Uniform Commercial Code and Emerging Technologies

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Uniform Commercial Code and Emerging Technologies

Prefatory Note to October 22, 2021 Draft

Note on formatting:

With the exception of the Payments amendments in Part E, the draft amendments to provisions of the UCC in this draft are NOT marked to show changes from the most recent UCC official text. Instead, those provisions are marked to reflect changes from the corresponding provisions in the 2021 ULC Annual Meeting Draft, June 30, 2021 (2021 AM Draft).

In Part E, Payments amendments, changes are marked to reflect changes from the UCC statutory text and official comments.

Part D, Documents of Title, is entirely new in this draft.

Because Article 12 is a completely new UCC article, its provisions are not underscored. However, changes to this Prefatory Note, to draft Article 12 and related changes to other provisions of the UCC, and to the Prefatory Notes and other Reporter’s Notes throughout this draft are marked to reflect changes from the 2021 AM Draft.

At this time, we are uncertain whether new sections that appear in the draft will make their way into the final Act. Any necessary renumbering will occur before the final draft is presented to the 2022 ULC Annual Meeting. Accordingly, new sections, subsections, and paragraphs are numbered with an “A” at the end, e.g., Section 9-107A.

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 250 300 observers.

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

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

In addition, several small working groups met remotely to discuss specific topics and to hear the views of various stakeholder groups. Since the 2021 ULC Annual Meeting the Chair, Reporters, and several members of the Drafting Committee have presented educational programs addressing the ongoing revision process to the Loan Syndication and Trading Association, the ABA Business Law Section, and the American College of Commercial Finance Lawyers. Also, the Committee held informal sessions with Commissioners on June 15 and 16, 2021, on the draft of proposed amendments to the UCC. The next meeting of the Drafting Committee (remote) is scheduled for November 5 and 6, 2021.

The work of the **Drafting** 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), documents of title, payment systems, miscellaneous UCC amendments, and consumer issues.

The **Drafting** 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 six-month period following the annual November 5-6, 2021 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 **Drafting** Committee will continue to reach out to industry groups and other stakeholders and are already planning plan to continue participating in CLE presentations to educate members of the bar and others.

**Organization of the draft**

The Joint **Drafting** 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. Moreover, this draft raises for discussion by the Drafting Committee additional issues relating to bundled transactions. Draft § 9-105 also provides an amended definition of “control” of an electronic copy of a record evidencing chattel paper, which reflects a more accurate and technologically flexible approach than the current definition.

D. Documents of Title. This draft includes a new draft § 7-106, dealing with control of electronic copy of document of title. It is patterned on draft § 9-105 for chattel paper, mentioned above.

E. Payments. These amendments primarily concern payments made by check and wire transfer. Many of the changes are to the official comments.

F. 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 Articles 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. 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.

1 This draft was written The 2021 AM Draft was prepared before El Salvador adopted Bitcoin as legal tender. However, the definition of “money” in Section 1-201, as proposed to be revised in this draft, would exclude bitcoin from the definition of money, notwithstanding the adoption by El Salvador (or any other sovereign state). See draft § 1-201(b)(24) (revised definition of “money” and Reporter’s Note discussing the proposed revision). The Drafting Committee has not yet had an opportunity to consider how this action may affect future drafts.
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 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 under the UCC would not necessarily 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. 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. 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. 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...
An 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.\(^5\)

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.\(^6\) 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 \(\text{bitcoin}\) 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 \(\text{bitcoin}\).
- 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 \(\text{bitcoin}\).\(^7\)
- By acquiring rights in the Bitcoin \(\text{bitcoin}\) by sale, \(B\) would become a *purchaser* of the Bitcoin \(\text{bitcoin}\) 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 control of the Bitcoin \(\text{bitcoin}\).

Now assume that \(S\) is a hacker, who acquired the Bitcoin \(\text{bitcoin}\) 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 \(\text{bitcoin}\), even if \(S\) “stole” it from the owner.

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\(^5\) 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).
If $B$ obtains control of the Bitcoin 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 bitcoin under non-Article 12 law, as an Article 12 qualifying purchaser, $B$ would acquire the Bitcoin bitcoin free of all claims of a property interest in the Bitcoin bitcoin. In the unlikely event that $O$ could locate $B$, $B$ would defeat $O$’s claim of ownership and own the Bitcoin 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 bitcoin can hold the Bitcoin 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)(b), $P$ 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,” which are included in the definition of “controllable electronic record” in draft § 12-102. 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 interests in controllable accounts and controllable payment intangibles. The Reporter’s Notes to these sections discuss the amendments.

*Note on formatting*

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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.
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.
ARTICLE 1

GENERAL PROVISIONS

Section 1-204. Value. Except as otherwise provided in Articles 3, 4, 5, [6,] and 12, 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 by making the generally applicable definition of “value” inapplicable to Article 12.

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:

1. “controllable electronic record” means an electronic record that can be subjected to control under Section 12-105. [Except as otherwise provided or the context otherwise requires, the] term includes a controllable account or a controllable payment intangible evidenced by a controllable electronic record. 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)].

(2) “Electronic record” means a record stored in an electronic medium.

(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 paragraph (a)(1), 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 a “controllable electronic record” within the scope of
Article 12, the electronic 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. Article 12 does not, however, limit the extent to which
property, including an electronic record, may be a financial asset under Article 8, including as a
result of an express agreement between a securities intermediary and another person to treat such
property held by the securities intermediary as a “financial asset” pursuant to Section 8-
102(a)(9)(iii) credited to a securities account.

This draft defines the term “controllable electronic record” to include a controllable account
or a controllable payment intangible evidenced by a controllable electronic record. Accordingly,
except where a specific reference to a controllable account or controllable payment is intended,
this draft deletes references to those terms in the text inasmuch as they are included by references
to a controllable electronic record. Although this definitional convention avoids excessive
repetition, the Drafting Committee should evaluate its wisdom—in particular, whether the
attendant brevity introduces undesirable ambiguity.

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

23. “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 that
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].

Reporters’ 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 9-201.

2. Controllable accounts and controllable payment intangibles. As to controllable accounts
and controllable payment intangibles, see Reporter’s Note 1 to draft § 9-102. The Drafting
Committee should consider whether, notwithstanding the inclusion of controllable accounts and
controllable payment intangibles in the definition of controllable electronic record, reference
should be made to those terms in subsection (a) in the interest of clarity.

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] [this article], 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 other interest in property.

(g) 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 a controllable electronic record or a controllable account or controllable payment intangible evidenced by the other controllable electronic record, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against the a qualifying purchaser of any controllable electronic record 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 of an instrument) and Section 8-303 (concerning rights of a protected purchaser of a security).

Subsection (g) (lead in) derives from Section 8-502 (protecting entitlement holders) and its applicability to a qualifying purchaser derives from Sections 3-302 and 3-306 (protecting holder in due course).

Subsection (g)

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 which.
as defined in draft § 12-102, includes a controllable account or controllable payment intangible
evidenced by the 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 by subsections (a) and (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 under subsection (b) 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. Purchaser and transferor under subsection (c): derivative controllable electronic
records. Subsection (c) sets forth the familiar “shelter” principle, under which a purchaser of a
controllable electronic record acquires whatever rights the transferor had or had power to transfer.
However, in some cases the controllable electronic record that is acquired by the purchaser will not
be the “same” controllable electronic record that was transferred by the transferor. Such a transfer
could involve the elimination of a “transferred” controllable electronic record and the resulting and
corresponding derivative creation and acquisition of a new controllable electronic record. An
example of such a derivative controllable electronic record is the unspent transaction output
(UTXO) generated by a transaction in bitcoin. Subsection (c) should be construed broadly to
encompass such transfers and resulting derivative controllable electronic records.

34. 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.

45. Conditions for, and consequences of, becoming a qualifying purchaser. The conditions for, and consequences of, becoming a qualifying purchaser pursuant to subsection (e) 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).

56. The take-free rule. Subsection (e) makes controllable electronic records highly negotiable. It protects a qualified qualifying 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 qualifying 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. A person in control of a controllable electronic record therefore has the power, even if not the right, to transfer rights in the record to a qualifying purchaser.

In this draft the phrase “In addition to acquiring the rights of a purchaser” has been deleted from subsection (e). That phrase appears to be borrowed verbatim from Section 8-303(b), which deals with the rights of a protected purchaser of a security. It is premised on the idea that the security that was purchased was the same security that was transferred by the transferor, as contemplated by Section 8-302(a). That paradigm does not always hold true, however, for security entitlements and financial assets credited to securities accounts. It also does not always hold true for controllable electronic records, as discussed in the following Notes.
67. Simplification: Proposed elimination of special treatment for “traceable controllable records.”

Most of the revisions to Section 9-104 in this draft reflect an effort to simplify the section and to make it more readable. The changes are not intended to make material changes in substance or results.

As explained in the Reporter’s Note to the 2021 AM Draft and Note 3 above, in some cases a purchaser will acquire and obtain control of a controllable electronic record that is not the same controllable electronic record that was “transferred” and a third person may claim a property interest in the “transferred” record from which the record that was purchased derives.

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. The transaction output is not the same controllable electronic record as the transaction input.

As contemplated in the 2021 AM Draft, 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)(1), then, would protect Buyer if the bitcoin were recorded in a transaction output that is not the same as the claimed transaction input. But the text of subsection (e) was not so limited—except by implication from the introductory phrase, which this draft proposes to delete as explained in Note 6. The qualifying purchaser would take free of a claim of a property right in the purchased controllable electronic record regardless of whether that claim results from a claim of a pre-purchase right in the purchased controllable electronic record or a claim of a right in any different, antecedent controllable electronic record. As revised, subsection (e) is intended to protect Buyer in both circumstances. Moreover, in many (perhaps most) cases the purchased controllable electronic record will be the “same” record as the pre-purchase record. Thus, if the pre-purchase record were “traceable” to the purchased record, the qualifying purchaser would be protected because the person asserting the claim would be asserting a property interest in the purchased record based on a claim “traced” from the pre-purchase record.

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. As explained above, the no-action rule in former subsection (g)(1) is was meant to provide analogous protection analogous to that of subsection (e) 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. As revised in this draft, the “no-action rule” in subsection (g) eliminates the distinction based on a controllable electronic record being traceable to another controllable electronic record. Instead, it applies to the purchase of any controllable electronic record. This approach follows Section 8-502 (from which subsection (g) derives), which does not involve traceability. Indeed, the no-action rule recognizes that tracing may be impossible. See Section 8-502, Comment 2.
The draft further simplifies subsection (g) by making the protection from actions based on claims of property rights applicable to qualifying purchasers, thus avoiding repetition of the necessary qualifying factors. Because a qualifying purchaser need only take without notice of claims of property rights in the purchased controllable electronic record, a purchaser’s notice of the claim on which an action is based would not necessarily disqualify the purchaser from status as a qualifying purchaser. This is so because the claimant’s property right claim might not have carried over to the purchased record. However, the purchaser’s notice of the claim on which the action is based would not suggest any culpability on the part of the purchaser unless the purchaser also had notice of the connection between that claim and the purchased controllable electronic record. If the purchaser were also to have notice of that connection, then, in an appropriate case, the purchaser might be disqualified from qualifying purchaser status based on the absence of good faith.

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.

In a further effort to simplify, this draft proposes to delete subsection (g)(2). Paragraph (2) would provide protection for a purchaser from a conflicting security interest in the purchased “traceable” controllable electronic record as proceeds of another, antecedent controllable electronic record. Inasmuch as a security interest would be a “claim of a property right,” the application of revised subsections (e) and (g) would provide protection for such a purchaser in the circumstances contemplated by paragraph (2). Of course, if the purchaser is a secured party whose security interest secures an obligation, the purchaser would take free of the conflicting property right only to the extent of the obligation secured. Cf. Section 3-302(e).

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; (which, as defined in draft § 12-102, includes controllable accounts, and controllable payment intangibles evidenced by a controllable electronic record). One might argue that the reference to inclusion of controllable accounts and controllable payment intangibles in the definition of controllable electronic records 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 (and related 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 Article 12 the UCC provides to the contrary. The reference in subsection (e) to “law other than [the Uniform Commercial Code]” now refers to “law other than this article” because
another article of the UCC might provide a contrary rule for some types of property that might be
tethered to a controllable electronic record.

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 Cecil Celebrity. The image file is not a
controllable electronic record, and O does not own the copyright in the image of
LeBron James Cecil Celebrity. 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 O’s rights, if any in the image file depicting
LeBron James Cecil Celebrity. 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 qualifying
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; and

(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 derived from 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 in any way 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

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 qualifying purchaser and
so take free of claims of a property interest in the controllable electronic record. See draft § 12-
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 and sources of 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, a record attached to or logically associated with the controllable electronic record, or any system in which it is recorded gives the purchaser that power. This description of the source of the relevant powers should be construed broadly and functionally. For example, a system in which the person in control is identified is a permissible source of a power even if it is related to but not precisely the “same” system in which the controllable electronic record is recorded. Moreover, a person would have a 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.

Paragraph (b)(2) allows for a person’s agreement to share a power with another person. 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. For example, a person in control may agree that another person’s action on the relevant system would be required to effect a transfer of control without impairing the requisite exclusivity.

6. **Transfer of control.** The power to transfer control under subsection (a)(1)(B)(ii) includes the power to cause another person to obtain control of a controllable electronic record that derives from a controllable electronic record. See draft § 12-104, Reporter’s Note 3.

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

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

A similar provision (now placed in square brackets) on control by a person on behalf of another person appears in draft § 9-105 on control of an electronic copy of a record evidencing chattel paper and in draft § 7-106 on control of an electronic copy of a document of title. See draft § 9-105(a)(2), Reporter’s Note 4.

The Drafting Committee is invited to consider whether a similar provision addressing
control by one person on behalf of another person should be added to draft § 12-105 for controllable electronic records and, if so, whether it should apply generally or should be made applicable only to control of controllable electronic records evidencing controllable accounts and controllable payment intangibles. For example, a new subsection (c), along the following lines might be added to draft § 12-105:

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

(1) has control of the controllable electronic record and acknowledges that it has control on behalf of the person, or
(2) obtains control of the controllable electronic record after having acknowledged that it will acquire control of the controllable electronic record on behalf of the person.

This formulation follows the structure of Section 9-313(c), but without the requirement that the acknowledgement be made in an authenticated record. The Drafting Committee may consider whether such a provision should impose an authenticated record requirement. The Drafting Committee also may consider whether it would be sufficient that these issues be addressed by official comments only.

The combined operation of subsection (b)(2) on sharing of control and a provision along the lines of a new subsection (c) set forth above would ensure that the continuance of various existing practices would not prevent or cause the loss of control. For example, a person in control may wish to grant another person the power to approve or disapprove a transfer of control on the system. Or, a control person may wish to permit a system administrator to transfer control to another person under specified conditions without participation by the person in control. And a person in control may wish to delegate the power to transfer control to an agent or fiduciary.

68. 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)(d) and (e)(h), 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 that:

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

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

(3) notifies the account debtor that control of the controllable electronic record that evidences the controllable account or controllable payment intangible was transferred;

(4) identifies the transferee in any reasonable way, including by name, identifying number, cryptographic key, office, or account number; and

(5) 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.

(c) After receipt of the a notification that complies with subsection (b), 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.

(e)(d) Subject to subsection (g)(h), 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 make less than the full amount of any required payment, or pay any portions of a payment by more than one method or to more than one person.

(d)(e) Subject to subsection (g)(h), 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)(f) A person furnishes reasonable proof that control has been transferred if the person demonstrates, using the agreed method, that the transferee has the power to 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)(g) Subject to subsection (g)(h), an account debtor may not waive or vary its option under subsection (e)(d)(3).

(g)(h) 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 transferor.
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)(e) 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 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)(f) 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)(e) requires that reasonable proof be provided “using the agreed method.” Subsection (e)(f) 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 (ed)(1).

4. Subsection (d)(3) differs from the corresponding provision in Section 9-406(b)(3). The Drafting Committee should consider whether this difference is appropriate.

45. 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]

(a) Except as provided in subsection[s (b) and] (d) [Alternative A], the local law of a controllable electronic record’s jurisdiction governs the matters covered by this article.

[(b) The local law of a controllable electronic record’s jurisdiction governs the matters]
covered by Section 12-106 unless an agreement effective under Section 1-301(a) determines that
the local law of another jurisdiction governs such matters.

(c) The following rules determine a controllable electronic record’s jurisdiction for
purposes of this section:

(1) If the controllable electronic record, or a record attached to or logically
associated with the controllable electronic record which is readily available for review, expressly
provides that a particular jurisdiction is the controllable electronic record’s jurisdiction for
purposes of this article or [the UCC], that jurisdiction is the controllable electronic record’s
jurisdiction.

(2) If paragraph 1 does not apply and the rules of the system in which the
controllable electronic record is recorded are readily available for review and expressly provide
that a particular jurisdiction is the controllable electronic record’s jurisdiction for purposes of this
article or [the UCC], that jurisdiction is the controllable electronic record’s jurisdiction.

(3) If none of the preceding paragraphs applies and the controllable electronic
record, or a record attached to or logically associated with the controllable electronic record which
is readily available for review, expressly provides that the controllable electronic record is
governed by the law of a particular jurisdiction, that jurisdiction is the controllable electronic
record’s jurisdiction.

(4) If none of the preceding paragraphs applies and the rules of the system in which
the controllable electronic record is recorded are readily available for review and expressly provide
that the controllable electronic record or the system is governed by the law of a particular
jurisdiction, that jurisdiction is the controllable electronic record’s jurisdiction.

Alternative 1

(5) If none of the preceding paragraphs applies, the controllable electronic record’s

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jurisdiction is the jurisdiction in which the transferor is located, unless the location of the transferor cannot be readily determined.

(d) If none of paragraphs (1) - (5) of subsection (c) applies, [except as provided in subsection (b)] the law that governs the matters covered by this article is determined under Section 1-301.

**Alternative 2**

(5) If none of the preceding paragraphs applies, the controllable electronic record’s jurisdiction is the jurisdiction in which the transferor is located.

(d) If paragraph (5) of subsection (c) applies and the location of the transferor cannot be readily determined, the transferor is [deemed to be] located in [this state][the District of Colombia][insert name of state that has adopted Article 12].

(e) Subsection (c) applies even if a transaction does not bear any relation to the controllable electronic record’s jurisdiction determined under paragraphs (c)(1) - (4).

(f) [Except as provided in subsection (d) [Alternative B], the] [The] location of the transferor for purposes of paragraph (c)(5) is determined under Section 9-307.

[(g) The rights acquired by a purchaser or a qualifying purchaser under Section 12-104 are governed by the law applicable under this section as determined at the time of that person’s purchase.]

**Reporter’s Note**

1. **Source of these provisions.** The provisions of draft § 12-107 derive from Sections 8-110 and 9-305 on law governing perfection and priority of security interests in investment property and the relevance of a securities intermediary’s jurisdiction and a commodity intermediary’s jurisdiction. This first draft is presented as a basis for an initial discussion of a choice-of-law rule for controllable electronic records.

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

3. Subsections (c)(5) and (d) (both alternatives) address a problem that does not normally exist in the context of Sections 9-110 and 9-305. Currently it is generally the case that many controllable electronic records, associated records, and systems in which such records are recorded do not identify the “controllable electronic record’s jurisdiction” or the governing law (except in some permissioned systems). (One hopes that once Article 12 and accompanying amendments are widely adopted that systems will adapt and the waterfall will become more generally viable for identifying the controllable electronic record’s jurisdiction.) This means that the waterfall ultimately turns to the location of the “transferor” of a controllable electronic record. This approach derives from the role of the location of a debtor under Sections 9-301 and 9-307. But in many cases involving controllable electronic records the transferor is not known to or easily discoverable by a purchaser. Subsection (d), Alternative 1, then points to the law applicable under Section 1-301. That approach may be an acceptable (or at least feasible) fallback for purposes of Article 12 in general. But it is unsatisfactory for purposes of the law applicable to perfection and priority of security interests, addressed by draft § 9-306A. Consequently, when the controllable electronic record’s jurisdiction is not resolved by the waterfall in draft § 12-107(c), draft § 9-306A must rely on the location of the debtor, which may be unknown. The likely result is that this uncertainty would discourage an extension of secured credit based on the controllable electronic record as collateral. But in the usual case an extender of secured credit will know the identity and location of its debtor, unlike the situation where a purchaser acquires a controllable electronic record in a public blockchain platform and the transferor is anonymous. Subsection (d), Alternative 2, offers another approach that provides more certainty, but may be problematic in other respects.

4. Draft subsection (g) appears in square brackets. The Drafting Committee may consider whether resolution of the timing issue that it addresses is implicit and therefore need not be expressly stated in the text. Note that Sections 8-110 and 9-305 do not contain an analogous rule. Alternatively, that subsection might be expanded to apply to the determination of other issues under Article 12.

ARTICLE 8

INVESTMENT SECURITIES

See draft § 12-102, Reporter’s Note 2 (last paragraph).

Section 8-102. Definitions and Index of Definitions.

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

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

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

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

The term financial asset is used to refer both to the underlying asset and the particular
means by which ownership of that asset is evidenced. Thus, with respect to a certificated security,
the term financial asset may, as context requires, refer either to the interest or obligation of the
issuer or to the security certificate representing that interest or obligation. Similarly, if a person
holds a security or other financial asset through a securities account, the term financial asset may,
as context requires, refer either to the underlying asset or to the person's security entitlement.
14. “Securities intermediary.” A “securities intermediary” is a person that in the ordinary
course of its business maintains securities accounts for others and is acting in that capacity. The
most common examples of securities intermediaries would be clearing corporations holding
securities for their participants, banks acting as securities custodians, and brokers holding securities
on behalf of their customers. However, a person need not be such an entity in order to be a
securities intermediary. Because a “securities account” is an account to which a financial asset is or
may be credited in accordance with Section 8-501(a) and the definition of “financial asset” is not
limited to securities, a person may be a “securities intermediary” even if that person does not credit
“securities” (as defined in Article 8) to the account. Rather, the securities accounts that a securities
intermediary maintains may consist exclusively of financial assets described in clauses (ii) and (iii)
of Section 8-102(a)(9). Clearing corporations are listed separately as a category of securities
intermediary in subparagraph (i) even though in most circumstances they would fall within the
general definition in subparagraph (ii). The reason is to simplify the analysis of arrangements such
as the NSCC-DTC system in which NSCC performs the comparison, clearance, and netting
function, while DTC acts as the depository. Because NSCC is a registered clearing agency under
the federal securities laws, it is a clearing corporation and hence a securities intermediary under
Article 8, regardless of whether it is at any particular time or in any particular aspect of its
operations holding securities on behalf of its participants.

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

The definition of securities intermediary includes the requirement that the person in
question is “acting in the capacity” of maintaining securities accounts for others. This is to take
account of the fact that a particular entity, such as a bank, may act in many different capacities in
securities transactions. A bank may act as a transfer agent for issuers, as a securities custodian for
institutional investors and private investors, as a dealer in government securities, as a lender taking
securities as collateral, and as a provider of general payment and collection services that might be
used in connection with securities transactions. A bank that maintains securities accounts for its
customers would be a securities intermediary with respect to those accounts; but if it takes a pledge
of securities from a borrower to secure a loan, it is not thereby acting as a securities intermediary
with respect to the pledged securities, since it holds them for its own account rather than for a
customer. In other circumstances, those two functions might be combined. For example, if the bank
is a government securities dealer it may maintain securities accounts for customers and also
provide the customers with margin credit to purchase or carry the securities, in much the same way
that brokers provide margin loans to their customers.

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

1. *Relationship between Articles 8 and 12.* These draft amendments to the Official

   Comments to Article 8 are intended to make clear that a controllable electronic record may be a

   financial asset credited to a securities account under Article 8 and to identify several significant

   aspects of the relationship between Articles 8 and 12.

2. *Financial assets held for a person other than an entitlement holder.* The drafting

   committee may wish to consider whether controllable electronic records might be held by a

   securities intermediary pursuant to Section 8-501(d) for a person other than an entitlement holder.

   Subsection (d) generally applies to “customer name securities” (see 15 U.S. Code § 78lll(3)) that

   are held directly by a securities intermediary’s customer. That subsection uses terminology

   applicable to conventional securities (*e.g.*, “indorsed”) and would require amendment (unless very

   “cheerfully” interpreted) for it to apply to financial assets such as controllable electronic records,

   which would be held directly by the intermediary’s customer, perhaps subject to shared control.

**ARTICLE 9**

**SECURED TRANSACTIONS**

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

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

   * * *

   (2) “Account”, except as used in “account for”, 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

   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 under Section 12-105 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 under Section 12-105 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.

“Qualifying purchaser” Section 12-104.

* * *

Reporter’s Note

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 §§ 12-102(a)(1) (defining “controllable electronic record” to include controllable accounts and controllable payment intangibles evidenced by a controllable electronic record); 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).

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

Supporting Obligations; Formal Requisites.

* * *

(b) [Enforceability.] Except as otherwise provided in subsections (c) through (j), 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, electronic documents, 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, 9-107, or 9-107A pursuant to the debtor’s security agreement.
(j) [Controllable account or controllable 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.

Reporter’s Note

1. Controllable accounts and controllable payment intangibles. A security interest may attach to a controllable account or controllable payment intangible without attaching to the related controllable electronic record. Accordingly, subsection (b)(3)(D) refers to controllable accounts and controllable payment intangibles even though control of that collateral would be achieved by control of the related controllable electronic record and that collateral is included in the definition of the term “controllable electronic record.”

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, 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]

(a) [Applicability of section.] This section applies to cases in which there is no outstanding secured obligation and the secured party is not committed to make advances, incur obligations, or otherwise give value.

(b) [Duties of secured party after receiving demand from debtor.] Within 10 days after receiving an authenticated demand by the debtor:

(1) a secured party having control of a deposit account under Section 9-104(a)(2) shall send to the bank with which the deposit account is maintained an authenticated statement that releases the bank from any further obligation to comply with instructions originated by the secured party;

(2) a secured party having control of a deposit account under Section 9-104(a)(3) shall:

(A) pay the debtor the balance on deposit in the deposit account; or

(B) transfer the balance on deposit into a deposit account in the debtor’s name;

(3) a secured party, other than a buyer, having control of electronic chattel paper under Section 9-105 shall:

(A) communicate the authoritative copy of the electronic chattel paper to the debtor or its designated custodian;

(B) if the debtor designates a custodian that is the designated custodian with which the authoritative copy of the electronic chattel paper is maintained for the secured party, communicate to the custodian an authenticated record releasing the designated custodian from any further obligation to comply with instructions originated by the secured party and instructing the custodian to comply with instructions originated by the debtor; and
(C) take appropriate action to enable the debtor or its designated custodian to
make copies of or revisions to the authoritative copy which add or change an identified assignee of
the authoritative copy without the consent of the secured party; and

(4) a secured party having control of investment property under Section 8-106(d)(2)
or 9-106(b) shall send to the securities intermediary or commodity intermediary with which the
security entitlement or commodity contract is maintained an authenticated record that releases the
securities intermediary or commodity intermediary from any further obligation to comply with
titlement orders or directions originated by the secured party; and

(5) a secured party having control of a letter-of-credit right under Section 9-107
shall send to each person having an unfulfilled obligation to pay or deliver proceeds of the letter of
credit to the secured party an authenticated release from any further obligation to pay or deliver
proceeds of the letter of credit to the secured party; and

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

(A) give control of the electronic document to the debtor or its designated

custodian;

(B) if the debtor designates a custodian that is the designated custodian with

which the authoritative copy of the electronic document is maintained for the secured party,

communicate to the custodian an authenticated record releasing the designated custodian from any

further obligation to comply with instructions originated by the secured party and instructing the

custodian to comply with instructions originated by the debtor; and

(C) take appropriate action to enable the debtor or its designated custodian to

make copies of or revisions to the authoritative copy which add or change an identified assignee of

the authoritative copy without the consent of the secured party; and

(7) a secured party having control of a controllable electronic record shall transfer
control of the controllable electronic record to the debtor or to a person designated by the debtor.

* * *

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:

* * *


(a) [Governing law: general rules.] Except as provided in subsection (b), perfection, the effect of perfection or nonperfection, and the priority of a security interest in a controllable electronic record is governed by:

(1) the local law of the controllable electronic record’s jurisdiction as specified in Section 12-107(c)(1) through (4), or

(2) if none of those paragraphs applies, the local law of the jurisdiction in which the debtor is located.

(b) [Governing law: perfection by filing.] The local law of the jurisdiction in which the debtor is located governs perfection of a security interest in a controllable electronic record intangibles by filing.

(c) [Location of debtor.] If the location of the debtor cannot readily be determined, the debtor is [deemed to be] located in [the District of Colombia][insert name of state that has adopted Article 12].

* * *

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

* * *

(h) [Controllable account or controllable 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.

* * *

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

* * *

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

* * *

(8) in controllable electronic records, 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;


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

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

* * *

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

(a) [General rule: effect on perfection of change in governing law.] A security interest perfected pursuant to the law of the jurisdiction designated in Section 9-301(1), or 9-305(c), or 9-306A(a)(2) or (b) remains perfected until the earliest of:

1. the time perfection would have ceased under the law of that jurisdiction;
2. the expiration of four months after a change of the debtor’s location to another jurisdiction; or
(3) the expiration of one year after a transfer of collateral to a person that thereby
becomes a debtor and is located in another jurisdiction.

* * *

(fA) [Change in jurisdiction of controllable accounts, controllable electronic records,
or controllable payment intangibles.] A security interest that is perfected pursuant to the law
designated in Section 9-306A(a)(1) remains perfected until the expiration of four months after a
change of the applicable law to another jurisdiction.

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

* * *

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. Control Priority priority. This section adopts an approach to priority in controllable
electronic records; (as defined, including controllable accounts; and controllable payment
intangibles) that is similar to the approach of Sections 9-327 (deposit account) and 9-328
(investment property): 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 certain purchasers (draft §§ 12-104(e) and (g) and 9-331) in
the vast majority of cases.

2. Alternative 9-330(d) approach. The “negotiability” attributes conferred by draft § 12-
104(e) and (g) for controllable electronic records and attendant controllable accounts and
controllable payment intangibles functionally mimic the treatment of negotiable instruments. As
explained in Note 1, the control priority rule of this draft section is based on the similar rule for
security interests in deposit accounts and investment property. An alternative approach would be
to follow Section 9-330(d), which provides for purchasers of instruments (as defined in Section 9-
102(a)(47) to include both negotiable and non-negotiable instruments) to obtain non-temporal
priority over conflicting security interests. The 9-330(d) standard for priority is somewhat more
generous than that provided in draft § 12-104(e) and (g) for qualifying purchasers—subsection (d)
uses the Section 1-204 definition of “value” and requires that the purchaser act “without
knowledge that the purchase violates the rights of the secured party.” However, the revisions to
draft § 12-104 proposed in this draft along with draft § 9-326A opt for simplicity over a more
granular allocation of priorities.

Section 9-331. Priority of Rights of Purchasers of Instruments, Documents, Securities,
Controllable Electronic Records, Controllable Accounts, and Controllable Payment
Intangibles Under Other Articles; Priority of Interests in Financial Assets and Security

(a) [Rights under Articles 3, 7, 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 (as defined in Section 12-104) 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, 8 and 12.

(b) [Protection under 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).
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 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 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).

* * *

(d) [Term restricting assignment generally ineffective.] Except as otherwise provided in subsection (e) and Sections 2A-303 and 9-407, and subject to subsection (h), a term in an agreement between an account debtor and an assignor or in a promissory note is ineffective to the extent that it:

(1) prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note; or

(2) provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account, chattel paper, payment intangible, or promissory note.

(e) [Inapplicability of subsection (d) to certain sales.] Subsection (d) does not apply to the sale of a payment intangible or promissory note, other than a sale of a controllable payment intangible and a sale pursuant to a disposition under Section 9-610 or an acceptance of collateral under Section 9-620.

* * *
(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.

2. **Sale of Controllable payment intangible.** The proposed amendment to subsection (e) would carve out controllable payment intangibles form the general exception for payment intangibles from the application of subsection (d). Providing that restrictions on assignments of controllable payment intangibles are ineffective pursuant to subsection (d) is consistent with the characteristics of negotiability generally conferred on controllable electronic records, controllable accounts, and controllable payment intangibles. The proposed amendment appears in square brackets pending discussion by the Drafting Committee.

**Section 9-408. Restrictions On Assignment Of Promissory Notes, Health-Care-Insurance Receivables, And Certain General Intangibles Ineffective.**

(a) [Term restricting assignment generally ineffective.] Except as otherwise provided in subsection (b), a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or a general intangible, including a contract, permit, license, or franchise, and which term prohibits, restricts, or requires the consent of the person obligated on the promissory note or the account debtor to, the assignment or transfer of, or creation, attachment, or perfection of a security interest in, the promissory note, health-care-insurance receivable, or general intangible, is ineffective to the extent that the term:

(1) would impair the creation, attachment, or perfection of a security interest; or

(2) provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.
(b) [Applicability of subsection (a) to sales of certain rights to payment.] Subsection (a) applies to a security interest in a payment intangible or promissory note only if the security interest arises out of a sale of the payment intangible or promissory note, other than a sale of a controllable payment intangible and a sale pursuant to a disposition under Section 9-610 or an acceptance of collateral under Section 9-620.

Reporter’s Note


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, 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 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 its November 5-6, 2021 meeting.]

**B. Money**

**Prefatory Note**

With one exception (two exceptions), all of these amendments address the use of intangible fiat currency (money) as collateral under UCC Article 9.  

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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.
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.\footnote{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.}

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. \textit{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 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, by an intergovernmental organization, or pursuant to an agreement between two or more governments. The term does not include a medium of exchange or by agreement between two or more countries and the amendment of UCC § 9-322, which deals with transfers of money and transfers of funds from a deposit account.
unless it was initially issued, created, or distributed by one or more of such persons.

***

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.

Only something currently authorized or adopted as a medium of exchange can be money. Coins and paper currency formerly issued by a government but now owned and traded only for their numismatic or historical value, and not as a medium of exchange, are not money. To be money, a medium of exchange must be initially issued, created or distributed by a government, by a governmental organization, or pursuant to an agreement between two or more governments. For this purpose, a currency printed or minted by a country’s central bank, treasury, or other similar department, and then distributed or circulated by or on behalf of the country, is money. So too is a currency printed or minted, and then circulated, by or on behalf of several countries, such as the Euro. An electronic medium of exchange established pursuant to a country’s law and initially distributed by or on behalf of the country also constitutes money, even if ownership is established or maintained through a blockchain or other system not operated by the government. In contrast, a medium of exchange initially issued, created, or distributed by one or more private parties is not money solely because the government of one or more countries later authorizes or later adopts it as a medium of exchange.

Note that the qualification “initially issued, created, or distributed” used in the second sentence of this definition is a subset of the broader, generally applicable terms, “authorized or adopted,” used in the first sentence.

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 definition as revised. (SDRs are not a medium of exchange.)

3. Examples: The following examples illustrate the definition of “money.”

Example 1: Nation A enacts legislation making sea shells a medium of exchange. Sea shells do not thereby become “money” because Nation A did not initially issue, create, or distribute the sea shells.
**Example 2:** Nation B enacts legislation making an existing crypto currency, created on a private blockchain, a medium of exchange. The crypto currency does not thereby becomes “money” because Nation B did not initially issue, create, or distribute the crypto currency.

**Example 3:** Nation C enacts legislation making the existing printed currency of Nation D a medium of exchange. Nation C’s action is not relevant to whether the printed currency of Nation D is “money.” If the currency was money prior to Nation C’s action, then it remains money; if the currency was not “money” prior to Nation C’s actions, then it has not become money merely as a result of Nation C’s actions because Nation C did not initially issue, create, or distribute the printed currency.

**Example 4:** Nation E creates a virtual currency and authorizes it as a medium of exchange. Nation E’s virtual currency is “money.”

**ARTICLE 9**

**SECURED TRANSACTIONS**

****

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

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

****

(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 (second) sentence clarifies that an account that otherwise would fall within the definition of “deposit account” would not be excluded from the definition even 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.” and “tangible 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. This definition of
"intangible money" is unusual inasmuch as it does not contain a positive statement of the meaning of the term and contains only an exclusion from the term’s meaning. However, in modifying the term “money,” defined in Section 1-201, the word “intangible” should be given its normal meaning (something that has no physical or corporeal existence). In similar fashion, there is no need to define “tangible money.” The word “tangible” modifies “money” and that word also should be given its normal meaning (something that does have physical or corporeal existence, such as goods).

* * *

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; and

(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 money 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 9-208. Additional Duties of Secured Party Having Control of Collateral.

(a) [Applicability of section.] This section applies to cases in which there is no
outstanding secured obligation and the secured party is not committed to make advances, incur
obligations, or otherwise give value.

(b) [Duties of secured party after receiving demand from debtor.] Within 10 days after
receiving an authenticated demand by the debtor:

* * *

(8) a secured party having control of intangible money under Section 9-105A shall
transfer control of the intangible money to the debtor or to a person designated by the debtor.

* * *

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;

* * *

* * *


(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; 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 tangible money.] A transferee of tangible money takes the money free of a security interest if the transferee receives delivery of the money without acting unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

(b) [Transferee of intangible money.] A transferee of intangible money takes the money free of a security interest if the transferee obtains control of the money without acting in collusion with the debtor in violating the rights of the secured party.

(b)(c) [Transferee of funds from deposit account.] A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account if the transferee receives the funds without acting 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.

1. “Delivery” of tangible money; “control” of intangible money. Conditioning the takes-free rule of subsection (a) on delivery of money reflects what has always been assumed—that a transfer of an interest in money that is not accompanied by a physical delivery would not impair the rights of third parties. Inasmuch as “intangible money” is a new classification, no pattern of past practices or understandings exists. New subsection (b) provides a rule for intangible money that complements draft subsection (a) by conditioning the takes-free rule on the transferee obtaining control.
2. Transferees of funds from deposit account. Similarly, the revisions to subsection (c) (formerly subsection (b)) make a corresponding change for a transfer of funds from a deposit account. To qualify for the take-free protection under subsection (c), the transferee must “receive[] the funds without acting in collusion [etc.] . . .” The draft amendments to Section 9-322(a) and (c) are intended to clarify what is implicit under the original text.

3. Meaning of “transfer”. A “transfer” of property occurs when the transferee has obtained a property interest in the relevant property. See Section 9-102, Comment 26 (“In numerous provisions, this Article refers to the “assignment” or the “transfer” of property interests.” (emphasis added)). Other law determines when the transferee has acquired a property interest. See Section 9-408, Comment 3 (“Other law determines whether a debtor has a property interest (‘rights in the collateral’) and the nature of that interest.”). Although the terms “transfer” and “transferee” are not defined in the UCC, the term “transfer” is broader in scope than “purchase,” which requires taking in a “voluntary transaction creating an interest in property.” Section 1-201(29). For example, “transfer” includes involuntary transfers such as the acquisition of a judicial lien by a lien creditor. See Section 9-102(a)(52) (defining “lien creditor”).

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

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

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.\textsuperscript{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.

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.

\textit{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.\textsuperscript{15} 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.

\textit{Approach taken in the draft.}

\textsuperscript{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.
\textsuperscript{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.
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.

(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, or (vii) rights to payment evidenced by
an instrument.

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ARTICLE 2

SALES

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Section 2-102. Scope; Certain Security and Other Transactions Excluded from this
Article.

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Official Comment

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2. This section does not specifically address the extent to which this Article applies to
transactions that cover both goods and non-goods, such as transactions that involve the sale of
goods and either the provision of services or the transfer of property other than goods. (Such
transactions are often referred to as “hybrid,” “mixed,” or “bundled” transactions.) This provides
courts some flexibility in deciding whether, and to what extent, this Article should be applied to
such transactions.

As a general matter, courts have applied this Article to such transactions when the goods
aspect of the transaction predominates and have declined to apply this Article when the non-goods
aspect predominates. See, e.g., Bonebrake v. Cox, 499 F.2d 951 (8th Cir. 1974). This approach,
which has been adopted in the definition of “chattel paper” in Section 9-102(a)(11)(B), is
appropriate, particularly when the issue is one that goes to the entire transaction, such as whether a
binding contract has been formed. When, however, an issue relates solely to the goods aspect of
the transaction, such as the characteristics the goods must have in order to conform to the contract,
application of this Article to that issue is appropriate even if the goods aspect of the transaction
does not predominate. This approach, sometimes referred to as the “gravamen” approach, has
expressly been applied by some courts and has implicitly been adopted by others. Examples of
express application of this approach include Data Processing Servs., Inc. v. L.H. Smith Oil Corp.,
(Ala. 1984). A good example of implicit application of this approach is provided by Frantz v.
Cantrell, 711 N.E.2d 856, 38 UCC Rep.Serv.2d 785 (1999). In Frantz, the plaintiff brought suit
against a lumber company that had contracted to install a new shingled roof on the plaintiff’s
house, asserting a claim for breach of implied warranty because the shingles curled and failed to
seal properly and, thus, were defective. The court analyzed the case entirely under this Article without considering whether the goods aspect of the transaction predominated or rather, which is more likely, the service aspect predominated.

* * *

ARTICLE 9

SECURED TRANSACTIONS

Section 9-102. Definitions and Index of Definitions.

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

* * *

(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) 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, or (vii) rights to payment evidenced by an instrument.

* * *

(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.

* * *

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

* * *

**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. “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. (Note that the definition of “account” in the 2021 AM Draft inadvertently situated it in Section 1-201 instead of Section 9-102, which has been adjusted in this draft.)

42. “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 subparagraph (a)(11)(B) may include the right to payment of a variety of “bundled” 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 subparagraph (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.)

3. The Drafting Committee also may wish to consider the additional issues posed below relating to chattel paper and related transactions. For background, see the following documents distributed with this draft (i) April 25, 2021, Memorandum from Steven Harris, Reporter, on Bundled Hardware, Software, and Service Transactions, and (ii) May 22, 2020, Report and Recommendations of the Subcommittee on Bundled Hardware, Software, and Service Transactions (Attachment A omitted). At its May 3, 2021 meeting the Drafting Committee decided that issues (b), (c), and (d) should be referred to the Subcommittee to consider whether they might be addressed by revisions to the relevant official comments. See draft new Official Comment to Section 2-102.

(a) Should the predominant-purpose test be extended beyond lease chattel paper to apply to chattel paper that involves a right to payment secured by specific goods under subparagraph (a)(11)(A)?

(b) Should the predominant-purpose test be applied to determine whether, in a “bundled” transaction, Article 2 or Article 2A applies (i.e., when the predominant purpose relates to the acquisition or use of goods)? If so, should this result be implemented by changes to the statutory text or pursuant to the official comments?

(c) When the predominant-purpose test does not result in the general application of Article 2 or Article 2A to a “bundled” transaction, should the relevant article nonetheless be applied to a specific matter that relates only to the goods involved in the transaction (e.g., a claim that goods are nonconforming)? If so, should this result be implemented by changes to the statutory text or pursuant to the official comments?

(d) In a “bundled” transaction involving a lease of goods and in which a service component is significant, is the transaction a “finance lease,” as defined in Section 2A-103(1)(g), if
the lease would be characterized as a “finance lease” if the transaction involved only goods?

4. “Instrument” and “writing.” Reminder: Although in many places the term “writing” has been and is proposed to be replaced by the technology neutral term, “record,” instruments (under both Articles 3 and 9) must be “written” and in “writing.”

**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. (i) prevent others from adding or changing an identified assignee of each authoritative electronic copy of the record; and
      2. (ii) transfer control of the authoritative copy of the record; or
   
2. [(2) another person on behalf of the secured party 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. (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. (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.
4. **Control on behalf of another person.** Draft subsection (a)(2) provides for a secured party to obtain control of an electronic copy by virtue of the acknowledgement by another person in control of the electronic copy in an authenticated record. This approach follows in general the definition of control in Section 8-106(d)(3) and provision for taking possession under Section 9-313(c). The Drafting Committee is invited to consider more generally the treatment of a person having control on behalf of another person at its November 2021 meeting. See the discussion in Reporter’s Note 7 to 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. (1) value has been given;
2. (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and
3. (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;
   - (D) the collateral is deposit accounts, investment property, or letter-of-credit rights, and the secured party has control under Section 9-104, 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 9-208. Additional Duties of Secured Party Having Control of Collateral.

(a) [Applicability of section.] This section applies to cases in which there is no outstanding secured obligation and the secured party is not committed to make advances, incur obligations, or otherwise give value.

(b) [Duties of secured party after receiving demand from debtor.] Within 10 days after receiving an authenticated demand by the debtor:

* * *

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

(A) communicate the authoritative copy of the electronic chattel paper to the debtor or its designated custodian;

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

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

* * *

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) Except as otherwise provided in paragraph (5), 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 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.

Reporter’s Note

1. Choice of governing law. Under the amended definition of chattel paper, a right to payment and rights in related property may be evidenced by one or more 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, 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; 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 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 may be perfected by control of the collateral under Section 9-104, 9-106, or
9-107.

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

(c) **Application of Section 9-313 to Perfection by Possession of Chattel Paper.**

Subsections (c), and (f) through (i) of Section 9-313 apply to possession of tangible authoritative copies of records evidencing chattel paper.

* * *

### 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).

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

Section 9-317. 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 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, 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 record evidencing the chattel paper and obtains control of the electronic authoritative copy, if any, of the record evidencing the chattel paper; and

(2) the authoritative copy of the record evidencing the chattel paper does not indicate that the copy 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 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.

***

Reporter’s 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.

NOTE: PART D IS NEW

D. Documents of Title

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:

***

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

* * *

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

(a) A person has control of an electronic document of title if a system employed for
evidencing the transfer of interests in the electronic document reliably establishes that person as the
person to which the electronic document was issued or transferred:

(b) A system satisfies subsection (a), and a person is deemed to have control of an
electronic document of title, if the document is created, stored, and assigned in such a manner that:

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

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

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

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

(3) the authoritative copy is communicated to and maintained by the person
asserting control 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 person asserting control;

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

Section 7-106. Control of Electronic Copy of Document of Title.

(a) [When secured party has control.] A secured party has control of an electronic copy of a document of title 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:

(A) enables the secured party to readily identify each electronic copy of the document of title as an authoritative copy or nonauthoritative copy of the document of title;

(B) enables the secured party to readily identify itself as the assignee of each authoritative electronic copy of the document of title; and

(C) subject to subsection (b), gives the secured party the exclusive power to:

(i) prevent others from adding or changing an identified assignee of each authoritative electronic copy of the document of title; and

(ii) transfer control of the authoritative copy of the document of title;

or

(2) another person obtains control of the document of title 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. Background. Draft § 7-106 on control of an electronic copy of a document of title is intended to focus discussion by the Drafting Committee on whether the provisions for electronic documents of title should be revised along the lines of the proposed revisions relating to chattel paper evidenced by electronic records. See generally the Prefatory Note to Part C (chattel paper).


3. Additional amendments. If the Drafting Committee wishes to pursue this approach, it will also be necessary to add conforming amendments to various provisions of Articles 7 and 9 and also to consider whether the approach taken for electronic copies of chattel paper should be followed in other respects, including adjustments to the definition of “document of title” in Section 1-201(b)(16). The terms “electronic document of title” and “tangible document of title,” are separately defined within that definition. The “electronic” and “tangible” dichotomy has been eliminated in the draft provisions on chattel paper. Accordingly, these terms have been placed in square brackets in the definition of “document of title” in this draft. The problems relating to “hybrid” chattel paper—involving some electronic and some tangible records evidencing the same chattel paper—may not be prevalent in the context of documents of title. For this reason, fewer statutory modifications may be needed with respect to authoritative electronic copies of documents of title.

DE. Payments

Reporter’s Prefatory Note

These amendments address issues arising under UCC Articles 3, 4, and 4A.
The changes relating to payments are fewer and simpler than in prior drafts. They cover the following six topics:

Negotiability. An amendment to § 3-106 specifies that negotiability is not negated by the inclusion of either a choice-of-law term or a choice-of-forum term in an instrument.

Remote Deposit Capture. Amendments to §§ 3-105 and 3-604, and to the official comments to §§ 3-309 and 4-207, clarify that an instrument is “issued,” if a drawer sends an image of and information describing an item, but never delivers the item. Prior drafts included warranty terms associated with such a process, but those warranties have been omitted as unnecessarily duplicative of federal law.
Statement of Account. Amendments to the official comment to § 4-406 clarify what constitutes a statement of account. A previously proposed amendment that would have required a statement of account to include an image of paid items for the statement to qualify under the safe harbor for sufficiency has been omitted.

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

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

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

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; (iv) an agreement as to what law governs the instrument or the rights and obligations created by the
instrument]; or (v) an undertaking to resolve a dispute concerning the promise or order in a
specified forum.

* * *

**Reporter’s Note**

1. **Choice-of-law provisions.** Pursuant to a suggestion made, the amendment now makes
clear that a choice-of-law provision does not affect negotiability.

2. **Arbitration.** By now referring to an undertaking to “resolve” a dispute, rather than to
“litigate,” the amendment would prevent an arbitration clause from undermining negotiability.

**Section 3–105. Issue of Instrument.**

(a) “Issue” means the first delivery of an instrument or first transmission of an image of an
item and of 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.

* * *

**Official Comment**

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

Subsection (a) permits an instrument to be issued by an electronic transmission of an image
of and information describing the instrument by maker and drawer, rather than by delivery. In
some cases, the relevant information can be ascertained from the image itself, in which case it is
not necessary for the information to be transmitted separately from the image. Thus, for example, a
drawer might write and sign a check, take a photograph of the check, send the photograph to the
drawee for processing electronically, and destroy the original check. In many cases, the electronic
image can be formatted to be an “electronic check” under Regulation CC. See 12 C.F.R.
§ 229.2(ggg). But even if not, the check is “issued” and hence can be enforced pursuant to this
Article.

2. Subsection (b) continues the rule that nonissuance, conditional issuance or issuance for a
special purpose is a defense of the maker or drawer of an instrument. Thus, the defense can be
asserted against a person other than a holder in due course. The same rule applies to nonissuance
of an incomplete instrument later completed.
3. Subsection (c) defines “issuer” to include the signer of an unissued instrument for convenience of reference in the statute.

   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 3–309. Enforcement of Lost, Destroyed, or Stolen Instrument.

   Official Comment

   ** **

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

   Example: The payee of a check creates an image of the check, destroys the check, and transmits the image for payment. Due to an error in transmission, the depositary bank never receives the transmission. The payee may be able to enforce the check if the payee can prove the terms of the check and otherwise satisfy the requirements of this section. The result would be different if there were no error in the transmission and the payor discharged its obligation on the check.

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 and an image is made and, subsequently, the information or image is transmitted for payment.

   ** **
Official Comment

Section 3–604 replaces former Section 3–605.

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

ARTICLE 4

BANK DEPOSITS AND COLLECTIONS

Section 4–207. Transfer Warranties.

* * *

Official Comment

* * *

3. The warranties provided for in this Section, and in Sections 4-208 and 4-209 are supplemented by warranties created under federal law. For example, pursuant to Section 4-209(b), a person who undertakes to retain an item in connection with an agreement for electronic presentment makes a warranty that retention and presentment comply with the agreement. Under federal law, such a person might also make a warranty that no person will be asked to make payment based on a check already paid. See 12 C.F.R. § 229.34(a).

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 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.

* * *
Official Comment

1. Under subsection (a), if a bank that has paid a check or other item for the account of a
customer makes available to the customer a statement of account showing payment of the item, the
bank must either return the item to the customer or provide a description of the item sufficient to
allow the customer to identify it. Under subsection (c), the customer has a duty to exercise
reasonable promptness in examining the statement or the returned item to discover any
unauthorized signature of the customer or any alteration and to promptly notify the bank if the
customer should reasonably have discovered the unauthorized signature or alteration.

The duty stated in subsection (c) becomes operative only if the “bank sends or makes
available a statement of account or items pursuant to subsection (a).” A bank is not under a duty to
send a statement of account or the paid items to the customer; but, if it does not do so, the
customer does not have any duties under subsection (c). A bank that permits a customer to access
the customer’s account online and to view there the activity associated with the account does not
thereby make available a “statement of account.” A “statement of account” is a periodic record,
typically monthly, not a continuous record, of the debits and credits to an account.

Subsection (a) applies when the bank “sends or makes available to a customer a statement
of account.” A bank that provides a customer with online access to a monthly statement of
account, along with a notification, such as an email or text message, that the statement of account
has been posted there, makes the statement of account available to the customer.

Under subsection (a), a statement of account must provide information “sufficient to allow
the customer reasonably to identify the items paid.” If the bank supplies its customer with an
image of the paid item, it complies with this standard. But a safe harbor rule is provided. The bank
complies with the standard of providing “sufficient information” if “the item is described by item
number, amount, and date of payment.” This means that the customer’s duties under subsection (c)
are triggered if the bank sends a statement of account complying with the safe harbor rule without
returning the paid items. A bank does not have to return the paid items unless it has agreed with
the customer to do so. Whether there is such an agreement depends upon the particular
circumstances. See Section 1–201(3). If the bank elects to provide the minimum information that
is “sufficient” under subsection (a) and, as a consequence, the customer could not “reasonably have
discovered the unauthorized payment,” there is no preclusion under subsection (d). If the customer
made a record of the issued checks on the check stub or carbonized copies furnished by the bank in
the checkbook, the customer should usually be able to verify the paid items shown on the statement
of account and discover any unauthorized or altered checks. But there could be exceptional
circumstances. For example, if a check is altered by changing the name of the payee, the customer
could not normally detect the fraud unless the customer is given the paid check, the statement of
account includes an image of the check, or the statement of account discloses the name of the
payee of the altered check. If the customer could not “reasonably have discovered the
unauthorized payment” under subsection (c) there would not be a preclusion under subsection (d).

The safe harbor provided by subsection (a) serves to permit a bank, based on the state of
existing technology, to trigger the customer’s duties under subsection (c) by providing a “statement
of account showing payment of items” without having to return the paid items, in any case in
which the bank has not agreed with the customer to return the paid items. The safe harbor does
not, however, preclude a customer under subsection (d) from asserting its unauthorized signature or
an alteration against a bank in those circumstances in which under subsection (c) the customer should not “reasonably have discovered the unauthorized payment.” Whether the customer has failed to comply with its duties under subsection (c) is determined on a case-by-case basis.

The provision in subsection (a) that a statement of account contains “sufficient information if the item is described by item number, amount, and date of payment” is based upon the existing state of technology. This information was chosen because it can be obtained by the bank’s computer from the check’s MICR line without examination of the items involved. The other two items of information that the customer would normally want to know—the name of the payee and the date of the item—cannot currently be obtained from the MICR line. The safe harbor rule is important in determining the feasibility of payor or collecting bank check retention plans. A customer who keeps a record of checks written, e.g., on the check stubs or carbonized copies of the checks supplied by the bank in the checkbook, will usually have sufficient information to identify the items on the basis of item number, amount, and date of payment. But customers who do not utilize these record keeping methods may not. The policy decision is that accommodating customers who do not keep adequate records is not as desirable as accommodating customers who keep more careful records. This policy results in less cost to the check collection system and thus to all customers of the system. It is expected that technological advances such as image processing may make it possible for banks to give customers more information in the future in a manner that is fully compatible with automation or truncation systems. At that time the Permanent Editorial Board may wish to make recommendations for an amendment revising the safe harbor requirements in the light of those advances.

* * *

ARTICLE 4A

FUNDS TRANSFERS

Section 4A–103. Payment Order - Definitions.

(a) In this Article:

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

* * *

Section 4A–104. Funds Transfer - Definitions.

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

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

An instruction to pay might be a component of a so-called “smart contract”: a computer
program or a transaction protocol intended to execute automatically. The fact that the smart
contract itself is subject to a condition does not necessarily mean that an instruction to a payment
issued pursuant to that smart contract “state[s] a condition to payment of the beneficiary” within
the meaning of Section 4A-103(a)(1)(i). Whether the instruction does state such a condition
depends on what the instruction says when it is received by the receiving bank. An instruction that
neither grants discretion nor imposes a limitation on payment by the receiving bank does not state a
condition to payment. What distinguishes the prior example is that the New York bank’s
instruction to the California bank did state a condition when the California bank received it.

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

* * *

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.

Official Comment

A large percentage of payment orders and communications amending or cancelling
payment orders are transmitted electronically and it is standard practice to use security procedures
that are designed to assure the authenticity of the message through steps designed to assure the
identity of the sender, the integrity of the message, or both. Security procedures can also be used to
detect error in the content of messages or to detect payment orders that are transmitted by mistake
as in the case of multiple transmission of the same payment order. Security procedures might also
apply to communications that are transmitted by telephone or in writing a record. Section 4A-201
defines these security procedures. The second sentence of the definition provides several examples
of a security procedure, but this list is not exhaustive. The inclusion of the phrase “or similar
security devices” means that, as new technologies emerge, what can be a security procedure will
change. The definition of security procedure limits the term to a procedure “established by
agreement of a customer and a receiving bank.” The term does not apply to procedures that the
receiving bank may follow unilaterally in processing payment orders. The question of whether loss
that may result from the transmission of a spurious or erroneous payment order will be borne by the
receiving bank or the sender or purported sender is affected by whether a security procedure was or
was not in effect and whether there was or was not compliance with the procedure. Security
procedures are referred to in Sections 4A-202 and 4A-203, which deal with authorized and verified
payment orders, and Section 4A-205, which deals with erroneous payment orders.

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

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.

* * *

Official Comment

* * *

3. Subsection (b) of Section 4A-202 is based on the assumption that losses due to
fraudulent payment orders can best be avoided by the use of commercially reasonable security
procedures, and that the use of such procedures should be encouraged. The subsection is designed
to protect both the customer and the receiving bank. A receiving bank needs to be able to rely on
objective criteria to determine whether it can safely act on a payment order. Employees of the
bank can be trained to “test” a payment order according to the various steps specified in the
security procedure. The bank is responsible for the acts of these employees. Subsection (b)(ii)
requires the bank to prove that it accepted the payment order in good faith and “in compliance with
the bank’s obligations under the security procedure.” If the fraud was not detected because the
bank’s employee did not perform the acts required by the security procedure, the bank has not
complied. Subsection (b)(ii) also requires the bank to prove that it complied with any agreement or
instruction that restricts acceptance of payment orders issued in the name of the customer. If an agreement establishing a security procedure places obligations on both the sender and the receiving bank, the receiving bank need prove only that it complied with the obligations placed on the receiving bank. A customer may want to protect itself by imposing limitations on acceptance of payment orders by the bank. For example, the customer may prohibit the bank from accepting a payment order that is not payable from an authorized account, that exceeds the credit balance in specified accounts of the customer, or that exceeds some other amount. Another limitation may relate to the beneficiary. The customer may provide the bank with a list of authorized beneficiaries and prohibit acceptance of any payment order to a beneficiary not appearing on the list. Such limitations may be incorporated into the security procedure itself or they may be covered by a separate agreement or instruction. In either case, the bank must comply with the limitations if the conditions stated in subsection (b) are met. Normally limitations on acceptance would be incorporated into an agreement between the customer and the receiving bank, but in some cases the instruction might be unilaterally given by the customer. If standing instructions or an agreement state limitations on the ability of the receiving bank to act, provision must be made for later modification of the limitations. Normally this would be done by an agreement that specifies particular procedures to be followed. Thus, subsection (b) states that the receiving bank is not required to follow an instruction that violates a written agreement evidenced by a record. The receiving bank is not bound by an instruction unless it has adequate notice of it. Subsections (25), (26) and (27) of Section 1-201 apply.

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

If a receiving bank and its customer agree to make the technology or service of a third party, for example a cloud service provider, part of the security procedure, the selected technology or service might become unavailable or might fail to perform as expected. In such a situation, it might have been impossible for the customer, the receiving bank, or both to comply with the obligations under security procedure. If the receiving bank is unable to prove compliance with the security procedure for purposes of Section 4A-202 and Section 4A-203, the receiving bank will be unable to treat a payment order as effective against the customer under Section 4A-202(b).

Example: Bank and Customer agree that the authenticity of Customer’s payment orders will be verified pursuant to a security procedure that provides that both parties will use
Service Provider’s Secure Communication Product. The Secure Communication Product includes an authenticated connection between users and an algorithm that produces a fraud risk score for each payment order sent over the connection. In order to use the Secure Communication Product, Customer and Bank must each individually enter into an agreement with Service Provider. Service Provider is the victim of a cyberattack that compromises the fraud score feature of the Secure Communication Product such that every payment order sent over the connection receives a low fraud risk score. After the attack but before it is discovered, Bank processes a payment order in Customer’s name that Customer claims was unauthorized. Whether Bank followed the security procedure is a question of fact. If it is determined that, because the product malfunctioned or otherwise, Bank did not follow the security procedure, Bank will not be able to treat the payment orders as authorized under 4A-202. If instead it is determined that Bank did follow the security procedure, Customer may be able to shift the loss back to Bank if Customer can make the required showing under Section 4A-203(a)(2).

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

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

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

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

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

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

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

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Official Comment

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

* * *

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.

* * *
(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.

** * * *

Official Comment

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

** * * *

EF. Miscellaneous Amendments

ARTICLE 1

GENERAL PROVISIONS

Section 1-201. General Definitions.

** * * *

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

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

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

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

* * *

(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 other than [the Uniform Commercial Code] that limits, or limits if conditions specified under such 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. “Conspicuous.” Whether a term is conspicuous should be determined by the fact-finder.
Thus, the sentence assigning that issue to the court should be deleted. Deletion of the examples in
the text will facilitate a thorough discussion of conspicuousness in the official comments.

2. Additional issues relating to “conspicuous.” The Drafting Committee may wish to
consider which of the following points are appropriate for the official comments to address:

a. What a reasonable person ought to notice may vary depending upon the market
in which a transaction occurs. For example, a merchant with respect to goods of the kind that
wishes to disclaim the implied warranty of merchantability may sell to business buyers, consumer
buyers, or both, and even within those broad markets there might be buyers who can be expected to
have greater and lesser levels of sophistication. When a business uses the same standard form
documents in transactions both with other businesses and with consumers, a term in the documents
might be conspicuous to other businesses (because it is so presented that a reasonable business
person against whom it is to operate ought to have noticed it) but not be conspicuous to consumers
(because it is not the case that a reasonable consumer against whom it is to operate ought to have
noticed it). Concerns over conspicuousness are particularly acute in online transactions.

b. The harder a person has to work to access a non-obvious term, the less likely it is
that the term is conspicuous with respect to that person. For example, there might be a difference
between a situation in which a person can discover a term by clicking a single link and a situation
in which the term can be discovered only by clicking more than one link. Even if a term can be
accessed by clicking a single link, how the link is labeled might affect whether a term is
conspicuous. For example, a disclaimer of implied warranties might not be conspicuous if the link
to the disclaimer is labeled “warranty rights.”

c. How information is displayed on a user’s screen depends on the user’s equipment
and display settings and is not within the sole control of the person drafting the language. For
example, a term that is seen easily when displayed on a 24-inch monitor may not be so noticeable
when displayed on a cell phone. This is different from the paper environment, where the person
supplying the form chooses how the relevant language is displayed. The equipment and display
settings used by the person against which a term is to operate are relevant to determining whether
the term is conspicuous.

d. Does conspicuousness have any meaning if the term at issue appears in a
document that most people do not read?

e. Can a term be conspicuous, especially in consumer contracts, if it is not
separately assented to or is explained in language that cannot be understood by an average
consumer?


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

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

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

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

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

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

25. “Person.” Except for the new treatment of a “protected series,” 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[, biometric measurement or calculation], or process with present intent to adopt or accept the record.

* * *

Reporters 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 may wish to consider including biometric technology in the definition of “signed.” Biometric technology is now included in draft § 4A-211 dealing with security procedures.

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
“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 subsections (6A) and 6(B) incorporate the essence of the Commentary into the statutory text. In this draft the phrase “in part 4 of this article” is deleted in both definitions because the terms also appear in other Parts of Article 9.