. Article 9 would determine whether SP’s security interest attached to the image file depicting LeBron James. If it did attach, law other than Article 12 would determine whether Buyer would acquire the image file free and clear of SP’s security interest.

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

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

Section 12-105. Control of Controllable Electronic Record.

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

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

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

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

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

(ii) transfer control of the controllable electronic record to another person or cause another person to obtain control of a controllable electronic record that is traceable to the controllable electronic record; and

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

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

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

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

Reporter’s Note

1. Why “control” matters. Control serves two major functions Article 12. An electronic record is a “controllable electronic record” and is subject to the provisions of this article only if it can be subjected to control under this section. See draft §§ 12-102; 12-103. And a person having control of a controllable electronic record is eligible to become a qualified purchaser and so take free of claims of a property interest in the controllable electronic record. See draft § 12-104.

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

2. Powers; inability to exercise a power. This section conditions control on a person’s having the three powers specified in paragraph (a)(1). A person would have a power described in this paragraph if the controllable electronic record or any system in which it is recorded gives the purchaser that power, even if the characteristics of the particular purchaser disable the person from exercising the power. This would be the case, for example, when the purchaser holds the private key required to access the benefit of the controllable electronic record but lacks the hardware required to use it.


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

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

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

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

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

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

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

One effect of paragraph (b)(2) is that, under a multi-signature (multi-sig) agreement, any
person that is readily identifiable under paragraph (a)(2) and shares the relevant power would be
eligible to have control, even if the action of another person is a condition for the exercise of the
power.

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

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

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

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

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

(b) Subject to subsections (c) and (g), an account debtor may not discharge its obligation by paying a person that formerly had control of the controllable electronic record if the account debtor receives a notification, authenticated by a person that formerly had control or the person to which control was transferred, that reasonably identifies the controllable account or controllable payment intangible, notifies the account debtor that control of the controllable electronic record that evidences the controllable account or controllable payment intangible was transferred, identifies the transferee, and provides a commercially reasonable method by which the account debtor is to pay the transferee. The transferee may be identified in any way, including by name, identifying number, cryptographic key, office, or account number. After receipt of the notification, the account debtor may discharge its obligation only by paying in accordance with the notification and may not discharge the obligation by paying a person that formerly had control.

(c) Subject to subsection (g), notification is ineffective under subsection (b):

(1) unless, before the notification is sent, the account debtor and the person that at that time had control of the controllable electronic record that evidences the controllable account or controllable payment intangible agree in an authenticated record to a commercially reasonable method by which a person can furnish reasonable proof that control has been transferred;

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

(3) at the option of the account debtor, if the notification notifies the account debtor
to divide a payment and pay portions by more than one method.

(d) Subject to subsection (g), if requested by the account debtor, the person giving the
notification shall seasonably furnish reasonable proof, using the agreed method, that control of the
controllable electronic record has been transferred. Unless the person complies 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).

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

(f) Subject to subsection (g), an account debtor may not waive or vary its option under
subsection (c)(3).

(g) 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.

**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 (obligor), 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 intangible”).
Section 9-406 would continue to apply to all other account debtors.

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

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

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

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

Subsection (d) contains a similar provision. Upon the account debtor’s request, the person giving the notification must seasonably furnish reasonable proof that control of the controllable electronic record has been transferred. If the person does not comply with the request, the account debtor may ignore the notification and discharge its obligation by a paying a person formerly in control.
“Reasonable proof” requires evidence that would be understood by a typical account debtor to whom it is proffered as demonstrating to a reasonably high probability that control of the controllable electronic record has been transferred to the transferee. Subsection (e) provides a safe harbor for providing reasonable proof. It enables a person to satisfy the account debtor’s request by demonstrating that the transferee has the power to avail itself of substantially all the benefit from the controllable electronic record, to prevent others from availing themselves of substantially all the benefit from the controllable electronic record, and to transfer these powers to another person. This demonstration would not necessarily prove that a person actually has control of a controllable electronic record because it need not show that the transferee held the last two powers exclusively. Nevertheless, such a demonstration would constitute “reasonable proof” under subsection (e). A person that has control should have little difficulty providing this proof, as a person cannot have control unless it can readily identify itself as having the requisite powers. See draft § 12-105(a)(2).

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

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

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


[The Drafting Committee will not consider this section until after the Annual Meeting]
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. * * *

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

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

* * *

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

* * *

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

* * *

“Controllable electronic record” Section 12-102.
1. “Controllable account”; “controllable payment intangible.” The draft affords special treatment to security interests in controllable accounts and controllable payment intangibles, i.e., those accounts and payment intangibles that are evidenced by a controllable electronic record that provides that the account debtor (obligor) undertakes to pay the person having control of the controllable electronic record. This special treatment includes the following:

- Attachment of a security interest in a controllable electronic record is attachment of a security interest in a related controllable account and controllable payment intangible. Draft § 9-203(j).

- Perfection of a security interest in a controllable electronic record is perfection of a security interest in a related controllable account and controllable payment intangible. Draft § 9-308(h).

- Perfection of a security interest in a controllable account or controllable payment intangible can be achieved by filing a financing statement or obtaining control of the controllable electronic record that evidences the controllable account or controllable payment intangible. Draft §§ 9-314(a); 9-107A(b).

- A security interest in a controllable electronic record, controllable account, or controllable payment intangible that is perfected by control has priority over a conflicting security interest that is perfected by another method. Draft § 9-326A.

- A person that enjoys the benefit of the take-free and no-action rules with respect to a controllable electronic record would also enjoy those benefits with respect to a controllable account or controllable payment intangible that is evidenced by the controllable electronic record. Draft § 12-104(e), (g).

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

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

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

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

Reporter’s Note

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

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

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

Supporting Obligations; Formal Requisites.

* * *

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

(1) value has been given;

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

(3) one of the following conditions is met:

* * *

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

* * *

(j) [Controllable account or payment intangible.] The attachment of a security interest in
a controllable electronic record that evidences a controllable account or controllable payment
intangible is also attachment of a security interest in the controllable account or controllable
payment intangible.

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

* * *

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

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

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

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

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

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

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

* * *

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

* * *


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

* * *

Section 9-314. Perfection by Control.

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

* * *

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

A security interest in a controllable electronic record, controllable account, or controllable payment intangible held by a secured party having control of the controllable electronic record, controllable account, or controllable payment intangible has priority over a conflicting security interest held by a secured party that does not have control.

Reporter’s Note

1. Priority. This section adopts an approach to priority in controllable electronic records, controllable accounts, and controllable payment intangibles that is similar to the approach of Sections 9-327 and 9-328: A security interest perfected by control has priority over conflicting security interests that are not perfected by control. The approach taken in Section 9-330, which applies to chattel paper and instruments, would be likely to yield the same outcomes that would obtain under the provisions applicable to qualifying purchasers (draft §§ 12-104(e) and (g) and 9-331) in the vast majority of cases.


(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 electronic record. 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
1. Purpose of this section. This section insures that Article 9 does not interfere with the
protections that Article 12 affords to a good faith purchaser for value under the take-free and no-
action rules in draft § 12-105(e) and (g).

Section 9-406. Discharge of Account Debtor; Notification of Assignment;
Identification and Proof of Assignment; Restrictions on Assignment of Accounts, Chattel
Paper, Payment Intangibles, and Promissory Notes Ineffective.
(a) [Discharge of account debtor; effect of notification.] Subject to subsections (b)
through (i) and (l), an account debtor on an account, chattel paper, or a payment intangible may
discharge its obligation by paying the assignor until, but not after, the account debtor receives a
notification, authenticated by the assignor or the assignee, that the amount due or to become due
has been assigned and that payment is to be made to the assignee. After receipt of the notification,
the account debtor may discharge its obligation by paying the assignee and may not discharge the
obligation by paying the assignor.
(b) [When notification ineffective.] Subject to subsection subsections (h) and (l),
notification is ineffective under subsection (a):
(1) if it does not reasonably identify the rights assigned;

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

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

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

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

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

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

***

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

Reporter’s Note

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

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

Section 9-605. Unknown Debtor or Secondary Obligor.

(a) Subject to subsection (b), a secured party does not owe a duty based on its status as a secured party:

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

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

(B) the identity of the person; and

(C) how to communicate with the person; or

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

(A) that the person is a debtor; and

(B) the identity of the person.

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


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

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

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

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

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

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

(B) the identity of the person; and

(C) how to communicate with the person; or

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

(A) that the person is a debtor; and

(B) the identity of the person.

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

Reporter’s Note

1. Liability to unknown persons. Practices are developing under which lenders extend
secured credit without knowing, or having the ability to discover, the identity of their borrowers.
Existing Sections 9-605 and 9-628 would excuse these secured parties from having duties to their
debtors, including, e.g., the duty to notify the debtor before disposing of the collateral and the duty
to account to the debtor for any surplus arising from a disposition.
Comment 2 to Section 9-628 observes, “Without this group of provisions [in Sections 9-605 and 9-628], a secured party could incur liability to unknown persons and under circumstances that would not allow the secured party to protect itself.” The draft amendments to this section reflect the policy that a secured party should not be free to avoid statutory duties or absolve itself from liability by entering into a transaction when the secured party can protect itself, i.e., when the secured party has notice that the nature of the collateral or any system in which the collateral is recorded would prevent the secured party from acquiring the knowledge necessary to fulfill its statutory duties. (A person has notice of a fact if, inter alia, from all the facts and circumstances known to the person at the time in question, has reason to know that it exists. Section 1-202(a)(3).)

EFFECTIVE DATE AND TRANSITION PROVISIONS

[The Drafting Committee will not consider these provisions until after the Annual Meeting]

B. Money

Prefatory Note

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

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

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

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

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12 The exception is an amendment to UCC § 1-201(b)(24) that would delete from the UCC’s generally applicable definition of “money” a unit of account that is established by an intergovernmental organization or by agreement between two or more countries.

13 These accounts sometimes are referred to as central bank digital currency or CBDC. Regarding El Salvador’s adoption of Bitcoin as legal tender, see supra note 1.
electronic record under draft Article 12.

ARTICLE 1

GENERAL PROVISIONS

Section 1-201. General Definitions.

* * *

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

* * *

(24) “Money” means a medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more countries.

* * *

Reporter’s Note

1. “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.

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

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

ARTICLE 9

SECURED TRANSACTIONS

* * *

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

* * *

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

* * *

Reporter’s Note

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

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

Section 9-105A. Control of Intangible Money.

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

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

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

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

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

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

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

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

(1) the intangible money or the system in which the intangible money is recorded, if
any, limits the use to which the intangible may be put or has protocols that are programmed to
result in a transfer of control; or

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

Reporter’s Note

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

Section 9-203. Attachment and Enforceability of Security Interest; Proceeds;

Supporting Obligations; Formal Requisites.

* * *

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

(1) value has been given;

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

(3) one of the following conditions is met:

(A) the debtor has authenticated a security agreement that provides a
description of the collateral and, if the security interest covers timber to be cut, a description of the
land concerned;
(B) the collateral is not a certificated security and is in the possession of the
secured party under Section 9-313 pursuant to the debtor’s security agreement;

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

(D) the collateral is deposit accounts, electronic chattel paper, intangible
money, investment property, letter-of-credit rights, or electronic documents and the secured party
has control under Section 7-106, 9-104, 9-105, 9-105A, 9-106, or 9-107 pursuant to the debtor’s
security agreement.

***

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

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

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

(3) Except as otherwise provided in paragraph (4), while tangible negotiable documents,
goods, instruments, 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.

* * *

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 deposit accounts, electronic chattel paper, electronic documents, intangible
money, investment property, or letter-of-credit rights which is perfected by control under Section
9-314;

* * *

* * *

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

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

(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; 9-313; and

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

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

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

* * *

Section 9-314. Perfection by Control.

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

(b) [Specified collateral: time of perfection by control; continuation of perfection.] A security interest in deposit accounts, electronic chattel paper, intangible money, letter-of-credit rights, or electronic documents is perfected by control under Section 7-106, 9-104, 9-105, 9-105A, or 9-107 when the secured party obtains control and remains perfected by control only while the secured party retains control.
Section 9-332. Transfer of Money; Transfer of Funds from Deposit Account.

(a) [Transferee of money.] A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

(b) [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 in collusion with the debtor in violating the rights of the secured party.

Reporter’s Note

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

C. Chattel Paper

Prefatory Note

These amendments to Uniform Commercial Code Article 9 address issues that have arisen with respect to transactions in chattel paper. Stripped to its essentials, chattel paper is a monetary obligation that is secured by a security interest in specific goods or that arises under a lease of specific goods. Article 9 treats chattel paper differently from accounts and other rights to payment. In particular, it provides for perfection of a security interest in chattel paper by taking possession of tangible chattel paper or control of electronic chattel paper and affords a “superpriority” to financiers that perfect in this manner.

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

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

- The statutory distinction between “tangible chattel paper” and “electronic chattel paper” causes practical problems.

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

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

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

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

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

Background.

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

Until Article 9 was revised in the 1990s, chattel paper was deserving of its name. It was a writing (paper), that was connected with a security interest in or lease of specific goods (chattels). A common example is an installment sale contract, under which a buyer of goods on credit promises to pay the sale price and secures that promise with a security interest in the goods. Another common example is an equipment lease, where the lessee promises to pay rent and the lessor retains a leasehold interest in the leased goods.

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

Shortcomings in the current Article 9 provisions.

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

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

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

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

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

- First, the rule that a secured party cannot obtain control of electronic chattel paper unless
there is a “single authoritative copy” impeded system design.

- Second, in some cases it has proven to be commercially desirable to “convert” tangible
chattel paper into electronic chattel paper or to “paper out” electronic chattel paper into
tangible chattel paper. The legal consequences of doing so are thought to be uncertain.

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

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

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14 The only copies that are relevant under the draft are those that are “authoritative.” Regarding the meaning of the
term, see the Reporter’s Notes to draft § 9-314A.
Lawyers proved uncomfortable issuing a legal opinion to the effect that a particular system satisfied the general standard for control. As a result, their clients had strong incentives to use systems that allow for a “single authoritative copy” rather than, for example, utilizing distributed ledger technology, which always involves multiple authoritative copies. Thus, the technology for maintaining electronic chattel paper remains frozen in time.

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

Controllable electronic records v. chattel paper.

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

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

Approach taken in the draft.

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

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

ARTICLE 1

GENERAL PROVISIONS

Section 1-201. General Definitions.

15 Where a record evidencing the monetary obligation is a negotiable instrument, the paper itself is likely to have considerable value. See the Concluding Note below for a discussion of chattel paper evidenced by a negotiable instrument.
(b) Subject to definitions contained in other articles of the [Uniform Commercial Code] that apply to particular articles or parts thereof:

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

Reporter’s Note

1. “Account.” As the Prefatory Note explains, the draft redefines “chattel paper” to mean a right to payment rather than a record evidencing a right to payment. The amendments to the definition of “account” reflect the redefinition.

ARTICLE 9
SECURED TRANSACTIONS

Section 9-102. Definitions and Index of Definitions.

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

* * *

(11) “Chattel paper” means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this paragraph, “monetary obligation” means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The term does not include (i) charters or other contracts involving the use or hire of a vessel or (ii) records that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card. If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper.

(11) “Chattel paper” means:

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

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

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

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

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

* * *

(31) “Electronic chattel paper” means chattel paper evidenced by a record or records
consisting of information stored in an electronic medium.

* * *

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

* * *

(79) “Tangible chattel paper” means chattel paper evidenced by a record or records
consisting of information that is inscribed on a tangible medium.

* * *

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

**Reporter’s Note**

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

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

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

SECTION 9-105. CONTROL OF ELECTRONIC CHATTEL PAPER.

(a) [General rule: control of electronic chattel paper.] A secured party has control of electronic chattel paper if a system employed for evidencing the transfer of interests in the chattel paper reliably establishes the secured party as the person to which the chattel paper was assigned.

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

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

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

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

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

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

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

Section 9-105. Control of Electronic Copy of Record Evidencing Chattel Paper.
(a) **[When secured party has control.]** A secured party has control of an electronic copy of a record evidencing chattel paper if:

1. the electronic copy, a record attached to or logically associated with the electronic copy, or the system in which the electronic copy is recorded, if any:
   1. (A) enables the secured party to readily identify each electronic copy of the record as an authoritative copy or nonauthoritative copy of the record;
   2. (B) enables the secured party to readily identify itself as the assignee of each authoritative electronic copy of the record; and
   3. (C) subject to subsection (b), gives the secured party the exclusive power to:
      1. prevent others from adding or changing an identified assignee of each authoritative electronic copy of the record; and
      2. transfer control of the authoritative copy of the record; or
2. another person obtains control of the electronic copy of a record evidencing chattel paper or, having previously obtained control of the electronic copy, acknowledges in an authenticated record that it has control on behalf of the secured party.

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

1. the electronic copy or the system in which the electronic copy is recorded, if any, limits the use to which the electronic record may be put or has protocols that are programmed to result in a transfer of control; or
2. the secured party has agreed to share the power with another person.

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

**Reporter’s Note**
1. 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 tangible authoritative copies of the record evidencing the chattel paper and obtaining control of all electronic authoritative 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 and that no other tangible authoritative copies exist. (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 (blockchain) 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. The draft allows a secured party to obtain control when there are multiple authoritative copies.

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

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

* * *

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

(1) value has been given;

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

(3) one of the following conditions is met:

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

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

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

(D) the collateral is deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights, and the secured party has control under Section 9-104, 9-105, 9-106, or 9-107 pursuant to the debtor’s security agreement; or

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

* * *

Reporter’s Note

1. Substitute for authenticated security agreement. Under existing subparagraphs (b)(3)(B) and (b)(3)(D), possession of tangible collateral and control of intangible collateral may substitute for an authenticated security agreement that provides a description of the collateral. With respect to chattel paper, some of the authoritative records that evidence the right to payment may be tangible and some electronic. Accordingly, new subparagraph (b)(3)(E) would provide that possession of the tangible authoritative records, if any, and control of the electronic records, if any, may substitute for an authenticated security agreement.
Section 9-301. Law Governing Perfection and Priority of Security Interests.

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

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

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

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

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

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

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

(4) * * *

(5) While a tangible authoritative 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.
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 tangible authoritative copies and one or more electronic authoritative copies.

Draft paragraph (5) would address these cases by tying the choice-of-law rules to the authoritative tangible copy. As a consequence, 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 a tangible authoritative 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 conflicting security interests in the same collateral being governed by a different priority rule. The Drafting Committee plans to reconsider the approach, as it may create difficulties when, for example, all existing tangible authoritative copies are destroyed.

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

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 deposit accounts, electronic chattel paper, 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.
Section 9-313. When Possession by or Delivery to Secured Party Perfects Security Interest Without Filing.

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

Reporter’s Note

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

Section 9-314. Perfection by Control.

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

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

Reporter’s Note

1. Perfection by control. Perfection by control of electronic chattel paper has been deleted from this section. Instead, new Section 9-314A would govern perfection by possession and control.
Section 9-314A. Perfection by Possession and Control of Chattel Paper.

(a) [Perfection by possession and control.] A secured party may perfect a security interest in chattel paper by taking possession of the tangible authoritative copy, if any, of the record evidencing the chattel paper and obtaining control of the electronic authoritative copy, if any, of the electronic record evidencing the chattel paper.

(b) [Time of perfection; continuation of perfection.] A security interest is perfected under subsection (a) when the secured party takes possession and obtains control and remains perfected under subsection (a) only while the secured party retains possession and control.

***

Reporter’s Note

1. “Authoritative copy.” This section of the draft provides that to perfect a security interest in chattel paper other than by filing, a secured party must obtain control of all electronic authoritative copies and take possession of all tangible authoritative copies.

Existing Section 9-105(b) distinguishes between authoritative and nonauthoritative copies of electronic chattel paper. Like current law, the draft refers to copies that are “authoritative.” And, like current law, the draft does not define the term. However, the draft would apply this concept also to tangible records that evidence chattel paper.

As explained above, perfection of a security interest in chattel paper by taking possession of the collateral was understood to mean taking possession of the wet-ink “original.” Experience has shown that the concept of an original breaks down when one allows for the possibility of the same monetary obligation being evidenced in different media over time, such as where electronic records evidencing the chattel paper “papered out” (replaced with tangible records evidencing the same chattel paper) or tangible records are “converted” to electronic records.

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

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

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

* * *

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

* * *

(d) [Licensees and buyers of certain collateral.] A licensee of a general intangible or a buyer, other than a secured party, of accounts, electronic chattel paper, 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 tangible authoritative copy, if any, of the record evidencing the chattel paper and obtains control of the electronic authoritative copy, if any, of the record evidencing the chattel paper.


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

(1) in good faith and in the ordinary course of the purchaser’s business, the purchaser gives new value and takes possession of the tangible authoritative copy, if any, of the
(2) the chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.

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

* * *

Concluding Note

As noted above in footnote 2, a right to payment that is evidenced by an Article 3 negotiable instrument is different from a right to payment that is evidenced by a nonnegotiable record. This is because the obligation to pay a negotiable instrument is “embodied in” or “travels with” the negotiable instrument. For this reason, the definition of “account debtor” excludes the obligor on a negotiable instrument, even if the negotiable instrument constitutes part of chattel paper.

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

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

D. Payments

Prefatory Note

These amendments address issues arising under UCC Articles 3, 4, and 4A.

ARTICLE 3

NEGOTIABLE INSTRUMENTS


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

(1) is payable to bearer or to order at the time it is issued or first comes into possession 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; or (iv) an undertaking to litigate a dispute concerning the promise or order in a specified forum.

* * *

Reporter’s Note

1. Choice-of-law provisions. The amendment does not address choice-of-law provisions, as an agreement concerning the governing law is not an undertaking or instruction.

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

* * *

Reporter’s Note

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

Section 3–604. Discharge by Cancellation or Renunciation.

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

* * *

ARTICLE 4

BANK DEPOSITS AND COLLECTIONS

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

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

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\textbf{ARTICLE 4A}

\textbf{FUNDS TRANSFERS}

\textbf{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:

***

\textbf{Section 4A–201. Security Procedure.}

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

58
Section 4A–202. Authorized and Verified Payment Orders.

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

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

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

* * *

Section 4A–203. Unenforceability of Certain Verified Payment Orders.

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

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

* * *

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

(a) If a payment order addressed to a receiving bank is transmitted to a funds-transfer
system or other third-party communication system for transmittal to the bank, the system is deemed
to be an agent of the sender for the purpose of transmitting the payment order to the bank. If there
is a discrepancy between the terms of the payment order transmitted to the system and the terms of
the payment order transmitted by the system to the bank, the terms of the payment order of the
sender are those transmitted by the system. This section does not apply to a funds-transfer system
of the Federal Reserve Banks or to a third-party communication system that is part of a security
procedure.

* * *

Section 4A–207. Misdescription of Beneficiary.

* * *

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

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

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

***

Section 4A–208. Misdescription of Intermediary Bank or Beneficiary’s Bank.

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

***

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

* * *

Section 4A–210. Rejection of Payment Order.

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

* * *

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

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

* * *

E. Miscellaneous Amendments
ARTICLE 1

GENERAL PROVISIONS

Section 1-201. General Definitions.

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

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

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

Legislative Note: The added second sentence would provide needed clarity as to the status of a protected series for purposes of the Uniform Commercial Code. A number of states have enacted statutes that provide for protected series within a limited liability company or other unincorporated organization. These statutes afford rights and impose duties upon a protected series and generally empower a protected series to conduct its own activities under its own name.

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

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

Reporter’s Note

1. “Electronic.” The draft adopts the standard ULC definition.

2. “Person.” The draft retains the UCC’s existing definition of “person.” Although the UCC definition differs from the ULC’s current standard definition, the Drafting Committee sees no reason to create uncertainty by revising the UCC definition.

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

ARTICLE 5

LETTERS OF CREDIT

Section 5-102. Definitions.

(a) In this article:

* * *

(14A) “Signed”, with respect to a record that is not a writing, means to attach to or logically associate with the record an electronic sound, symbol, or process with present intent to adopt or accept the record.

* * *

Reporter’s Note

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

The Drafting Committee plans to consider more generally the definition and use of “sign”
throughout the Uniform Commercial Code.

ARTICLE 9

SECURED TRANSACTIONS

Section 9-102. Definitions and Index of Definitions.

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

* * *

(6A) “Assignee,” in part 4 of this article, means a person (i) 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 (ii) to which accounts, chattel paper,
payment intangibles, or promissory notes have been sold; and

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

* * *

Reporter’s Note

1. “Assignor”; “assignee”. Instead of referring to a “debtor,” “secured party,” and
“security interest,” all of which terms are defined in the UCC, several provisions of Article 9, Part
4, refer to an “assignor,” “assignee,” and “assignment,” or sometimes an “assigned contract,” none
of which terms are defined in the UCC. Some courts read the undefined terms in an unduly narrow
way. In 2020, the Permanent Editorial Board for the UCC issued a Commentary clarifying the
meanings of these terms and amended the official comments accordingly. *PEB Commentary No.
21, Use of the Term “Assignment” in Article 9 of the Uniform Commercial Code* (Mar. 11, 2020).
New subsection (6A) incorporates the essence of the Commentary into the statutory text.