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Uniform Commercial Code And Emerging Technologies

Tentative Draft No. 1

(April 2022)

MATERIALS INCLUDED

Reporter's Prefatory Note
Draft Amendments to Articles 1, 2, 2A, 3, 4, 4A, 5, 7, 8, and 9
Draft Article 12
Transition Provisions

The Executive Office
The American Law Institute
4025 Chestnut Street
Philadelphia, PA 19104-3099
Telephone: (215) 243-1626 • Fax: (215) 243-1636
E-mail: ali@ali.org • Website: http://www.ali.org

Uniform Commercial Code and Emerging Technologies
Comments and Suggestions Invited

We welcome written comments on this draft. They may be submitted via the website project page or sent via email to UCCIcomments@ali.org. Comments will be forwarded directly to the Reporter, Drafting Committee Chair, the Director, and the Deputy Director. You may also send comments via standard mail; contact information appears below.

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Reporter
Professor Charles W. Mooney
University of Pennsylvania Carey School of Law
3501 Sansom St.
Philadelphia, PA 19104-3464
Email: cmooney@law.upenn.edu

Drafting Committee Chair
Edwin E. Smith, Esquire
Morgan, Lewis & Bockius LLP
One Federal St. Fl. 18
Boston, MA 02110-1726
Email: edwin.smith@morganlewis.com

Director
Professor Richard L. Revesz
The Executive Office
The American Law Institute
4025 Chestnut Street
Philadelphia, PA 19104-3099
Email: director@ALI.org

Deputy Director
Ms. Stephanie A. Middleton
The Executive Office
The American Law Institute
4025 Chestnut Street
Philadelphia, PA 19104-3099
Email: smiddleton@ALI.org

PROJECT STATUS AT A GLANCE

In 2019, The American Law Institute and the Uniform Law Commission formed a joint committee to review the Uniform Commercial Code with a view to recommending amendments or revisions to accommodate emerged and emerging technological developments. No portion of this project has previously been approved by the membership.

Uniform Commercial Code and Emerging Technologies

The committee appointed by and representing the National Conference of Commissioners on Uniform State Laws in preparing this act consists of the following individuals:

Edwin E. Smith	Massachusetts, *Chair*
Juliet M. Moringiello	Pennsylvania, *Vice Chair*
Carl S. Bjerre	Oregon
Thomas J. Buiteweg	Michigan
Henry Deeb Gabriel	North Carolina
Larry T. Garvin	Ohio
Thomas S. Hemmendinger	Rhode Island
William H. Henning	Alabama
Philip A. Nicholas	Wyoming
Harvey S. Perlman	Nebraska
Sandra S. Stern	New York
Frank Sullivan Jr.	Indiana
Martin D. Carr	California, *Division Chair*
Dan Robbins	California, *President*

American Law Institute Members

Amelia H. Boss	Pennsylvania
Sylvia F. Chin	New York *(2021–)*
Neil B. Cohen	New York
Marek Dubovec	Arizona
Walter Effross	District of Columbia
Teresa Wilton Harmon	Illinois
Tarik J. Haskins	Delaware
Stephanie A. Heller	New York
Charles W. Mooney Jr.	Pennsylvania *(2019–2021)*
Norman M. Powell	Delaware
Sandra M. Rocks	New York
Steven O. Weise	California

Other Participants

Charles W. Mooney Jr.	Pennsylvania, *Reporter (2021–)*
Stephen L. Sepinuck	Washington, *Associate Reporter*
Steven L. Harris	Illinois, *Reporter (2019–2021)*
Stephen Y. Chow	Massachusetts, *American Bar Association Advisor*
Candace M. Zierdt	North Dakota, *American Bar Association Advisor*
Guido Carducci	France, *American Bar Association Section Advisor*
Stephen J. Curley	Connecticut, *American Bar Association Section Advisor*
Mark J. Cutrona	Delaware, *Style Liaison*
Tim Schnabel	Illinois, *Executive Director*

Copies of this act may be obtained from:

Uniform Law Commission
111 N. Wabash Ave., Suite 1010
Chicago, IL 60602
(312) 450-6600
www.uniformlaws.org

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UNIFORM COMMERCIAL CODE AND EMERGING TECHNOLOGIES

April 11, 2022 DRAFT

Submitted to the American Law Institute 2022 Annual Meeting
May 16-18, 2022

Note on formatting:

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

Because Article 12 is a completely new UCC article and Annex A on transition rules also is new, the provisions of Article 12 and Annex A are not underscored.

New sections are numbered with an "A" or "B" at the end, e.g., Sections 9-107A and 9-306B. It is contemplated that this numbering convention will be retained for these sections that remain in the final Act. In similar fashion, new defined terms in Section 1-201(b) and 9-102(a) also are numbered with an "A" or "B." This approach will avoid the need to renumber existing provisions.

Reporter's Prefatory Note to April 11, 2022 Draft

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

1. *Background*

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

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

The Joint Committee was initially formed as a study committee. However, the Joint

Committee subsequently received the permission of the Sponsors to act as a drafting committee for amendments to the UCC dealing with digital assets, bundled transactions (*i.e.*, transactions involving the sale or lease of goods together with the provision of services, the licensing of information, or both), and payments, as well as for certain discrete amendments to the UCC unrelated to emerging technologies. For convenience, further references are to the Drafting Committee.

The Drafting Committee has held the following meetings:

- October 4–5, 2019, in Denver, Colorado.
- January 31–February 1, 2020, in Washington, D.C.
- Remote meetings by Zoom on: May 29–30, July 23 and 31, September 2, and December 1, 2020; February 1, March 9, April 27 and 29, May 3 and 10, July 6, and November 5–6, 2021; and January 28–29, March 7-8, and March 28, 2022.
- Remote informal open meetings, held on June 15 and 16, 2021, for ULC Commissioners and members of the Drafting Committee preliminary to the ULC Annual Meeting.
- ULC Annual Meeting (remote and in-person), first reading, July 13, 2021.

The Chair and Reporter along with Drafting Committee members Neil B. Cohen and Steven O. Weise presented a draft to the ALI Council meeting on January 20, 2022, which was approved by the Council with the usual caveats. In addition, several small working groups have met remotely (and continue to meet) to discuss specific topics and to hear the views of various stakeholder groups. Since the 2021 ULC Annual Meeting, the Chair, Vice Chair, Reporters, and several members of the Drafting Committee have presented educational programs addressing the ongoing revision process to groups including the Loan Syndication and Trading Association, the ABA Business Law Section, the American College of Commercial Finance Lawyers, the Association of Commercial Finance Attorneys, and the New York City Bar Association. The Chair, Reporter and several members of the Drafting Committee participated in an ALI Members Consultative Group meeting on October 1, 2021, and another ALI MCG meeting is scheduled for April 25, 2022.

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

The Drafting Committee held three meetings in 2022. The Committee expects to complete the draft of the amendments and obtain American Law Institute approval of the draft at its May 2022 annual meeting, and final approval of the Commission at its July 2022 annual meeting. Members of the Drafting Committee will continue to reach out to industry groups and other stakeholders and plan to continue participating in CLE presentations to educate members of the bar and others.

2. *Overview of UCC Revisions*

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

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

The draft includes a new UCC Article 12 that would govern the transfer of property rights in certain intangible digital assets ("controllable electronic records") that have been or may be created using new technologies. These assets include, for example, certain types of virtual currency and nonfungible tokens (NFTs). "Control" of controllable electronic records is a central organizing concept under Article 12. Controllable electronic records are defined to include only those electronic records that can be subjected to control. Control is the functional equivalent of "possession" of a controllable electronic record and a necessary condition for protection as a good faith purchaser for value (a "qualifying purchaser") of a controllable electronic record. Article 12 confers an attribute of negotiability on controllable electronic records because a qualifying purchaser takes its interest free of conflicting property claims.

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

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

For a more detailed description of Article 12, see the Reporter's Prefatory Note to Article 12.

b. S*ecured transactions amendments – UCC Article 9*

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

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 hybrid transaction involving services or non-goods property as well as goods. This draft also addresses additional issues relating to hybrid transactions, mentioned in 2.d., below. The draft also provides an amended definition of "control" of an authoritative electronic copy of a record evidencing chattel paper, which reflects a more accurate and technologically flexible approach than the current definition.

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

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

For a more detailed description of the Article 9 amendments, see the Reporter's Prefatory Note to Article 9 Amendments.

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

The draft proposes several amendments to Articles 3, 4 and 4A. The amendments relate to negotiability, remote deposit capture, statements of account, the scope of Article 4A (definition of payment order), and security procedures. The draft also deletes references to a "writing" (which are changed to a "record"). Many of the proposed changes are to the official comments and are intended to further clarify the black letter text.

For a more detailed description of the payments amendments, see the Reporter's Prefatory Note to Payments Amendments.

d. *Other emerging technologies-related amendments*

The draft contains a revised definition of “conspicuous” in Article 1 and a revised and updated draft official comment on the term. It adds to Article 1 the current standard definition of “electronic” used by the ULC. It also adopts a revised definition of “signed” in Article 1, which addresses records other than writings.

The draft revises Sections 2-102 and 2A-102 and related definitions to clarify the scope of Articles 2 and 2A with respect to hybrid transactions. It also includes amendments to several provisions of Articles 2 and 2A to change references to a “writing” or “written” communication to refer instead to a “record.”

The draft proposes a revised Section 7-106, defining “control” for electronic documents of title. The revised section retains the general rule and the safe harbor under the current provision and adds an additional safe harbor along the lines of the revised section on control of chattel paper. The draft also includes revisions to the official comments to several provisions of Articles 7 and 9, in particular to clarify the treatment of nonnegotiable documents of title.

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

e. Miscellaneous amendments

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

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

f. Draft Official Comments. The draft includes revised official comments to some sections. These indicative revisions are presented not only to explain the draft statutory text but also to encourage feedback on the draft comments. Of course, none of the revisions to official comments will be finalized until completion of the usual processes for the preparation of official comments.

In the preparation of revised official comments consideration will be given to removing references to obsolete and withdrawn uniform laws except as may be necessary or useful to explain particular issues.

3. *Organization of the draft*

Revised provisions of the UCC text and comments appear in the order that they would appear in the UCC—beginning with Article 1 and continuing through Article 12. Following Article 12 a new Annex A provides transition rules.

UNIFORM COMMERCIAL CODE AND EMERGING TECHNOLOGIES

ARTICLE 1

GENERAL PROVISIONS

* * *

Section 1-103. Construction of [Uniform Commercial Code] to Promote its Purposes and Policies; Applicability of Supplemental Principles of Law.

(a) <u>The</u> [~~The~~ Uniform Commercial Code] must be liberally construed and applied to promote its underlying purposes and policies, which are:

(1) to simplify, clarify, and modernize the law governing commercial transactions;

(2) to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and

(3) to make uniform the law among the various jurisdictions.

(b) Unless displaced by the particular provisions of <u>the</u> [~~the~~ Uniform Commercial Code], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions.

Official Comment

* * *

2. **Applicability of supplemental principles of law.** Subsection (b) states the basic relationship of the Uniform Commercial Code to supplemental bodies of law. The Uniform Commercial Code was drafted against the backdrop of existing bodies of law, including the common law and equity, and relies on those bodies of law to supplement it provisions in many important ways. At the same time, the Uniform Commercial Code is the primary source of commercial law rules in areas that it governs, and its rules represent choices made by its drafters and the enacting legislatures about the appropriate policies to be furthered in the transactions it covers. Therefore, while principles of common law and equity may *supplement* provisions of the

Uniform Commercial Code, they may not be used to *supplant* its provisions, or the purposes and policies those provisions reflect, unless a specific provision of the Uniform Commercial Code provides otherwise. In the absence of such a provision, the Uniform Commercial Code preempts principles of common law and equity that are inconsistent with either its provisions or its purposes and policies.

The language of subsection (b) is intended to reflect both the concept of supplementation and the concept of preemption. Some courts, however, had difficulty in applying the identical language of former Section 1-103 to determine when other law appropriately may be applied to supplement the Uniform Commercial Code, and when that law has been displaced by the Code. Some decisions applied other law in situations in which that application, while not inconsistent with the text of any particular provision of the Uniform Commercial Code, clearly was inconsistent with the underlying purposes and policies reflected in the relevant provisions of the Code. *See*, *e.g.*, *Sheerbonnet, Ltd. v. American Express Bank, Ltd.*, 951 F. Supp. 403 (S.D.N.Y. 1995). In part, this difficulty arose from Comment 1 to former Section 1-103, which stated that "this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act." The "explicitly displaced" language of that Comment did not accurately reflect the proper scope of Uniform Commercial Code preemption, which extends to displacement of other law that is inconsistent with the purposes and policies of the Uniform Commercial Code, as well as with its text.

These supplemental principles take into account developments in technology. For example, automated transactions and electronic agents are now widely recognized as being capable of acting for a person who employs such tools. See generally Uniform Electronic Transactions Act §§ 2(2), 2(6), and 14.

* * *

Reporter's Note

1. *No change.* No change is proposed to Section 1-103.

2. *Cross-references to Comment 2.* A cross-reference to the new paragraph in Comment 2 should be added to the official comments to other appropriate sections, including Section 1-201 (e.g., definitions of "agreement" and "signed").

* * *

Section 1-107. Section Captions.

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

Official Comment

* * *

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

surplusage. This is not the case, however, with respect to subsection headings appearing in ~~Article 9~~ Articles 9 and 12 and Annex A (Transition Provisions). See ~~Comment 3 to~~ ~~Section~~ Section 9-101, Comment 3 ("subsection headings are not a part of the official text itself and have not been approved by the sponsors."); draft § 12-101, Comment.

Reporter's Note

No change. No change is proposed to Section 1-107.

* * *

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.~~

* * *

(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 ~~it~~ 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.

* * *

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

* * *

(21) "Holder" means:

(A) the person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession; or

(B) the person in possession of a negotiable tangible document of title if the goods are deliverable either to bearer or to the order of the person in possession; or

(C) the person in control, other than pursuant to Section 7-106(e), of a negotiable electronic document of title.

* * *

(24) "Money" means a medium of exchange that is currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization, or pursuant to an agreement between two or

more countries. <u>The term does not include an electronic record that is a medium of exchange recorded and transferable in a system that existed and operated for the medium of exchange before the medium of exchange was authorized or adopted by any such government.</u>

* * *

(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. <u>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 the 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.</u>

* * *

(37) "Signed" includes using any symbol executed or adopted with present intention to adopt or accept a writing and<u>, with respect to a record that is not a writing, includes the attachment to or logical association with the record of an electronic symbol, sound, or process with the present intent to adopt or accept the record. "Sign" and "Signature" have corresponding meanings.</u>

<u>Legislative Note:</u>

<u>A state should enact the amendment to paragraph (b)(27) whether the state has enacted the Uniform Protected Series Act (2017) or otherwise recognizes a protected series under its law. Because the sentence applies only under the enacting state's Uniform Commercial Code, inclusion of the sentence 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 clarifies the status of a protected series as a "person" under the choice-of-law and substantive law rules of the enacting state's Uniform Commercial Code.</u>

Official Comment

* * *

10. "Conspicuous." ~~Derived from former Section 1-201(10).~~ This definition states the general standard that to be conspicuous a term ought to be noticed by a reasonable person against which the term is to operate. Whether a term is conspicuous is an issue for the court. ~~Subparagraphs (A) and (B) set out several methods for making a term conspicuous. Requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving guidance to the party relying on the term regarding how that result can be achieved). Although these paragraphs indicate some of the methods for making a term attention-calling, the test is whether attention can reasonably be expected to be called to it. The statutory language should not be construed to permit a result that is inconsistent with that test.~~ Whether the appearance and presentation of a particular term satisfy this standard is determined by reference to the totality of the circumstances and requires a case-by-case analysis.

Historically, contract terms were presented in writing, making the use of standards that relate to the size and appearance of type relevant to the determination of conspicuousness. Today terms in a record are frequently communicated electronically. New technologies have created opportunities for terms to be displayed or presented in novel ways, such as by the use of pop-up windows, text balloons, dynamically expanding or dynamically magnifying text, and non-visual elements such as vibrations, to name a few.

The definition has been revised by deleting the statutory examples relating to the appearance of type and instead indicating in the comments a broader universe of factors that are applicable to both written and electronic presentations. This approach is intended to be both more protective of consumers and more useful to drafters by providing more clarity and flexibility in the methods that may be used to call attention to a term.

The attributes of a reasonable person against which a term is to operate can vary depending upon the nature of the transaction and the market in which the transaction occurs. For example, assume that a merchant of goods wishes to enter into a transaction for the sale or lease of goods which does not include an implied warranty of merchantability or fitness for particular purpose. Depending on the particular transaction, the person against which the term excluding implied warranties is to operate may be a large business buyer or lessee, a small business, or a consumer. Similarly, the determination of whether a term is conspicuous may, depending on the context, yield a different conclusion when the term is used in a standard form agreement than when terms of the agreement are the subject of negotiation or discussion.

Terms presented in an online record raise issues that differ in some respects from the issues associated with presenting the same terms in a writing. For example, how a term appears depends to some extent on the equipment and settings of the person presented with the term.

The test of whether a term is conspicuous remains constant notwithstanding the different contexts referenced above. A term is conspicuous if its appearance and presentation are such that it ought to be noticed by a reasonable person against which the term is to operate. If the term is in a standard form intended for use in many agreements, the determination of whether the term is conspicuous may be made with reference to typical likely parties to the agreements, taking into account all aspects of the transaction, the range of likely equipment and settings used by such parties, and the education, sophistication, disabilities, and other attributes of such parties. If the term is not in a standard form, the determination of whether it is conspicuous should be made with reference to a reasonable person in the position of the actual person against which it is to operate.

Factors relevant to whether a term is conspicuous include, but are not limited to, the following:

(i) The use of headings and text that contrast with the surrounding text. For example, a term is likely to be conspicuous if it is introduced by a heading in uppercase letters equal to or greater in size than the surrounding text. Similarly, a term is likely to be conspicuous if set out in 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. However, even with those characteristics, for a term to be conspicuous the overall statutory test must always be met. For example, even if in bold, uppercase letters, a term might not be conspicuous if placed among other terms also in bold, uppercase letters so there is no contrast with the surrounding text or if the application of other factors causes the term not to be provided such that a reasonable person against which it is to operate ought to have noticed it.

(ii) The placement of the term in the record. A term appearing at, or hyperlinked from, text at the beginning of a record, or near the place where the person against which the term is to operate must signify assent, is more likely to be conspicuous than a term in the middle of a lengthy record absent the use of a method reasonably designed to draw the person's attention to the term in middle of the record (for example, by providing separate reasonable notice of the term before presenting the record containing the term to the person for assent or forcing the person to stop on a screen highlighting the term during the presentation of the record for assent).

(iii) If terms are available only through the use of a hyperlink, in addition to the placement of the hyperlink as described above, factors to be considered include whether there is language drawing attention to the hyperlink and describing its function, and the size and color of the text used for the hyperlink and any related language.

(iv) The language of the heading, if any. A misleading heading – such as the heading "Warranty" for a paragraph that contains a disclaimer of warranties – might cause a reasonable person to fail to notice the language that would disclaim warranties, so that the term would not be conspicuous.

(v) The effort needed to access the term. The process and flow of the display and presentation is also relevant. For example, a term accessible only by triggering multiple hyperlinks is less likely to be conspicuous than a term accessible from a single hyperlink.

(vi) Whether the person against which the term is to operate must separately assent to or acknowledge the term. Obtaining separate assent or acknowledgment of a term is generally sufficient to make the term conspicuous.

As noted above, the evolution of technology has led to an evolution in the ways in which terms in an electronic record are displayed or presented. A term displayed or presented in a novel way utilizing emerging technologies is, of course, conspicuous if the effect of the display or presentation is that a reasonable person against which the term is to operate ought to have noticed it.

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

* * *

24. "Money." ~~Substantively identical to former Section 1-201. The test is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected.~~ [To be revised to reflect discussion in Reporter's Note 5.]

Reporter's Note

1. "*Conspicuous.*"

a. Examples. Deletion of the examples facilitates a more thorough discussion of the conspicuous definition in the revised official comment.

b. *Current UCC Provisions Using "Conspicuous" or "Conspicuously."*

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

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

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

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

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

2. *"Document of title."* This definition is not changed and is provided here for

convenience of reference.

3. *"Electronic."* The draft adopts the standard ULC definition.

4. *"Holder."* This definition has been revised to exclude persons who have control pursuant to Section 7-106(d) through the acknowledgment of a person in control.

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

Only something currently authorized or adopted as a medium of exchange by a government, and as further elaborated in the second sentence of the definition, 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. The only change made to the definition is the addition of the third sentence.

An electronic medium of exchange established pursuant to a country's law and that is recorded and transferable in a system that did not exist and did not operate for that medium of exchange before the electronic medium of exchange was authorized or adopted by the country's government also constitutes money. This is so even if ownership is established or maintained through a blockchain or other system not operated by the government. In contrast, an existing medium of exchange created or distributed by one or more private parties is not money solely because the government of one or more countries later authorizes or adopts the pre-existing medium of exchange.

Although the term "money" is used in several Articles, the definition is particularly significant under Article 9. Prior to the amendments to this section, money was generally understood to include only tangible coins, bills, notes, and the like. This worked well under Article 9, which provided that the only method of perfecting a security interest in money as original collateral was by taking possession. *See* former UCC § 9-312(b)(3). The amended definition of money is broader and includes both "tangible money" (things that were money under the prior, more limited definition) and "electronic money" (a new type of collateral under Article 9). A security interest in electronic money as original collateral may be perfected only by control. Draft § 9-102(a)(31A) (defining "electronic money"); 9-312(b)(4) (perfection by control for electronic money). The definition of "money" for purposes of Article 9 is more limited than the definition in this section—the Article 9 definition excludes deposit accounts and money in electronic form that cannot be subjected to control under Section 9-105A. *See* UCC § 9-102(a)(54A).

Examples: The following examples illustrate the revised definition of "money."

> **Example 1:** Nation A enacts legislation authorizing or adopting an existing crypto currency (spitcoin), created on a private blockchain, as a medium of exchange. Spitcoin does not thereby become "money" because it was recorded and transferable in a system that existed and operated for that crypto currency before the electronic record was authorized or adopted by Nation A.

Example 2: Nation B creates a new crypto currency (beebuck) and authorizes or adopts it as a medium of exchange. Beebuck is "money." Beebuck is not recorded and transferable in a system that existed and operated for that crypto currency before the electronic record was authorized or adopted by Nation B.

Example 3: Nation C enacts legislation authorizing or adopting as a medium of exchange beebuck, the crypto currency previously adopted by Nation B in Example 2. Although beebuck *is* recorded and transferable in a system that existed and operated for beebuck before it was authorized or adopted by Nation C, beebuck was *already* money when authorized or adopted by Nation C. Consequently, Beebuck is "money." Nation C's action had no relevance or effect on the characterization of beebuck as money.

The current official comment will be deleted and replaced by official comments to this section and to appropriate sections in Article 9 which reflect the explanations and descriptions in this Note.

6. *"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 UCC. The draft uses the ULC's standard language to accomplish this purpose.

The added second sentence of the definition of "person" would provide needed clarity as to the status of a protected series for purposes of the Uniform Commercial Code. Several 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.

Providing that a protected series is a "person" for purposes of the enacting state's Uniform Commercial Code will expressly permit a protected series, whether created under the law of the enacting state or of another state, to be a "seller" or a "buyer" under Article 2, a "lessor" or a "lessee" under Article 2A, or an "organization" and a "debtor" under Article 9, and, 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 UCC.

7. *"Signed."* The definition has been updated to provide that records other than writings may be signed. Following the approach taken in the definition of "written", the revised definition also provides that the terms "sign" and "signature" have corresponding meanings.

* * *

Section 1-204. Value. Except as otherwise provided in Articles 3, 4, ~~[and]~~ 5, ~~[and 6],~~ [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

"Value." The amendment to this section implements the policy choice described in Reporter's Note 9 to draft § 12-104 by making the generally applicable definition of "value" inapplicable to Article 12. *See* draft § 12-102(a)(4) (defining "value").

* * *

ARTICLE 2

SALES

* * *

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

(1) Unless the context otherwise requires and except as provided in subsections (3) and (4), this article applies to transactions in goods.

(2) If the sale-of-goods aspects of a hybrid transaction predominate, this article applies to the transaction.

(3) If the sale-of-goods aspects of a hybrid transaction do not predominate, only the provisions of this article which relate primarily to the sale-of-goods aspects of the transaction

and not to the transaction as a whole apply.

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

(5) This Section does not preclude the application in appropriate circumstances of other law to the aspects of a hybrid transaction which do not relate to the sale of goods even if the sale-of-goods aspects of the transaction predominate.

Official Comment

Prior Uniform Statutory Provision: Section 75, Uniform Sales Act.
Changes: Section 75 has been rephrased. Subsections (2), (3), and (5) are new.

Purposes of Changes and New Matter:

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

2. Relevant factors in determining whether the sale-of-goods aspects of a hybrid transaction predominate include the language of the agreement and the portion of the total price that is attributable to the sale of goods, although neither is determinative. An agreed-upon allocation of a portion of the total price to the sale of goods is ordinarily binding on the parties. Because the definition of “goods” expressly includes “specially manufactured goods,” services involved in manufacturing goods are normally attributable to the sale-of-goods aspects of the transaction. Services in designing specially manufactured goods, however, would not normally be attributable to the sale-of-goods aspects of the transaction.

3. If the sale-of-goods aspects of a hybrid transaction predominate, then this article applies to the transaction. However, the application of this Article to a hybrid transaction does not preclude the application of principles of law and equity to supplement the provisions of this article, see Section 1-103(b), nor does it preclude, in appropriate circumstances, the application of other law to the non-sale-of-goods aspects of the transaction. Whether it is appropriate to apply such other law will depend in part on what purposes the other law is designed to achieve and whether application of the other law would be likely to interfere with the application of this article.

Example 1. Owner hires Contractor to replace the roof on a structure. As part of the transaction, Contractor promises to remove the existing shingles and install new shingles, which Contractor is providing. The transaction is a hybrid transaction because it involves the passing of title to the new shingles and the provision of services. If the sale-of-goods aspects of the transaction predominate, this article applies to the transaction.

Example 2. Same facts as in Example 1. Even if the sale-of-goods aspects of the transaction predominate, other law might apply to the services aspects of the transaction. For example, if applicable law regulates the provision of roofing services, such as by requiring the roofer to be licensed, requiring specified disclosures, requiring or implying a warranty with respect to the quality of services, or giving the property owner a brief period of time to cancel the contract, such other law might apply.

Example 3. In a single transaction, Seller agrees to sell a warehouse full of goods to Buyer. The transaction includes the goods contained in the warehouse, the warehouse itself, and the real property on which the warehouse is situated. Assume the goods aspects of the transaction predominate. The application of this article to the transaction does not preclude the application of real property law to the real-property aspects of the transaction. Accordingly, whether the sale of the real property complies with the applicable requirements of real property law is determined by law other than this article. Other law will also determine whether consummation of the sale of the real property is a condition to the parties' obligations to buy and sell the goods.

4. If the sale-of-goods aspects of a hybrid transaction do not predominate, under subsection (3), the provisions of this article relating primarily to the sale of goods apply. These provisions include those relating to: warranties under Sections 2-212, 2-313, 2-314, 2-315, 2-316, 2-317, 2-318; tender of delivery and risk of loss under Sections 2-503, 2-504, 2-509, 2-510; acceptance, rejection, and cure under Sections 2-508, 2-601, 2-602, 2-603, 2-604, 2-605, 2-606; and remedies for non-delivery of the goods or for tender of nonconforming goods under Sections 2-711, 7-712, 7-713, 2-714, 2-715, 2-716. In contrast, the provisions of this article dealing with the transaction as a whole do not apply. These provisions include those relating to: the requirement of a writing, Section 2-201; contract formation, Sections 2-204 through 2-207; and whether consideration is needed to modify the agreement, Section 2-209.

Example 4. Owner sends a purchase order to Contractor offering to hire Contractor to replace the roof on a structure. The proposed transaction involves Contractor removing the existing shingles and installing new shingles, which Contractor is to provide. Contractor responds with a confirmation purporting to accept but containing additional and different terms. The transaction is a hybrid transaction because it involves the passing of title to the new shingles and the provision of services. If the sale-of-goods aspects of the transaction do not predominate, this article does not apply to determine whether a contract was formed. That issue is governed by other law.

Example 5. Under the facts of Example 1, assume that the sale-of-goods aspects of the transaction do not predominate. The agreement provides that the job will be completed by December 31. Due to unforeseen circumstances affecting the availability of supplies and labor, the job is not completed by the agreed-upon deadline. Whether Contractor’s failure to perform on time is excused is determined by general contract law, rather than by this article (Section 2-615).

Example 6. Under the facts of Example 1, assume that the sale-of-goods aspects of the transaction do not predominate. A dispute between the parties arises and during litigation one party seeks to admit evidence of usage of trade to supplement or explain the parties’ written agreement. If the proffered evidence relates to the sale-of-goods aspects of the transaction, the parol evidence rule in this article, Section 2-202 applies. If the proffered evidence relates to the other aspects of the transaction or to the transaction as a whole, other law will govern the admissibility of the evidence.

Example 7. Restaurateur hires Remodeler to remodel Restaurateur’s kitchen. The transaction requires Remodeler to supply a new oven meeting detailed specifications, but the services aspects of the transaction predominate. The oven supplied does not meet a minor aspect of those specifications (but does substantially satisfy the specifications as a whole). Whether Restaurateur may reject the oven (or must retain it subject to price adjustment), whether Restaurateur has a right to cover by purchasing a substitute oven, and the measure of Restaurateur’s damages for the oven’s nonconformity to the specifications are determined by this article.

Example 8. Restaurateur hires Remodeler to remodel Restaurateur’s kitchen by a specified completion date. The transaction requires Remodeler to supply a new oven, but the services aspects of the transaction predominate. Remodeler breaches by failing to complete the project by the specified date. The measure of Restaurateur’s damages for Remodeler’s failure to timely complete the project is not determined by this article.

5. The rules of subsections (2) and (3) are essentially gap fillers that apply when the parties’ agreement is silent on what legal rules govern the different aspects of their transaction. In general, parties are free to preclude the application of this article to the aspects of their transaction that are not about the sale of goods.

Example 9. Robotics Manufacturer contracts to design, build, and sell customized robotics to Car Maker. The transaction includes a sale of goods and the provision of services and is therefore a hybrid transaction. The parties may, in their agreement, provide that Article 2 does not govern the services aspects of the transaction.

* * *

Reporter's Note

1. *Background on the law*

Many ordinary transactions involve a sale of goods and a sale, lease, or license of other property or the provision of services. The statutory text of Article 2[1] provides no guidance on whether or to what extent the Article applies to such a "hybrid" transaction, although by defining a "sale" as "the passing of title [to goods] from the seller to the buyer for a price," Section 1-206 arguably brings hybrid transactions within the scope of Article 2.[2] A similar issue can arise with respect to a lease of goods.

For more than a half century, courts have dealt with this issue. Their principal approach has been to apply the "predominant purpose test," under which Article 2 will apply either in full or not at all to the transaction. Under the predominant purpose test, courts seek to determine whether the transaction, at its inception, is predominantly about the goods or if, instead, the other aspects of the transaction predominate. Relevant factors in making this determination include: (i) the language used in the agreement; (ii) the portion of the total price (or cost) allocable to the goods, and whether the agreement itself includes such an allocation; and (iii) the nature of the seller's business (*i.e.*, whether the seller is in the business of selling goods of that kind). Because the factors often point to different conclusions, application of the predominant purpose test is often difficult, and leads to both inconsistent results and uncertainty.

Some courts have approached the problem of hybrid transactions differently. The Maryland Court of Appeals somewhat famously used the "gravamen of the claim" test to deal with a claim about an allegedly defective diving board supplied in connection with a transaction for the installation of an in-ground swimming pool.[3] The court's decision was based, however, on some non-uniform language in Maryland's version of Section 2-316, and the gravamen of the claim test has neither had significant traction outside Maryland nor been consistently used in Maryland. That might be due in part because the gravamen of the claim test can also be difficult to apply.

Other courts have, either expressly or implicitly, used what is sometimes referred to as the "bifurcation approach." Under this approach, Article 2 applies to the sale-of-goods aspect of the transaction and other law applies to the other aspects of the transaction.[4] The bifurcation

[1] For simplicity, the remainder of this Note refers principally to sales of goods and to Article 2 and refers only occasionally to leases and to Article 2A. That decision should not be interpreted as a denigration of leases or other issues that hybrid transactions create with respect to leases.

[2] Technically, Article 2 applies to "transactions in goods." *See* UCC § 2-102. However, the terms "buyer," "seller," "contract,' and "agreement" are all generally defined in reference to a sale of goods. *See* UCC §§ 2-103(1); 2-106(1). Most provisions of Article 2 refer to at least one of those terms.

[3] Anthony Pools v. Sheehan, 455 A.2d 434 (Md. 1983).

[4] *See, e.g.*, TK Power, Inc. v. Textron, Inc., 433 F. Supp. 2d 1058 (N.D. Cal. 2006); H. Hirschfield Sons, C. v. Colt Industries Operating Corp., 309 N.W.2d 714 (Mich. Ct. App. 1981); Stephenson v. Frazier, 399 N.E.2d 794 (Ind. Ct.

approach is similar to the gravamen of the claim, but instead of applying all of Article 2 to some (but not all) types of claims relating to a hybrid transaction, it distinguishes the provisions in Article 2 that deal with the goods from those that deal with the transaction as a whole, and applies only the former in a hybrid transaction.

2. *Approach taken in the draft*

Each of the alternative approaches for dealing with hybrid transactions has its problems. The predominant purpose test is difficult to apply and, when the non-sale-of-goods aspects of the transaction predominate, the implied warranties in Sections 2-314 and 2-315 do not apply even though there might be no good reason for them not to. The gravamen of the claim test is also difficult to apply and can lead to intractable problems. For example, if Article 2 applies to only some but not all of the claims asserted, it is very unclear whether and how to apply the provisions of Article 2 that deal with the transaction as a whole, such as the Statute of Frauds in Section 2-201 and the parol evidence rule in Section 2-202. The bifurcation approach creates the challenging problem of determining which Code provisions apply to a hybrid transaction and which do not.

Operating on the assumption that, in part due to emerging technologies, hybrid transactions are increasing and will continue to increase – in total numbers, in the dollar amount of their collective price, and as a percentage of number transactions involving a sale or lease of goods – the draft seeks to provide more clarity to the law by adopting the bifurcation approach and providing extensive comments on how to apply it.

To do this, the draft includes a definition of "hybrid transaction" in Article 2 and "hybrid lease" in Article 2A, and amendments to the scope section of each Article. In each case, the proposed amendments on scope set up a two-tiered test. If the sale-of-goods aspects of a hybrid transaction or the lease-of-goods aspects of a hybrid lease predominate, then the Article applies. If the other aspects of the hybrid transaction or hybrid lease predominate, then the provisions of the Article which relate primarily to the sale or lease of goods, but not to the transaction as a whole, apply.

* * *

Section 2-106. Definitions: "Contract"; "Agreement"; "Contract for Sale"; "Sale"; "Present Sale"; "Conforming" to Contract; "Termination"; "Cancellation"<u>;</u> <u>"Hybrid Transaction"</u>.

(1) In this article unless the context otherwise requires "contract" and "agreement" are

App. 1980); Miller v. Belk, 207 S.E.2d 792 (N.C. Ct. App. 1974); Melms v. Mitchell, 512 P.2d 1336 (Or. 1973); Foster v. Colorado Radio Corp., 381 F.2d 222 (10th Cir. 1967).

limited to those relating to the present or future sale of goods. "Contract for sale" includes both a present sale of goods and a contract to sell goods at a future time. A "sale" consists in the passing of title from the seller to the buyer for a price (Section 2–401). A "present sale" means a sale which is accomplished by the making of the contract.

(2) Goods or conduct including any part of a performance are "conforming" or conform to the contract when they are in accordance with the obligations under the contract.

(3) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On "termination" all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives.

(4) "Cancellation" occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of "termination" except that the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance.

(5) "Hybrid transaction" means a single transaction involving a sale of goods and:

(A) the provision of services;

(B) a lease of other goods; or

(C) a sale, lease, or license of property other than goods.

Official Comment

Prior Uniform Statutory Provision: Subsection (1)—Section 1(1) and (2), Uniform Sales Act; Subsection (2)—none, but subsection generally continues policy of Sections 11, 44 and 69, Uniform Sales Act; Subsections (3), (4), and (5)—none.

Changes: Completely rewritten.

Purposes of Changes and New Matter:

1. Subsection (1): "Contract for sale" is used as a general concept throughout this article, but the rights of the parties do not vary according to whether the transaction is a present sale or a

contract to sell unless the Article expressly so provides.

2. Subsection (2): It is in general intended to continue the policy of requiring exact performance by the seller of his obligations as a condition to his right to require acceptance. However, the seller is in part safeguarded against surprise as a result of sudden technicality on the buyer's part by the provisions of Section 2–508 on seller's cure of improper tender or delivery. Moreover, usage of trade frequently permits commercial leeways in performance and the language of the agreement itself must be read in the light of such custom or usage and also, prior course of dealing, and in a long-term contract, the course of performance.

3. Subsections (3) and (4): These subsections are intended to make clear the distinction carried forward throughout this article between termination and cancellation.

4. In some transactions, the passing of title to goods from the seller to the buyer in return for a price is part of a larger transaction. The other aspects of the transaction might involve the seller providing services to the buyer, the seller leasing other goods to the buyer, or the seller transferring to the buyer rights to property than goods. Such a transaction is a "hybrid transaction," as defined in new subsection (5). Section 2-102 indicates the extent to which this article applies to a hybrid transaction.

5. A hybrid transaction is a single transaction. If contracting parties enter into separate agreements at the same time, each agreement must be evaluated separately to determine if it is a hybrid transaction.

> **Example 1.** To sell an ongoing business, Seller and Buyer enter into three separate written agreements: (i) a sale of goods used in the business; (ii) an agreement for Seller to provide consulting services to Buyer for a period of six months; and (iii) a sale of intangible assets associated with the business. Because the parties executed three separate agreements, and the agreement for the sale of goods does not involve a sale, lease, or license of other property or the provision of services, that agreement is not a hybrid transaction.

> **Example 2.** To sell an ongoing business, Seller and Buyer enter into two separate written agreements: (i) a sale of goods and intangible assets used in the business; and (ii) an agreement for Seller to provide consulting services to Buyer for a period of six months, and not to compete with Buyer for a period of one year. The agreement to sell goods and intangible assets is a hybrid transaction.

Even when contracting parties enter into a single agreement involving both a sale of goods and a sale, lease, or license of other property or the provision of services, the agreement would not involve a single transaction, and hence the transaction would not be a hybrid transaction, if the sale of goods is unrelated to and independent of the other aspects of the transaction and the terms of the agreement relating to the sale of goods are readily severable from the terms of the agreement relating to the other aspects of the transaction.

> **Example 3.** Farmer A and Farmer B sign a written agreement pursuant to which

Farmer A will sell a tractor to Farmer B and Farmer A will board and feed Farmer B's cattle until the cattle are sold. The agreement specifies a price for the tractor, which is due upon delivery, and specifies a mechanism for determining the price for Farmer A's services, which is to be paid when the cattle are sold. The parties would have entered into an agreement to buy and sell the tractor even if they had not entered into an agreement to board and feed the cattle, and vice-versa. The transaction is not a hybrid transaction. Article 2 applies to the sale of the tractor. Other law applies to the agreement to board and feed the cattle.

Example 4. In a single record, Landscaper agrees to sell plants to Homeowner and to install the plants on Homeowner's property. The agreement specifies a total price but provides no mechanism for determining what portion of the price is allocable to the sale of plants and what portion is allocable to the installation services. The transaction is a hybrid transaction.

Reporter's Note

See Reporter's Note to draft § 2-102.

* * *

Section 2-201. Formal Requirements; Statute of Frauds.

(1) Except as otherwise provided in this section a contract for the sale of goods for the price of $500 or more is not enforceable by way of action or defense unless there is some ~~writing~~ record sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A ~~writing~~ record is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such ~~writing~~ record.

(2) Between merchants if within a reasonable time a ~~writing~~ record in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless [written] [a record containing a] notice of objection to its contents is given within 10 days after it is received.

Official Comment

* * *

~~Purposes of Changes: The changed phraseology of this~~ **Purposes:** This section is intended to make it clear that:

1. The required ~~writing~~ record need not contain all the material terms of the contract and such material terms as are stated need not be precisely stated. All that is required is that the ~~writing~~ record afford a basis for believing that the offered oral evidence rests on a real transaction. It may be written in lead pencil on a scratch pad or another medium. It need not indicate which party is the buyer and which the seller. The only term which must appear is the quantity term which need not be accurately stated but recovery is limited to the amount stated. The price, time and place of payment or delivery, the general quality of the goods, or any particular warranties may all be omitted.

Special emphasis must be placed on the permissibility of omitting the price term in view of the insistence of some courts on the express inclusion of this term even where the parties have contracted on the basis of a published price list. In many valid contracts for sale the parties do not mention the price in express terms, the buyer being bound to pay and the seller to accept a reasonable price which the trier of the fact may well be trusted to determine. Again, frequently the price is not mentioned since the parties have based their agreement on a price list or catalogue known to both of them and this list serves as an efficient safeguard against perjury. Finally, "market" prices and valuations that are current in the vicinity constitute a similar check. Thus, if the price is not stated in the memorandum it can normally be supplied without danger of fraud. Of course, if the "price" consists of goods rather than money the quantity of goods must be stated.

Only three definite and invariable requirements as to the memorandum are made by this subsection. First, it must evidence a contract for the sale of goods; second, it must be "signed", a word which includes any authentication which identifies the party to be charged; and third, it must specify a quantity.

* * *

3. Between merchants, failure to answer a ~~written confirmation of~~ record confirming a contract within ten days of receipt is tantamount to a ~~writing~~ record under subsection (2) and is sufficient against both parties under subsection (1). The only effect, however, is to take away from the party who fails to answer the defense of the Statute of Frauds; the burden of persuading the trier of fact that a contract was in fact made orally prior to ~~the written confirmation~~ giving a record confirming a contract is unaffected. Compare the effect of a failure to reply under Section 2-207.

4. Failure to satisfy the requirements of this section does not render the contract void for all purposes, but merely prevents it from being judicially enforced in favor of a party to the contract. For example, a buyer who takes possession of goods as provided in an oral contract

which the seller has not meanwhile repudiated, is not a trespasser. Nor would the Statute of Frauds provisions of this section be a defense to a third person who wrongfully induces a party to refuse to perform an oral contract, even though the injured party cannot maintain an action for damages against the party so refusing to perform.

5. The requirement of "signing" is discussed in the comment to Section 1-201.

6. ~~It~~ For purposes of subsection (1), it is not necessary that the ~~writing~~ record be delivered to anybody. It need not be signed by both parties but it is, of course, not sufficient against one who has not signed it. Prior to a dispute no one can determine which party's signing of the memorandum may be necessary but from the time of contracting each party should be aware that to him it is signing by the other which is important.

7. If the making of a contract is admitted in court, either in a written pleading, by stipulation or by oral statement before the court, no additional ~~writing~~ record is necessary for protection against fraud. Under this section it is no longer possible to admit the contract in court and still treat the Statute as a defense. However, the. contract is not thus conclusively established. The admission so made by a party is itself evidential against him of the truth of the facts so admitted and of nothing more; as against the other party, it is not evidential at all.

Reporter's Note

In furtherance of medium neutrality, references in subsection (1) to "writing" and "written" have been changed to refer to a "record."

* * *

Section 2-202. Final Written Expression: Parol or Extrinsic Evidence.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a ~~writing~~ record intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

(a) by course of performance, course of dealing, or usage of trade (Section 1-303); and

(b) by evidence of consistent additional terms unless the court finds the ~~writing~~ record to have been intended also as a complete and exclusive statement of the terms of the agreement.

Official Comment

* * *

Purposes:

1. This section definitely rejects:

(a) Any assumption that because a ~~writing~~ record has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon;

(b) The premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used; and

(c) The requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.

2. Paragraph (a) makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any ~~writing~~ record stating the agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such ~~writings~~ records are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties is considered the best indication of what they intended the ~~writing~~ record to mean.

3. Under paragraph (b) consistent additional terms, not reduced to ~~writing~~ a record, may be proved unless the court finds that the ~~writing~~ record was intended by both parties as a complete and exclusive statement of all the terms. If the additional terms are such that, if agreed upon, they would certainly have been included in the ~~document~~ record in the view of the court, then evidence of their alleged making must be kept from the trier of fact.

Reporter's Note

In furtherance of medium neutrality, references to a "writing" now refer to a "record."

* * *

§ 2-203. Seals Inoperative.

The affixing of a seal to a ~~writing~~ record evidencing a contract for sale or an offer to buy or sell goods does not constitute the ~~writing~~ record a sealed instrument and the law with respect to sealed instruments does not apply to such a contract or offer.

Reporter's Note

In furtherance of medium neutrality, the reference to a "writing" now refers to a "record."

* * *

Section 2-205. Firm Offers.

An offer by a merchant to buy or sell goods in a signed ~~writing~~ <u>record</u> which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

Official Comment

* * *

~~Purposes of Changes:~~ **<u>Purposes:</u>**

1. This section is intended to modify the former rule which required that "firm offers" be sustained by consideration in order to bind, and to require instead that they must merely be characterized as such and expressed in signed ~~writings~~ <u>records</u>.

2. The primary purpose of this section is to give effect to the deliberate intention of a merchant to make a current firm offer binding. The deliberation is shown in the case of an individualized document by the merchant's signature to the offer, and in the case of an offer included on a form supplied by the other party to the transaction by the separate signing of the particular clause which contains the offer. "Signed" here also includes authentication but the reasonableness of the authentication herein allowed must be determined in the light of the purpose of the section. The circumstances surrounding the signing may justify something less than a formal signature or initialing but typically the kind of authentication involved here would consist of a minimum of initialing of the clause involved. A handwritten memorandum on the writer's letterhead purporting in its terms to "confirm" a firm offer already made would be enough to satisfy this section, although not subscribed, since under the circumstances it could not be considered a memorandum of mere negotiation and it would adequately show its own authenticity. Similarly, an authorized telegram will suffice, and this is true even though the original draft contained only a typewritten signature. However, despite settled courses of dealing or usages of the trade whereby firm offers are made by oral communication and relied upon without more evidence, such offers remain revocable under this article since authentication by a ~~writing~~ <u>record</u> is the essence of this section.

Reporter's Note

In furtherance of medium neutrality, the reference to a signed "writing" now refers to a signed "record."

* * *

Section 2-207. Additional Terms in Acceptance or Confirmation.

* * *

Official Comment

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8. Notwithstanding references in this section and throughout this article to "writing," "writings," or "written," the use by parties of a record other than a writing may be given effect for purposes of this article under law other than the Uniform Commercial Code, such as the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001, *et seq.*, [as amended,] and the Uniform Electronic Transactions Act.

Reporter's Note

In furtherance of medium neutrality, the reference to a signed "writing" now refers to a signed "record."

* * *

* * *

Section 2-209. Modification, Rescission and Waiver.

(1) An agreement modifying a contract within this article needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed ~~writing~~ record cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

* * *

Official Comment

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3. Subsections (2) and (3) are intended to protect against false allegations of oral modifications. "Modification or rescission" includes abandonment or other change by mutual consent, contrary to the decision in Green v. Doniger, 300 N.Y. 238, 90 N.E.2d 56 (1949); it does not include unilateral "termination" or "cancellation" as defined in Section 2-106.

The Statute of Frauds provisions of this article are expressly applied to modifications by subsection (3). Under those provisions the "delivery and acceptance" test is limited to the goods which have been accepted, that is, to the past. "Modification" for the future cannot therefore be conjured up by oral testimony if the price involved is $500.00 or more since such modification must be shown at least by a signed memo. And since a memo is limited in its effect to the quantity of goods set forth in it there is safeguard against oral evidence.

Subsection (2) permits the parties in effect to make their own Statute of Frauds as regards any future modification of the contract by giving effect to a clause in a signed agreement which expressly requires any modification to be by signed ~~writing~~ record. But note that if a consumer is to be held to such a clause on a form supplied by a merchant it must be separately signed.

4. Subsection (4) is intended, despite the provisions of subsections (2) and (3), to prevent contractual provisions excluding modification except by a signed ~~writing~~ record from limiting in other respects the legal effect of the parties' actual later conduct. The effect of such conduct as a waiver is further regulated in subsection (5).

Reporter's Note

In furtherance of medium neutrality, the reference to a signed "writing" now refers to a signed "record."

* * *

Section 2-316. Exclusion or Modification of Warranties.

* * *

Official Comment

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10. As to the use of a record other than a writing and communications that are not written, see Section 2-207, Comment 8. Whether a term is conspicuous, including a term in a record other than a writing, is discussed in Section 1-201, Comment 10.

* * *

Section 2-605. Waiver of Buyer's Objections by Failure to Particularize.

* * *

Official Comment

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<u>5. As to the use of a record other than a writing and communications that are not written, see Section 2-207, Comment 8.</u>

* * *

Section 2-607. Effect of Acceptance; Notice of Breach; Burden of Establishing Breach After Acceptance; Notice of Claim or Litigation to Person Answerable Over.

* * *

Official Comment

* * *

<u>9. As to the use of a record other than a writing and communications that are not written, see Section 2-207, Comment 8.</u>

* * *

Section 2-609. Right to Adequate Assurance of Performance.

* * *

Official Comment

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<u>7. As to the use of a record other than a writing and communications that are not written, see Section 2-207, Comment 8.</u>

* * *

Section 2-616. Procedure on Notice Claiming Excuse.

* * *

Official Comment

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1. * * *

2. As to the use of a record other than a writing and communications that are not written, see Section 2-207, Comment 8.

* * *

Section 2-702. Seller's Remedies on Discovery of Buyer's Insolvency.

* * *

Official Comment

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4. As to the use of a record other than a writing and communications that are not written, see Section 2-207, Comment 8.

* * *

ARTICLE 2A

LEASES

* * *

Section 2A-102. Scope.

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

(2) If the lease-of-goods aspects of a hybrid lease predominate, this article applies to the transaction.

(3) If the lease-of-goods aspects of a hybrid lease do not predominate:

(A) only the provisions of this article which relate primarily to the lease-of-goods aspects of the transaction and not to the transaction as a whole apply;

(B) Section 2A-209 applies if the lease is a finance lease; and

(C) Section 2A-407 applies to the promises of a person that is the lessee in a finance lease to the extent the promises are consideration for the right to possession and use of the leased goods.

(4) This Section does not preclude the application in appropriate circumstances of other law to the aspects of a hybrid lease which do not relate to the lease of goods even if the lease-of-goods aspects of the transaction predominate.

Official Comment

1. This article applies to any transaction, regardless of form, that creates a lease.

2. If the lease-of-goods aspects of a hybrid lease predominate, this article applies to the transaction. If the lease-of-goods aspects of a hybrid lease do not predominate, subsection (3)(A) applies and the provisions of this article which relate primarily to the lease-of-goods aspects of the transaction and not to the transaction as a whole apply.

3. Relevant factors in determining whether the lease-of-goods aspects of a hybrid lease predominate include the language of the agreement and the portion of the total price that is attributable to the lease of goods, although neither is determinative. An agreed-upon allocation of a portion of the total price to the right to possession and use of the goods is ordinarily binding on the parties, as is an agreement that the transaction includes or does not include a finance lease.

4. A finance lease, defined in Section 2A-103(1)(g), may be included in a hybrid lease in which the lease-of-goods aspects of the transaction do not predominate. In such a situation, subsection (3)(B) makes Section 2A-209 applicable to the transaction and subsection (3)(C) addresses the application of Section 2A-407 to the promises made by the lessee under the finance lease. That latter section applies to those promises that are consideration for the lessee's right to possession and use of the leased goods. Whether a promise of a lessee so qualifies is a question of fact but an agreed-upon allocation of a portion of the total price to the right to possession and use of the leased goods is ordinarily binding on the parties. The fact that subsection (3)(B) and (C) expressly make Sections 2A-209 and 2A-407 applicable if the lease is a finance lease does not prevent application of other provisions of this article relating to finance leases pursuant to subsection (3)(A).

> **Example 1.** Lessor and Customer enter into a contract that provides for Lessor to: (i) lease equipment to Customer; and (ii) provide to Customer a variety of maintenance and consulting services. The services aspects of the transaction predominate. Lessor did not select, manufacture, or supply the goods; instead, the goods were selected by Customer, and Lessor acquired the goods from Supplier for the sole purpose of leasing the goods to Customer. Assume that the lease aspects of the transaction involve a finance lease under Section 2A-103(1)(g). Pursuant to subsection (3)(A), Sections 2A-212 and 2A-213 apply. Under those sections, because the lease aspect of the transaction is a finance lease, Lessor

makes no implied warranty of merchantability or implied warranty of fitness for particular purpose. Pursuant to subsection (3)(B), Section 2A-209 applies to the transaction. Under that section, all warranties made by Supplier to Lessor extend to Customer.

Example 2. Same facts as Example 1. As consideration for Lessor's obligations under the contract, Customer promises to pay a single monthly fee of a specified amount. The contract does not indicate what portion of the monthly fee is consideration for the services or what portion is consideration for possession and use of the equipment. Section 2A-407 applies to the lessee's promises that are consideration for the lessee's right to possession and use of the equipment. In an action involving the application of Section 2A-407, the determination of what portion of the monthly fee is for the right to possession and use of the equipment is a question of fact.

Example 3. Same facts as Example 1 except that the lease-of-goods aspects of the transaction predominate. Section 2A-407 applies to all of the lessee's promises under the transaction.

5. If the lease-of-goods aspects of a hybrid lease predominate, then this article applies to the transaction. However, the application of this article to a hybrid lease does not preclude the application of principles of law and equity to supplement the provisions of this article, see Section 1-103(b), nor does it preclude, in appropriate circumstances, the application of other law to the non-lease-of-goods aspects of the transaction. Whether it is appropriate to apply such other law will depend in part on what purposes the other law is designed to achieve and whether application of the other law would be likely to interfere with the application of this article.

Example 4. Same facts as Example 3 (the lease-of-goods aspects of the transaction predominate) except that the lease is not a finance lease. This article applies to the transaction. Nevertheless, because principles of law and equity also apply unless displaced by particular provisions the Uniform Commercial Code, see Section 1-103(b), and this article does not displace other law relating to whether Lessor's performance of services conforms to the contract, other law determines whether the services conform to the contract.

6. The rules of subsections (2) and (3) are essentially gap fillers that apply when the parties' agreement is silent on what legal rules govern the different aspects of their transaction. In general, parties are free to preclude the application of this article to the aspects of their transaction that are not about the lease of goods. *See* Comment 5 to Section 2-102.

Section 2A-103. Definitions and Index of Definitions.

(1) In this article, unless the context otherwise requires:

* * *

(aa) “Hybrid lease” means a single transaction involving a lease of goods and:

(i) the provision of services;

(ii) a sale of other goods; or

(iii) a sale, lease, or license of property other than goods.

* * *

Official Comment

* * *

(aa) In some transactions, the transfer of the right to possession and use of goods for a term in return for consideration (i.e., a lease), is part of a larger transaction. The other aspects of the transaction might involve the provision of services, a sale of other goods, or a transfer of rights to property other than goods. Such a transaction is a hybrid lease. Section 2A-102 indicates the extent to which this article applies to a hybrid lease.

A hybrid lease is a single transaction. If contracting parties enter into separate agreements at the same time, each agreement must be evaluated separately to determine if it is a hybrid lease.

> **Example 1.** Lessor and Customer A enter into a single agreement that provides for Lessor, in return for periodic payments from Customer A, to: (i) lease a photocopier to Customer A for twelve months; (ii) supply all the paper, staples, and toner needed to operate the copier during that period, and (iii) provide routine maintenance and repair services needed to keep the copier operating during that period. The transaction is a hybrid lease because it involves a lease of goods (the copier), a sale of goods (the paper, staples, and toner), and the provision of services.

> **Example 2.** Lessor and Customer B enter into three separate written agreements at the same time: (i) a lease of a photocopier to Customer B for twelve months; (ii) a contract for Lessor to supply Customer B with all the paper, staples, and toner needed to operate the copier during that period, and (iii) a contract for Lessor to provide routine maintenance and repair services needed to keep the copier operating during that period. Because the parties executed three separate agreements, and the lease does not involve a sale, lease, or license of other property or the provision of services, the lease is not a hybrid lease.

Even when contracting parties enter into a single agreement involving both a lease of goods and a sale, lease, or license of other property or the provision of services, the agreement would not involve a single transaction, and hence the transaction would not be a hybrid lease, if the lease of goods is unrelated to the other aspects of the transaction and the terms of the agreement relating to the lease of goods are readily severable from the terms of the agreement relating to the other aspects of the transaction.

Example 3. Farmer A and Farmer B sign a written agreement pursuant to which Farmer A will lease a tractor to Farmer B for one year and Farmer B will board and feed Farmer A's cattle until the cattle are sold. The agreement specifies a rental payment for the tractor, which is due monthly, and a mechanism for determining the price for Farmer B's services, which is to be paid when the cattle are sold. The parties would have entered into an agreement to lease the tractor even if they had not entered into an agreement to board and feed the cattle, and vice-versa. The transaction is not a hybrid lease. Article 2A applies to the lease of the tractor. Other law applies to the agreement to board and feed the cattle.

* * *

(g) "Finance Lease". * * *

* * *

Notwithstanding references in this section and throughout this article to "writing," "writings," or "written," the use by parties of a record other than a writing may be given effect for purposes of this article under law other than the Uniform Commercial Code, such as the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 *et seq.*, [as amended,] and the Uniform Electronic Transactions Act.

* * *

Section 2A-107. Waiver or Renunciation of Claim or Right After Default.

* * *

Official Comment

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4. As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g).

* * *

Section 2A-201. Statute of Frauds.

(1) A lease contract is not enforceable by way of action or defense unless:

(a) the total payments to be made under the lease contract, excluding payments for options to renew or buy, are less than $1,000; or

(b) there is a ~~writing~~ record, signed by the party against whom enforcement is sought or by that party's authorized agent, sufficient to indicate that a lease contract has been made between the parties and to describe the goods leased and the lease term.

(2) Any description of leased goods or of the lease term is sufficient and satisfies subsection (1)(b), whether or not it is specific, if it reasonably identifies what is described.

(3) A ~~writing~~ record is not insufficient because it omits or incorrectly states a term agreed upon, but the lease contract is not enforceable under subsection (1)(b) beyond the lease term and the quantity of goods shown in the writing.

(4) A lease contract that does not satisfy the requirements of subsection (1), but which is valid in other respects, is enforceable:

(a) if the goods are to be specially manufactured or obtained for the lessee and are not suitable for lease or sale to others in the ordinary course of the lessor's business, and the lessor, before notice of repudiation is received and under circumstances that reasonably indicate that the goods are for the lessee, has made either a substantial beginning of their manufacture or commitments for their procurement;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony or otherwise in court that a lease contract was made, but the lease contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods that have been received and accepted by the lessee.

(5) The lease term under a lease contract referred to in subsection (4) is:

(a) if there is a ~~writing~~ record signed by the party against whom enforcement is sought or by that party's authorized agent specifying the lease term, the term so specified;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony, or otherwise in court a lease term, the term so admitted; or

(c) a reasonable lease term.

Official Comment

* * *

Changes: This section is modeled on Section 2-201, with changes to reflect the differences between a lease contract and a contract for the sale of goods. In particular, subsection (1)(b) adds a requirement that the ~~writing~~ record "describe the goods leased and the lease term", borrowing that concept, with revisions, from the provisions of Section 9-203(1)(a). Subsection (2), relying on the statutory analogue in Section 9-110, sets forth the minimum criterion for satisfying that requirement.

Reporter's Note

In furtherance of medium neutrality, the reference to a signed "writing" now refers to a signed "record."

* * *

Section 2A-202. Final Written Expression: Parol or Extrinsic Evidence.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a ~~writing~~ record intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

(a) by course of dealing or usage of trade or by course of performance;

and

(b) by evidence of consistent additional terms unless the court finds the ~~writing~~ record to have been intended also as a complete and exclusive statement of the terms of the agreement.

Reporter's Note

In furtherance of medium neutrality, the reference to a "writing" now refers to a "record."

* * *

Section 2A-203. Seals Inoperative.

The affixing of a seal to a ~~writing~~ record evidencing a lease contract or an offer to enter into a lease contract does not render the ~~writing~~ record a sealed instrument and the law with respect to sealed instruments does not apply to the lease contract or offer.

Reporter's Note

In furtherance of medium neutrality, the reference to a "writing" now refers to a "record."

* * *

Section 2A-205. Firm Offers.

An offer by a merchant to lease goods to or from another person in a signed ~~writing~~ record that by its terms gives assurance it will be held open is not revocable, for lack of consideration, during the time stated or, if no time is stated, for a reasonable time, but in no event may the period of irrevocability exceed 3 months. Any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

Reporter's Note

In furtherance of medium neutrality, the reference to a signed "writing" now refers to a signed "record."

* * *

Section 2A-208. Modification, Rescission and Waiver.

(1) An agreement modifying a lease contract needs no consideration to be binding.

(2) A signed lease agreement that excludes modification or rescission except by a signed ~~writing~~ record may not be otherwise modified or rescinded, but, except as between merchants, such a requirement on a form supplied by a merchant must be separately signed by the other party.

Reporter's Note

In furtherance of medium neutrality, the reference to a signed "writing" now refers to a signed "record."

* * *

Section 2A-214. Exclusion or Modification of Warranties.

* * *

Official Comment

* * *

As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g). Whether a term is conspicuous, including a term in a record other than a writing, is discussed in Section 1-201, Comment 10.

* * *

Section 2A-303. Alienability of Party's Interest Under Lease Contract or of Lessor's Residual Interest in Goods; Delegation of Performance; Transfer of Rights.

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Official Comment

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10. As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g).

* * *

Section 2A-309. Lessor's and Lessee's Rights When Goods Become Fixtures.

* * *

Official Comment

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7. As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g).

* * *

Section 2A-310. Lessor's and Lessee's Rights When Goods Become Accessions.

* * *

Official Comment

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As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g).

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Section 2A-401. Insecurity: Adequate Assurance of Performance.

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Official Comment

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As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g).

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Section 2A-406. Procedure on Excused Performance.

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Official Comment

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As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g).

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Section 2A-514. Waiver of Lessee's Objections.

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Official Comment

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As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g).

* * *

Section 2A-516. Effect of Acceptance of Goods; Notice of Default; Burden of Establishing Default After Acceptance; Notice of Claim or Litigation to Person Answerable Over.

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Official Comment

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As to the use of a record other than a writing and communications that are not written, see Section 2A-103, Comment (g).

* * *

Reporter's Prefatory Note to Payments Amendments

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

Negotiability. An amendment to Section 3-104 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 Sections 3-105 and 3-604, and to the official comments to Sections 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.

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

References to a "Writing." Amendments to Sections 4A-202, 4A-203, 4A-207, 4A-208 and 4A-305 change the references to a "writing" to a "signed record."

Security Procedures. Amendments to Sections 4A-201 and 4A-202, and to the official comment to Section 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

Section 3-104. Negotiable Instrument.

(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<u>; (iv) a term that specifies the law that governs the promise or order; or (v) an undertaking to resolve in a specified forum a dispute concerning the promise or order</u>.

Official Comment

1. The definition of "negotiable instrument" defines the scope of Article 3 since Section 3-102 states: "This Article applies to negotiable instruments." The definition in Section 3-104(a) incorporates other definitions in Article 3. An instrument is either a "promise," defined in Section 3-103(a)(12), or "order," defined in Section 3-103(a)(8). A promise is a written undertaking to pay money signed by the person undertaking to pay. An order is a written instruction to pay money signed by the person giving the instruction. Thus, the term "negotiable

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

* * *

Section 3-105. Issue of Instrument.

(a) "Issue" means:

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

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

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

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

Official Comment

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

Subsection (a) permits an instrument to be issued by an electronic transmission of an image of and information derived from the instrument by maker and drawer, rather than by delivery. Thus, for example, a drawer might, with the permission of the payee, write and sign a check, take a photograph of the check, send the photograph to the drawee for processing electronically, and destroy the original check. If the electronic image and the information derived from it can be processed as an "electronic check" under Regulation CC, see 12 C.F.R. § 229.2(ggg), the check is "issued" and hence can be enforced pursuant to this article.

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Reporter's Note

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

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

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Official Comment

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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 and information derived from the check 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 a check is not discharged solely by the destruction of the check in connection with a process in which information is extracted from the check and an image of the check is made and, subsequently, the information and image are transmitted for payment.

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

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

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. The destruction of the

check also does not affect whether the check has been issued. See Section 3-105(a) and comment 1.

Reporter's Note

Deletion of subsection (c). Subsection (c) has been deleted as unnecessary in view of the revised definition of "signed" in Section 1-201.

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ARTICLE 4

BANK DEPOSITS AND COLLECTIONS

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Section 4-207. Transfer Warranties.

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Official Comment

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

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

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

* * *

ARTICLE 4A

FUNDS TRANSFERS

Section 4A-103. Payment Order – Definitions.

(a) In this article:

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

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

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

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

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Official Comment

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

Section 4A-104. Funds Transfer – Definitions.

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Official Comment

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

> ~~For example,~~ **Example:** a New York bank may have issued a letter of credit in favor of X, a California seller of goods to be shipped to the New York bank's customer in New York. The terms of the letter of credit provide for payment to X if documents are presented to prove shipment of the goods. Instead of providing for presentment of the documents to the New York bank, the letter of credit states that they may be presented to a California bank that acts as an agent for payment. The New York bank sends an

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

An instruction to pay might be a component of a computer program or a transaction protocol intended to execute automatically under specified circumstances. The fact that the program or protocol itself is subject to a condition does not necessarily mean that an instruction to pay issued pursuant to that program or protocol "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~~ an 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 obligations under the security procedure chosen by the customer.

* * *

Official Comment

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

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.

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

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

Official Comment

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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~~ an 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.

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 the 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 reasonability 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~~ A security procedure that fails to meet prevailing standards of good banking practice applicable to the particular bank

<ins>and customer</ins> 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. <ins>The reasonableness of a security procedure is to be determined at the time that a payment order is processed, not at 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.</ins> 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~~ <ins>a record</ins> 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.

<ins>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 Section 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.</ins>

~~5.~~<ins>6.</ins> 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.

~~6.~~7. 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.

~~7.~~8. 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.

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Section 4A-207. Misdescription of Beneficiary.

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(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~~ <u>record</u> stating the information to which the notice relates.

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Section 4A-208. Misdescription of Intermediary Bank or Beneficiary's Bank.

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

(1) If the sender is a bank, the receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank if the receiving bank, when it

executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person or whether the number refers to a bank. The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(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~~ <u>record</u> 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~~ <u>a record</u>. 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~~ <u>a record</u>. 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.

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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~~ <u>a record</u>." 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.

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ARTICLE 5

LETTERS OF CREDIT

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Section 5-116. Choice of Law and Forum.

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

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

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

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

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

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

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

Reporter's Note

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

* * *

ARTICLE 7

DOCUMENTS OF TITLE

Section 7-102. Definitions and Index of Definitions.

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

* * *

(9) "Person entitled under the document" means the holder, in the case of a negotiable document of title, or the person to which delivery of the goods is to be made by the terms of, or pursuant to instructions in a record under, a nonnegotiable document of title.

* * *

(11) [Reserved] ~~“Sign” means, with present intent to authenticate or adopt a record:~~

~~(A) to execute or adopt a tangible symbol; or~~

~~(B) to attach to or logically associate with the record an electronic sound, symbol, or process.~~

* * *

Official Comment

* * *

6. “Person entitled under the document” is moved from former Section 7-403.

In the case of a negotiable document of title, the person entitled is the holder. See Section 1-201(b)(21) (defining “holder”). For a nonnegotiable document of title, the person entitled is the person provided in the terms of the document or instructions under the document. A transferee of a nonnegotiable document to which the document has been delivered acquires the transferee’s rights and rights that the transferor had actual authority to convey. Section 7-504(a). However, until but not after the bailee receives notice of a transfer, such a transferee’s rights are subject to those of persons identified in Section 7-504(b), including “as against the bailee, by good faith dealings of the bailee with the transferor. Moreover, such a transferee is *not* a person entitled under the document unless so provided in the document or in instructions under the document.

Neither the definition nor the official comments to Article 7 provide an explanation of what constitutes an “instruction under” a nonnegotiable document. In practice the term is generally understood to include an instruction to the bailee, by the person named in the document, to deliver the goods to a transferee of the document or to another person. An instruction under a nonnegotiable document should be distinguished from a mere “notice” or “notification” to the bailee of a transfer or security interest, as contemplated by Sections 7-504(b) and 9-312(d)(2). However, an instruction could, functionally, also constitute such a notice.

* * *

Reporter’s Note

Deletion of subsection (a)(11). Subsection (a)(11) has been deleted as unnecessary in view of the revised definition of “signed” in Section 1-201.

* * *

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

(a) **[General rule.]** 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) **[Single authoritative copy.]** A system satisfies subsection (a), and a person ~~is deemed to have~~ has control of an electronic document of title, if the document is created, stored, and ~~assigned~~ transferred 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~~ transferee 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

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

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

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

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

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

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

(B) transfer control of each authoritative electronic copy.

(d) **[Presumption of exclusivity of certain powers.]** If a person has the powers that are specified in subsection (c)(3), the powers are presumed to be exclusive.

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

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

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

(f) **[No requirement to acknowledge.]** A person that has control under this section is not required to acknowledge that it has or will obtain control on behalf of another person.

(g) **[No duties or confirmation.]** If a person acknowledges that it has or will obtain control on behalf of another person, unless the person otherwise agrees or law other than this article otherwise provides, the person does not owe any duty to the other person and is not required to confirm the acknowledgment to another person.

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

(1) the authoritative electronic copy, a record attached to or logically associated with the electronic copy, or a system in which the electronic copy is recorded limits the use of the document or has a protocol that is programmed to cause a change, including a transfer or loss of control; or

(2) the person shares the power with another person.

Reporter's Note

1. *Background of revisions.* Draft § 7-106 on control of electronic documents of title preserves the existing subsection (a) general rule and the existing subsection (b) "safe harbor." The minor stylistic revisions are not substantive. The other proposed revisions add an additional "safe harbor" in subsection (c) and a new subsection (e) on control through another person. The requirements for obtaining control under subsection (c) are inspired by draft § 12-105 on control of controllable electronic records. *See* Reporter's Note to draft § 12-105.

2. *Control of electronic documents of title: In general.* As Note 1 indicates, subsections (a) and (b) are substantially unchanged. *It is important to note that compliance with the new conditions for control in subsection (c) also would satisfy the conditions provided in subsection (b).* However, subsection (b) has been retained out of an abundance of caution and to provide assurances that existing systems for control of electronic documents of title under current law will continue to be viable after the draft revisions become effective. Subsection (c) generally follows proposed revisions to draft § 9-105 on control of chattel paper evidenced by electronic records. It differs from subsection (b), which is based on a "single authoritative copy" of an electronic document of title. *See generally* draft § 9-105 and Reporter's Note. The new conditions for "control" in subsection (c) are meant to reflect the functions that possession serves with respect to writings, but in a more accurate and technologically flexible way than does the current definition in subsection (b). As to shared control by a debtor and a secured party and the relevance to perfection of a security interest, see draft § 9-314, Reporter's Note 2.

3. *Negotiable and nonnegotiable electronic documents of title.* This section applies to both negotiable and nonnegotiable electronic documents of title. For negotiable electronic documents of title, "delivery" is a necessary condition for negotiation, and therefore for due negotiation, under Section 7-501(b). "Delivery" of an electronic document of title is defined in Section 1-201(b)(15) as the "voluntary transfer of control." The person in control of a negotiable document, other than pursuant to subsection (e), also is a "holder," as defined in draft § 1-201(b)(21)(C). Of course, nonnegotiable documents cannot be negotiated.

A security interest in an electronic document of title, whether negotiable or nonnegotiable, may be perfected by control. UCC § 9-314(a). But perfection of a security interest by control in a nonnegotiable document does not perfect a security interest in goods covered by the document and does not confer on a secured party or other purchaser the status of a person entitled. See Section 7-102(a)(9) (defining "person entitled under the document") & Comment 6. (On perfection of security interests in negotiable documents of title and goods covered by negotiable and nonnegotiable documents of title, see generally draft § 9-312(a), (c), and (g) & Comment 7.) However, a system for control of electronic documents in which bailees participate could be designed to provide that a transfer of control to a purchaser constitutes a reissuance of the document in the name of a secured party under Section 9-312(d)(1) or a notice to the bailee of a security interest under Section 9-312(d)(2). A system also could provide that a transfer of control constitutes an instruction under the document that would make the transferee a person entitled.

4. *Control through another person.*

a. Subsection (e) provides for a person to obtain control through the control of another person. It follows draft revisions to the corresponding provisions for control of deposit accounts (draft § 9-104), control of authoritative electronic copies of records evidencing chattel paper (draft § 9-105), control of electronic money (draft § 9-105A), and control of controllable electronic records (draft § 12-105). For a brief discussion, see draft § 12-105, Reporter's Note 8.

b. Subsections (f) and (g) derive from Section 9-313(f) and (g). Subsection (f) makes clear that a person that has control under this section has no duty to acknowledge that it has or will obtain control on behalf of another person. Arrangements for a person to acknowledge that it has or will obtain control on behalf of another person are not standardized. Accordingly, subsection (g) leaves to the agreement of the parties and to any other applicable law any duties of a person that does acknowledge that it has or will obtain control on behalf of another person and provides that a person making an acknowledgment is not required to confirm the acknowledgment to another person.

* * *

Section 7-403. Obligation of Bailee to Deliver; Excuse.

(a) A bailee shall deliver the goods to a person entitled under a document of title if the person complies with subsections (b) and (c), unless and to the extent that the bailee establishes any of the following:

(1) delivery of the goods to a person whose receipt was rightful as against the claimant;

(2) damage to or delay, loss, or destruction of the goods for which the bailee is not

liable;

(3) previous sale or other disposition of the goods in lawful enforcement of a lien or on a warehouse's lawful termination of storage;

(4) the exercise by a seller of its right to stop delivery pursuant to Section 2-705 or by a lessor of its right to stop delivery pursuant to Section 2A-526;

(5) a diversion, reconsignment, or other disposition pursuant to Section 7-303;

(6) release, satisfaction, or any other personal defense against the claimant; or

(7) any other lawful excuse.

(b) A person claiming goods covered by a document of title shall satisfy the bailee's lien if the bailee so requests or if the bailee is prohibited by law from delivering the goods until the charges are paid.

(c) Unless a person claiming the goods is a person against which the document of title does not confer a right under Section 7-503(a):

(1) the person claiming under a document shall surrender possession or control of any outstanding negotiable document covering the goods for cancellation or indication of partial deliveries; and

(2) the bailee shall cancel the document or conspicuously indicate in the document the partial delivery or the bailee is liable to any person to which the document is duly negotiated.

Official Comment

* * *

5. In addition to compliance with subsection (b), ~~Subsection~~ subsection (c) conditions the bailee's duty to deliver the goods to a person entitled under a negotiable document on the surrender of possession or control of the document for cancellation or indication of partial deliveries. It also states the obvious duty of a bailee to take up a negotiable document or note

partial deliveries conspicuously thereon, and the result of failure in that duty. It is subject to only one exception, that stated in subsection (a)(1) of this section and in Section 7-503(a). Subsection (c) is limited to cases of delivery to a claimant; it has no application, for example, where goods held under a negotiable document are lawfully sold to enforce the bailee's lien.

<u>Subsection (c) does not specify any conditions on the duty of the bailee to deliver the goods covered by a nonnegotiable document to a person entitled, other than the conditions inherent in the definition of "person entitled under the document." See Section 7-102(a)(9) (defining "person entitled under the document") & Comment 6.</u>

6. When courts are considering subsection (a)(7), "any other lawful excuse," among others, refers to compliance with court orders under Sections 7-601, 7-602 and 7-603.

Reporter's Note

No change. No change is proposed to Section 7-403.

* * *

Section 7-504. Rights Acquired in Absence of Due Negotiation; Effect of Diversion; Stoppage of Delivery.

(a) A transferee of a document of title, whether negotiable or nonnegotiable, to which the document has been delivered but not duly negotiated, acquires the title and rights that its transferor had or had actual authority to convey.

(b) In the case of a transfer of a nonnegotiable document of title, until but not after the bailee receives notice of the transfer, the rights of the transferee may be defeated:

(1) by those creditors of the transferor which could treat the transfer as void under Section 2-402 or 2A-308 ;

(2) by a buyer from the transferor in ordinary course of business if the bailee has delivered the goods to the buyer or received notification of the buyer's rights;

(3) by a lessee from the transferor in ordinary course of business if the bailee has delivered the goods to the lessee or received notification of the lessee's rights; or

(4) as against the bailee, by good-faith dealings of the bailee with the transferor.

* * *

Official Comment

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2. As in the case of transfer--as opposed to "due negotiation"--of negotiable documents, subsection (a) empowers the transferor of a nonnegotiable document to transfer only such rights as the transferor has or has "actual authority" to convey. In contrast to situations involving the goods themselves the operation of estoppel or agency principles is not here recognized to enable the transferor to convey greater rights than the transferor actually has. Subsection (b) makes it clear, however, that the transferee of a nonnegotiable document may acquire rights greater in some respects than those of his transferor by giving notice of the transfer to the bailee. New subsection (b)(3) provides for the rights of a lessee in the ordinary course.

Note that a transferee of a nonnegotiable document that takes delivery of the document under subsection (a) would not, *ipso facto*, be a "person entitled under the document" with a right to receive delivery of the goods from the bailee under Section 7-403(a). See Section 7-102(a)(9) (defining "person entitled under the document") & Comment 6.

Subsection (b)(2)&(3) require delivery of the goods. Delivery of the goods means the voluntary transfer of physical possession of the goods. See amended 2-103.

Reporter's Note

No change. No change is proposed to Section 7-504.

* * *

ARTICLE 8

INVESTMENT SECURITIES

Reporter's Prefatory Note to Article 8 Amendments

Proposed amendments to the official comments to Section 8-102 primarily serve to make clear that a controllable electronic record may be a financial asset credited to a securities account under Article 8. *See also* draft § 12-102, Reporter's Note 2. The proposed amendment to Section 8-106(d) on control through another person conforms that provision to proposed amendments to Section 7-106 (control of electronic documents of title) and Section 9-105 (control of authoritative electronic copies of records evidencing chattel paper) and to draft §§ 9-105A (control of electronic money) and 12-105 (control of controllable electronic records). The proposed amendment to Section 8-303 conforms the text on the rights of a protected purchaser to the corresponding provision for a qualifying purchaser under Article 12. The proposed revision of the official comment to Section 8-501 addresses certain financial assets as to which both a securities intermediary and its customer have control. These financial assets could be treated as being held directly by the customer and would not be included in a security entitlement. The Reporter's Note to Section 8-505 addresses distributions made with respect to financial assets as to which there is no issuer.

Section 8-102. Definitions and Index of Definitions.

* * *

(a) In this article:

* * *

(6) "Communicate" means to:

(i) send a signed ~~writing~~ record; or

(ii) transmit information by any mechanism agreed upon by the persons transmitting and receiving the information.

* * *

(9) "Financial asset," except as otherwise provided in Section 8-103, means:

(i) a security;

(ii) an obligation of a person or a share, participation, or other interest in a person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on financial markets, or which is recognized in any area in which it is issued or dealt in as a medium for investment; or

(iii) any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this article.

As context requires, the term means either the interest itself or the means by which a person's claim to it is evidenced, including a certificated or uncertificated security, a security certificate, or a security entitlement.

* * *

(14) "Securities intermediary" means:

(i) a clearing corporation; or

(ii) a person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity.

* * *

Official Comment

* * *

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

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

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

It is not necessary for all of the Part 5 rules to be relevant to a particular financial asset for the relevant property to qualify as a “financial asset” credited to a securities account. Many of the duties set forth in Part 5 will often be relevant to a digital asset treated as a financial asset credited to a securities account, including the duty to exercise rights as directed by the entitlement holder, comply with the entitlement holder's entitlement orders, and change the position to another form of holding. If the parties agree to treat a digital asset as a financial asset under Article 8 and the digital asset is in fact held in a securities account for an entitlement holder, the rules applicable to "controllable electronic records" under Article 12 would not apply 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 under 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 Section 8-102(a)(9)(ii) and (iii). 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. *No change.* No change is proposed to the definitions of "financial asset" or "securities intermediary."

2. *"Communicate."* In furtherance of medium neutrality, the reference in the definition of "communicate" to a signed "writing" now refers to a signed "record"

3. *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. *See also* draft § 12-102, Reporter's Note 2 (second paragraph).

* * *

Section 8-106. Control

* * *

(d) A purchaser has "control" of a security entitlement if:

* * *

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

~~behalf of the purchaser.~~

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

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

* * *

(h) **[No requirement to acknowledge.]** A person that has control under this section is not required to acknowledge that it has control on behalf of a purchaser.

(i) **[No duties or confirmation.]** If a person acknowledges that it has or will obtain control on behalf of a purchaser, unless the person otherwise agrees or law other than this article otherwise provides, the person does not owe any duty to the purchaser and is not required to confirm the acknowledgment to another person.

Reporter's Note

1. *Control through another person.*

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

b. New subsections (h) and (i) derive from Section 9-313(f) and (g). Subsection (h) makes clear that a person that has control under this section has no duty to acknowledge that it has or will obtain control on behalf of a purchaser. Arrangements for a person to acknowledge that it has or will obtain control on behalf of the purchaser are not standardized. Accordingly, subsection (i) leaves to the agreement of the parties and to any other applicable law any duties of a person that does acknowledge that it has or will obtain control on behalf of a purchaser and provides that a person making an acknowledgment is not required to confirm the acknowledgment to another person.

* * *

Section 8-303. Protected Purchaser.

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

(1) gives value;

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

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

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

Reporter's Note

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

* * *

Section 8-501. Securities Account; Acquisition of Security Entitlement from Securities Intermediary.

* * *

(d) If a securities intermediary holds a financial asset for another person, and the financial asset is registered in the name of, payable to the order of, or specially indorsed to the ~~other~~ person, and has not been indorsed to the securities intermediary or in blank, the other person is treated as holding the financial asset directly rather than as having a security entitlement with respect to the financial asset.

* * *

Official Comment

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4. Part 5 of Article 8 sets out a carefully designed system of rules for the indirect holding system. Persons who hold securities through brokers or custodians have security entitlements that are governed by Part 5, rather than being treated as the direct holders of securities. Subsection (d) specifies the limited circumstance in which a customer who leaves a financial asset with a broker or other securities intermediary has a direct interest in the financial asset, rather than a security entitlement. The customer can be a direct holder only if the security certificate, or other financial asset, is registered in the name of, payable to the order of, or specially indorsed to the customer, and has not been indorsed by the customer to the securities intermediary or in blank. The distinction between those circumstances where the customer can be treated as direct owner and those where the customer has a security entitlement is essentially the same as the distinction drawn under the federal bankruptcy code between customer name securities and customer property. The distinction does not turn on any form of physical identification or segregation. A customer who delivers certificates to a broker with blank indorsements or stock powers is not a direct holder but has a security entitlement, even though the broker holds those certificates in some form of separate safe-keeping arrangement for that particular customer. The customer remains the direct holder only if there is no indorsement or stock power so that further action by the customer is required to place the certificates in a form where they can be transferred by the broker.

The rule of subsection (d) corresponds to the rule set out in Section 8-301(a)(3) specifying when acquisition of possession of a certificate by a securities intermediary counts as "delivery" to the customer.

Subsection (d) uses terminology applicable to conventional certificated securities (*e.g.*, "indorsed") and contemplates the limited circumstances in which a securities intermediary (defined in Section 8-102(a)(14) to include only a clearing corporation or another person that in the ordinary course of its business maintains securities accounts for others and that is acting in that capacity) may hold a financial asset for a customer under a direct holding arrangement rather than as a security entitlement. However, assets such as controllable electronic records, controllable accounts, and controllable payment intangibles also might be controlled by a securities intermediary for the benefit of a customer under a similar direct holding arrangement. For example, the securities intermediary and the customer might share control of the financial asset under an arrangement whereby the exercise of powers, such as the power to transfer control, requires the exercise of the power by both the intermediary and the customer. Such an arrangement would be, functionally, substantially equivalent to the arrangement explicitly contemplated by subsection (d). Alternatively, the person holding such an asset for the benefit of another may not be acting in the capacity of a securities intermediary, even if the person also regularly acts in that capacity. In such a case the relationship would be governed by the agreement of the parties and the application of law other than this article.

Reporter's Note

No change. No change is proposed to Section 8-501.

* * *

Section 8-505. Duty of Securities Intermediary with Respect to Payments and Distributions.

(a) A securities intermediary shall take action to obtain a payment or distribution made by the issuer of a financial asset. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to attempt to obtain the payment or distribution.

(b) A securities intermediary is obligated to its entitlement holder for a payment or distribution made by the issuer of a financial asset if the payment or distribution is received by the securities intermediary.

Official Comment

1. One of the core elements of the securities account relationships for which the Part 5 rules were designed is that the securities intermediary passes through to the entitlement holders the economic benefit of ownership of the financial asset, such as payments and distributions made by the issuer <u>of the financial asset</u>. Subsection (a) expresses the ordinary understanding that a securities intermediary will take appropriate action to see to it that any payments or distributions made by the issuer are received. One of the main reasons that investors make use of securities intermediaries is to obtain the services of a professional in performing the record-keeping and other functions necessary to ensure that payments and other distributions are received.

2. Subsection (a) incorporates the same "agreement/due care" formula as the other provisions of Part 5 dealing with the duties of a securities intermediary. See Comment 4 to Section 8-504. This formulation permits the parties to specify by agreement what action, if any, the intermediary is to take with respect to the duty to obtain payments and distributions. In the absence of specification by agreement, the intermediary satisfies the duty if the intermediary exercises due care in accordance with reasonable. commercial standards. The provisions of Section 8-509 also apply to the Section 8-505 duty, so that compliance with applicable regulatory requirements constitutes compliance with the Section 8-505 duty.

3. Subsection (b) provides that a securities intermediary is obligated to its entitlement holder for those payments or distributions made by the issuer that are in fact received by the intermediary. It does not deal with the details of the time and manner of payment. Moreover, as with any other monetary obligation, the obligation to pay may be subject to other rights of the obligor, by way of set-off counterclaim or the like. Section 8-509(c) makes this point explicit.

Reporter's Note

1. *No change.* No change is proposed to Section 8-505.

2. *Distribution on account of financial asset if there is not an issuer.* This section applies to payments and distributions made by an issuer of a financial asset credited to a securities account. If a distribution is made to, or made available to, a securities intermediary on account of a financial asset as to which there is no issuer, the duties, if any, of the securities intermediary with respect to the distribution are subject to the agreement of the intermediary and the entitlement holder. However, in the absence of an agreement, this section may be applied by analogy in an appropriate case. If the securities intermediary is a secured party, Section 9-207(c) applies. The official comments will be revised to reflect the substance of this Note.

* * *

ARTICLE 9

SECURED TRANSACTIONS

Reporter's Prefatory Note to Article 9 Amendments

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

2. *Article 12-related conforming amendments.* Article 12-related conforming amendments to Article 9 include the addition of two new types of collateral: controllable accounts (a subset of accounts) and controllable payment intangibles (a subset of payment intangibles, which is a subset of general intangibles). Perfection of a security interest in a controllable electronic record, controllable account, or controllable payment intangible may be by control or by filing a financing statement. Control of a controllable electronic record is determined under draft § 12-105. Control of a controllable account or controllable payment intangible is achieved by obtaining control of the controllable electronic record that evidences the account or payment intangible. Draft § 9-107A. The rights of a secured party that takes free of competing property interests as a qualifying purchaser of a controllable account, controllable electronic record, or controllable payment intangible are respected under Article 9. Draft § 9-331.

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

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

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

First, the definition of "chattel paper" creates uncertainty in "bundled" or "hybrid" transactions in which monetary obligations exist not only under a lease of goods but also with respect to other property and services relating to the leased goods. Frequently, the value of the non-goods aspect of a transaction is substantially greater than the value of the lessee's rights under the lease of goods. 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."

Second, the statutory distinction between "tangible chattel paper" and "electronic chattel paper" causes practical problems. As to tangible chattel paper (i.e., evidenced by writings), problems arose in the case of multiple originals of writings and situations in which separate writings covered different components of chattel paper. Official comments issued in connection with the 1999 amendments to Article 9 addressed these issues. As to electronic chattel paper, the safe harbor for control is based on a "single authoritative copy" of the chattel paper. Moreover, in some situations tangible chattel paper is converted to electronic form and electronic chattel paper is converted to tangible form. Additional uncertainty exists when one or more 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 also exist.

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.

Finally, the draft provides a new choice-of-law rule for perfection and priority of security interests in chattel paper that is evidenced by authoritative electronic copies of records or by such electronic copies and authoritative tangible copies. For such chattel paper, draft § 9-306A provides that perfection and priority are governed by the law of the "electronic chattel paper's jurisdiction," based loosely on Sections 8-110 and 9-305. For chattel paper evidenced only by authoritative tangible copies, draft § 9-306A(d) provides that perfection by possession and priority are governed by the law of the location of the tangible copies. Perfection by filing continues to be governed by the law of the location of the debtor for all chattel paper.

4. Money-related amendments

Section 1-201(b)(24) defines "money" as including "a medium of exchange currently authorized or adopted by a domestic or foreign government . . . ." There is no way of knowing how money in an intangible form might develop, but there are indications that some countries might authorize or adopt intangible tokens as a medium of exchange and others might authorize or adopt deposit accounts with a central bank as money.[5] For many purposes, there is no need for the UCC to distinguish among types of money. For Article 9 purposes, however, distinctions must be drawn. Only tangible money is susceptible of perfection by possession. And the steps needed for perfection by control with respect to intangible tokens, such as controllable electronic records, will not work for deposit accounts with a central bank, and vice versa. For this reason, the draft provides a new definition of "money" for purposes of Article 9 that expressly excludes deposit accounts. Thus, "electronic money," defined in draft § 9-102 as "money in an electronic form," would not include deposit accounts. The new Article 9 definition of "money" also excludes money in an electronic form that cannot be subjected to control under Section 9-105A.

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 deposit accounts, aside from distinguishing them from "money" and therefore from "electronic money." Under the draft, a security interest in electronic money as original collateral can be perfected only by control. The requirements for obtaining control of electronic money under draft § 9-105A are essentially the same as those for obtaining control of a controllable electronic record under draft Article 12.

The draft also makes changes to the take-free rules for transferees of money in Section 9-332, including the addition of a new rule applicable to electronic money, and transferees of funds from deposit accounts.

Section 9-102. Definitions and Index of Definitions.

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

* * *

(2) "Account", except as used in "account for", "account to," "account statement," "customer's account," "on account of", "statement of account," and paragraphs (14) and (29), means a right to payment of a monetary obligation, whether or not earned by

[5] These tokens or accounts sometimes are referred to as central bank digital currency or CBDC.

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. The term does not include (i) ~~rights to payment evidenced by chattel paper or an instrument,~~ chattel paper, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v) letter-of-credit rights or letters of credit, ~~or~~ (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the ~~card.~~ card, or (vii) rights to payment evidenced by an instrument.

* * *

(6A) "Assignee" means a person:

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

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

(6B) "Assignor" means a person that:

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

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

(7) [Reserved] ~~"Authenticate" means:~~

~~(A) to sign; or~~

~~(B) with present intent to adopt or accept a record, to attach to or logically associate with the record an electronic sound, symbol, or process.~~

* * *

(11) "Chattel paper" ~~means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this paragraph, "monetary obligation" means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods.~~ 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 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) charters or other contracts involving the use or hire of a vessel or (ii) records that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card. If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper.~~

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.

* * *

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

(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 under Section 12-105 has control of the controllable electronic record.

* * *

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

* * *

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

* * *

(42) “General intangible” means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes controllable electronic records, payment intangibles, and software.

* * *

(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.

* * *

(54A) “Money” has the meaning provided in Section 1-201(24), but the term does not include (i) a deposit account or (ii) money in an electronic form that cannot be subjected to control under Section 9-105A.

* * *

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

* * *

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

property:

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

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

(C) rights arising out of collateral;

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

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

* * *

(79A) "Tangible money" means money in a tangible form.

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

* * *

"Controllable electronic record" Section 12-102.

* * *

"Qualifying purchaser" Section 12-102.

* * *

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

Official Comment

* * *

5. **Receivables-related Definitions.**

* * *

b. **"Chattel Paper."**~~**; "Electronic Chattel Paper"; "Tangible Chattel Paper."**~~ ~~"Chattel paper" consists of a monetary obligation together with a security interest in or a lease of specific goods if the obligation and security interest or lease are evidenced by "a record or records.". The definition has been expanded from that found in former Article 9 to include records that evidence a monetary obligation and a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, or a lease of specific goods and license of software used in the goods. The expanded definition covers transactions in which the debtor's or lessee's monetary obligation includes amounts owed with respect to software used in the goods. The monetary obligation with respect to the software need not be owed under a license from the secured party or lessor, and the secured party or lessor need not be a party to the license transaction itself. Among the types of monetary obligations that are included in "chattel paper" are amounts that have been advanced by the secured party or lessor to enable the debtor or lessee to acquire or obtain financing for a license of the software used in the goods. The definition also makes clear that rights to payment arising out of credit-card transactions are not chattel paper.~~ "Chattel paper" consists of a monetary obligation that is either secured by specific goods or arises in connection with a lease of specific goods, in each case if the obligation and security interest or lease is evidenced by a record. The monetary obligation itself need not relate to the goods. For example, a loan secured by specific goods and evidenced by one or more records creates chattel paper regardless of the purpose of the loan.

Rights to payment arising out of ~~Charters~~ charters of vessels or the use of credit or charge cards are expressly excluded from the definition of chattel paper; they are accounts. The term "charter" as used in this section includes bareboat charters, time charters, successive voyage charters, contracts of affreightment, contracts of carriage, and all other arrangements for the use of vessels.

~~Under former Section 9-105, only if the evidence of an obligation consisted of "a writing or writings" could an obligation qualify as chattel paper. In this Article, traditional, written chattel paper is included in the definition of "tangible chattel paper." "Electronic chattel paper" is chattel paper that is stored in an electronic medium instead of in tangible form.~~

~~The concept of an electronic medium should be construed liberally to include electrical, digital, magnetic, optical, electromagnetic, or any other current or similar emerging technologies.~~

What distinguishes chattel paper from other rights to payment is the fact that creditor has an interest in specific goods to enforce the right to payment. For example, the fact that a secured party also has an interest in other property does not prevent the right to payment from being chattel paper, provided that the creditor relies on the specific goods as the primary collateral.

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

In Example 8, the inclusion of some incidental collateral, such as a deposit account, does not prevent characterization of the right to payment as chattel paper. Another typical example would be the inclusion of after-acquired replacement parts to be installed on the specific goods. On the other hand, to be chattel paper, a right to payment must be accompanied by a security interest in *specific* goods or a lease of *specific* goods. A right to payment secured by a security interest in rotating collateral is not chattel paper.

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

> **Example 10.** To secure a loan, Borrower grants Lender a security interest in a specifically described item of equipment and also in all of Borrower's existing and after-acquired equipment. The loan and the security interest are evidenced by one or more records. The right to payment is not chattel paper.

Example 9 is the easy case because no "specific goods" are identified. As to Example 10, it is true that the monetary obligation is secured by "specific goods" and the definition of chattel paper does not specify that the obligation must be secured *only* by specific goods. However, if the right to payment in Example 10 were to be characterized as chattel paper, it would be possible to convert virtually any monetary obligation evidenced by records and secured by any collateral into chattel paper merely by including as collateral a specific item of goods (whether inventory, equipment, consumer goods, or farm products). The special rules for chattel paper contemplate reliance on specific goods as the primary collateral, even if some incidental property also might be included. If the inclusion of additional goods or other property indicate that primary reliance is not on the specific goods, then classification as chattel paper would not be appropriate. Of course, there may be close cases. In those situations, parties should take appropriate precautions.

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

> **Example 11.** In one or more signed records, Customer and Car Dealer enter into a transaction pursuant to which, in exchange for a payment of $2,000 per month: (i) Customer is entitled to possession of a specific vehicle for 36 months; (ii) Car Dealer will provide round-the-clock monitoring of the vehicle's location and condition, and alert authorities to provide road-side assistance in the event of a malfunction or accident; and (iii) Car Dealer will, from time to time, remotely update the vehicle's automobile's operating system. The value of the right to possess and use the vehicle is significantly greater than the value of the monitoring service and updates. Because the goods aspect of the transaction predominates, under paragraph (11)(B)(ii) Customer's monetary obligation, including the portion attributable to Car Dealer's obligation to provide

monitoring and updates, constitutes chattel paper.

Example 12. In one or more signed records, Customer and Cableco enter into a transaction pursuant to which, in exchange for a payment of $200 per month, Cableco will provide Customer with specified television programming and a device needed to access the programming (a "lease" of the device). If the components of the transaction were priced separately, the price for the programming would be nine times the price for possession and use of the device. Because the goods aspect of this transaction does not predominate, under paragraph (11)(B)(ii) Customer's monetary obligation does not constitute chattel paper.

The latest revision to the definition of chattel paper omits the references to a "license of software used in the goods" as superfluous, inasmuch as there is no reason to single out software. Other types of property may secure an obligation or be included in a transaction involving a lease, as discussed above. See also Sections 2-102 (scope of Article 2); 2-106(5) (defining "hybrid transaction"); 2A-102 (scope of Article 2A); 2A-103(aa) (definition of "hybrid lease").

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

Reporter's Note

1. *"Account."* 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. The definition also includes a new exception for the use of the term in the definition of "deposit account."

2. *"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, including 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 (6B) incorporate the

essence of the Commentary into the statutory text.

2A. *"Authenticate."* This definition is deleted because the revised definition of "signed" in Section 1-201(b)(37) makes the term unnecessary. The term will be replaced with "signed" in this Section and in other Sections of Article 9 and the official comments.

3. *"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 subsection (a)(11)(B) may include the right to payment of a variety of "bundled" or "hybrid" 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 relating to other property 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 subsection (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 draft official comment explains the predominant-purpose test in the context of the definition and gives examples of its application.

4. *"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. (Of course, a person would be an account debtor only if it were actually obligated on the underlying account or payment intangible.) 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 happens to have 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.

This special treatment includes the following:

- 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 §§ 9-312(a); 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.

- The benefit of the take-free and no-action rules for qualifying purchasers (including secured parties) of controllable electronic records also extends to qualifying purchasers of controllable accounts and controllable payment intangibles, whether or not the qualifying purchaser also purchases the related controllable electronic record. *See* draft § 12-104(a) and Reporter's Notes 6 and 7.

5. *"Deposit account."* This definition is not changed and is provided here for convenience of reference.

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

7. *"Instrument."* The change to the definition of "instrument" makes it clear that the definition excludes an instrument that is a record included in the definition of "chattel paper." Note that while in many places in the UCC 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."

8. *Money, deposit accounts, and electronic money under Article 9.* As observed in the Reporter's Prefatory Note to Article 9 Amendments, some countries may authorize or adopt deposit accounts with a central bank as a form of "money," as defined in Section 1-201(b)(24) (as that definition is proposed to be revised in the draft). However, the existing Article 9 provisions governing "deposit accounts" would remain suitable for such 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 deposit accounts. However, *for purposes of Article 9* and in the interest of clarity, the definition of "money" in draft § 9-102(a)(31A) excludes deposit accounts. Under this definition, deposit accounts would not be money for Article 9 purposes even if they were to become money under the Article 1 definition. In similar fashion, the definition of "money" for purposes of Article 9 excludes money (as defined in Section 1-201(b)(24)) in an electronic form that cannot subjected to control under draft § 9-105A, which would be a general intangible under Article 9.

The principal function of the new Article 9 definition of "money" is to ensure that (i) even if some deposit accounts were to become "money" as defined in Article 1, the provisions relating to perfection and priority for security interests in deposit accounts, and not those for money, will apply, and (ii) money, as defined in Article 1, in an electronic form that cannot be subjected to control will be subject to the perfection and priority rules for general intangibles. It will be necessary to ensure that this definitional strategy does not cause any difficulties for other provisions of Article 9, such as references to the cognate term "monetary." The current thinking is that this will not be problematic.

9. *Proceeds.*

a. *No change to definition of proceeds.* No change to the definition of "proceeds" is proposed and the definition is provided here for convenience of reference.

b. *"Fork" involving controllable electronic record.* Sometimes there occurs a change in the software (code) of a system (sometimes referred to as a "protocol" or "platform") in which a controllable electronic record is recorded. When such a change occurs in a blockchain platform, the blockchain may remain intact, no new blockchain may result, and the change sometimes is colloquially referred to as a "soft fork." If, instead, such a change results in a new, separate blockchain that exists alongside the original blockchain and a new controllable electronic record is created, the change is sometimes referred to as a "hard fork." But the terms "fork," "soft fork," and "hard fork" are ambiguous and not used consistently. Even in a hard fork situation the pre-fork controllable electronic record typically would remain intact (although its value might be affected). A person in control of the original record may not automatically obtain control of a new record. Additional steps may be required for the person in control of the original record to obtain control of the new record.

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

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

e. *New controllable electronic record as financial asset credited to securities account.* If the original record were a financial asset credited to a securities account, the new record might become proceeds of a security entitlement for the reasons described in Note 9.c. Concerning the duties, if any, of a securities intermediary with respect to such a distribution, see Section 8-505, Reporter's Note 2.

* * *

Section 9-104. Control of Deposit Account.

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

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

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

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

(4) another person, other than the debtor:

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

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

(b) **[Debtor's right to direct disposition.]** A secured party that has satisfied subsection (a) has control, even if the debtor retains the right to direct the disposition of funds from the deposit account.

Reporter's Note

1. *Control on behalf of another person.* Draft subsection (a)(4) provides for a secured party to obtain control of a deposit account by virtue of the acknowledgment by another person, other than the debtor, in control of the deposit account.

a. Subsection (a)(4) follows draft revisions to the corresponding provisions for control of electronic documents of title (draft § 7-106), control of an electronic copy of a record evidencing chattel paper (draft § 9-105), control of electronic money (draft § 9-105A), and control of controllable electronic records (draft § 12-105). For a brief discussion, see draft § 12-105, Reporter's Note 8.

b. An acknowledgment by a person in control under subsection (a)(4) would not impose any duties on the bank with which the deposit account is maintained and the official comments will make this clear. Indeed, the bank may have no knowledge or involvement whatsoever with a control person's acknowledgment under that subsection.

c. Subsection (a)(4) should not be construed to permit the bank with which the deposit account is maintained to short-circuit subsection (a)(2), which provides for control through a control agreement between the bank and the control person. However, it would be possible for the bank, acting in a capacity other than as the depository bank (for example, as a secured party) to acknowledge that it has control on behalf of another purchaser under subsection (a)(4).

d. Draft § 9-107B(a) makes clear that a person that has control under this section has no duty to acknowledge that it has or will obtain control on behalf of another person. Arrangements for a person to acknowledge that it has or will obtain control on behalf of another person are not standardized. Accordingly, draft Section 9-107B(b) leaves to the agreement of the parties and to any other applicable law any duties of a person that does acknowledge that it has or will obtain control on behalf of another person and provides that a person making an acknowledgment is not required to confirm the acknowledgment to another person.

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

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

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

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

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

~~(3) the authoritative copy is communicated to and maintained by the secured party~~

~~or its designated custodian;~~

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

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

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

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

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

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

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

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

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

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

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

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

(c) **[One or more authoritative copies.]** A system satisfies subsection (a) and a purchaser 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 a system in which the electronic copy is recorded:

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

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

(C) gives the purchaser exclusive power, subject to subsection (d), to:

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

(ii) transfer control of each authoritative electronic copy; or

(2) another person, other than the debtor:

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

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

(d) **[Presumption of exclusivity of certain powers.]** If a person has the powers that are specified in subsection (c)(1)(C), the powers are presumed to be exclusive.

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

(1) the electronic copy, a record attached to or logically associated with the electronic copy, or a system in which the electronic copy is recorded limits the use of the electronic record or has a protocol programmed to cause a change, including a transfer or loss of control; or

(2) the purchaser shares the power with another person.

Reporter's Note

1. *The function of control.* Under the draft, as under current law, a secured party can perfect a security interest in chattel paper by filing. *See* Section 9-312(a). Alternatively, a secured party can perfect a security interest in chattel paper by taking possession of all authoritative tangible copies of the record evidencing the chattel paper and obtaining control of all authoritative electronic copies. *See* draft § 9-314A. Possession and control also are conditions for achieving priority under draft § 9-330(a), (b), and (c).

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.

Subsections (a) and (b) are substantially unchanged. (The amendments to subsection (a) primarily reflect the changes to the definition of chattel paper in Section 9-102.) *It is important to note that compliance with the new conditions for control in subsection (c) would satisfy the conditions provided in subsection (b).* However, subsection (b) has been retained out of an abundance of caution and to provide assurances that existing systems for control of electronic chattel paper under current law will continue to be viable after the draft revisions become effective.

The revised conditions for of "control" provided in subsection (c) are 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 purchaser can produce the copies in its possession and provide evidence that these are authoritative copies. The purchaser need not prove that no other tangible authoritative copies exist. *See* draft § 12-105, Reporter's Note 8. (The Reporter's Note to draft § 9-314A explains the meaning of "authoritative copy.") The purchaser's possession of the tangible authoritative copies gives the purchaser the power to prevent others from taking possession of the copies and to transfer possession of the copies.

Under subsection (c), to obtain control of an electronic copy of a record evidencing chattel paper a purchaser 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 purchaser must have the exclusive power to prevent others from adding or changing an identified assignee and to transfer control of the authoritative copies. The requirements for obtaining control under subsection (c) are inspired by draft § 12-105 on control of controllable electronic records. *See* Reporter's Note to draft § 12-105.

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

As to shared control (see subsection (e)(2)) by a debtor and a secured party and the relevance to perfection of a security interest, see Section 9-314, Reporter's Note 2.

3. *Control on behalf of another person.*

a. Draft subsection (c)(2) provides for a purchaser to obtain control of an electronic copy by virtue of the acknowledgment by another person in control of the electronic copy. It follows draft revisions to the corresponding provisions for control of electronic documents of title (draft § 7-106), control of deposit accounts (draft § 9-104), control of electronic money (draft § 9-105A), and control of controllable electronic records (draft § 12-105). For a brief discussion, see draft § 12-105, Reporter's Note 8.

b. Draft § 9-107B(a) makes clear that a person that has control under this section has no duty to acknowledge that it has or will obtain control on behalf of another person. Arrangements for a person to acknowledge that it has or will obtain control on behalf of another person are not standardized. Accordingly, draft Section 9-107B(b) leaves to the agreement of the parties and to any other applicable law any duties of a person that does acknowledge that it has or will obtain control on behalf of another person and provides that a person making an acknowledgment is not required to confirm the acknowledgment to another person.

4. *References to "secured party" changed to "*purchaser.*"* References to a "secured party" in this section have been changed to refer to a "purchaser." This change aligns the text with the priority rules of Section 9-330(a), (b), and (c).

Section 9-105A. Control of Electronic Money.

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

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

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

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

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

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

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

(b) **[Presumption of exclusivity of certain powers.]** If a person has the powers that are specified in subsection (a)(1)(B), the powers are presumed to be exclusive.

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

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

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

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

(1) the electronic money, a record attached to or logically associated with the electronic money, or a system in which the electronic money is recorded limits the use of the electronic money or has a protocol programmed to cause a change, including a transfer or loss of control; or

(2) the person shares the power with another person.

Reporter's Note

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

As to shared control (see subsection (d)(2)) by a debtor and a secured party and the relevance to perfection of a security interest, see Section 9-314, Reporter's Note 2.

2. *Control on behalf of another person.*

a. Draft subsection (c) provides for a person to obtain control of electronic money by virtue of the acknowledgment by another person in control of the electronic copy. It follows draft revisions to the corresponding provisions for control of electronic documents of title (draft § 7-106), control of deposit accounts (draft § 9-104), control of an electronic copy of a record evidencing chattel paper (draft § 9-105, and control of controllable electronic records (draft § 12-105). For a brief discussion, see draft § 12-105, Reporter's Note 8.

b. Draft § 9-107B(a) makes clear that a person that has control under this section has no duty to acknowledge that it has or will obtain control on behalf of another person. Arrangements for a person to acknowledge that it has or will obtain control on behalf of another person are not standardized. Accordingly, draft Section 9-107B(b) leaves to the agreement of the parties and to any other applicable law any duties of a person that does acknowledge that it has or will obtain control on behalf of another person and provides that a person making an acknowledgment is not required to confirm the acknowledgment to another person.

* * *

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

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

(b) **[Control of controllable account and controllable payment intangible.]** 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 §§ 9-312 and 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. *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 §§ 9-312, 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 does not affect a secured party's alternative method of perfection, *i.e.*, filing. Moreover, that fact does 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 9-107B. No Requirement to Acknowledge or Confirm; No Duties.

(a) **[No requirement to acknowledge.]** A person that has control under Section 9-104, 9-105, or 9-105A is not required to acknowledge that it has or will obtain control on behalf of another person.

(b) **[No duties or confirmation.]** If a person acknowledges that it has or will obtain control on behalf of another person, unless the person otherwise agrees or law other than this article otherwise provides, the person does not owe any duty to the other person and is not required to confirm the acknowledgment to another person.

* * *

Reporter's Note

1. *Source of these provisions.* Draft § 9-107B derives from Section 9-313(f) and (g).

2. *Purpose.* Subsection (a) makes clear that a person that has control under the specified sections has no duty to acknowledge that it has or will obtain control on behalf of another person. Arrangements for a person to acknowledge that it has control on behalf of another person are not standardized. Accordingly, subsection (b) leaves to the agreement of the parties and to any other applicable law any duties of a person that does acknowledge that it has or will obtain control on behalf of another person.

* * *

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~~ signed 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;

* * *

(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 <u>controllable accounts, controllable electronic records, controllable payment intangibles,</u> deposit accounts, ~~electronic chattel paper,~~ <u>electronic documents, electronic money,</u> investment property, <u>or</u> letter-of-credit rights, ~~or electronic documents,~~ and the secured party has control under Section 7-106, 9-104, <u>9-105A,</u> 9-106, ~~or~~ 9-107<u>, or 9-107A</u> pursuant to the debtor's security agreement<u>; or</u>

<u>(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</u>.

Reporter's Note

Substitute for signed security agreement. Under subparagraphs (b)(3)(B) and (b)(3)(D), possession of tangible collateral and control of intangible collateral may substitute for a signed 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, under draft § 9-314A may substitute for a signed security agreement.

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

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

(b) **[When after-acquired property clause not effective.]** <u>Subject to subsection (c), a</u> security interest does not attach under a term constituting an after-acquired property clause to:

(1) consumer goods, other than an accession when given as additional security,

unless the debtor acquires rights in them within 10 days after the secured party gives value; or

(2) a commercial tort claim.

<u>(c) **[Limitation on subsection (b).]** Subsection (b) does not prevent a security interest from attaching:</u>

<u>(1) to consumer goods as proceeds under Section 9-315(a) or commingled goods under Section 9-336(c);</u>

<u>(2) to a commercial tort claim as proceeds under Section 9-315(a); or</u>

<u>(3) under an after-acquired property clause to property that is proceeds of consumer goods or a commercial tort claim.</u>

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

* * *

Official Comment

* * *

3. **After-Acquired Consumer Goods.** Subsection (b)(1) makes ineffective an after-acquired property clause covering consumer goods (defined in Section 9-109), except as accessions (see Section 9-335), acquired more than 10 days after the secured party gives value. Subsection (b)(1) is unchanged in substance from the corresponding provision in former Section 9-204(2). <u>However, a term granting a security interest in consumer goods that will be purchase-money collateral in the transaction is not "a term constituting an after-acquired property clause." Consequently, subsection (b)(1) does not prevent the security interest from attaching even if the collateral is not an accession and the debtor acquires rights in the collateral more than 10 days after the secured party gives value.</u>

* * *

Reporter's Note

The proposed revision would clarify the appropriate result when a debtor acquires consumer goods or a commercial tort claim as proceeds of collateral and when a consumer acquires an interest in commingled goods. This clarification would override the erroneous holdings of several cases addressing commercial tort claims that are proceeds. The official comment will be revised accordingly. The proposed addition to Comment 3, would provide additional clarification.

* * *

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, <u>9-105A,</u> 9-106, ~~or~~ 9-107<u>, or 9-107A</u>:

(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.

* * *

Reporter's Note

New methods of control. Cross-references have been added to reflect the new methods of "control" for electronic money (draft § 9-105A) and for controllable electronic records, controllable accounts, and controllable payment intangibles (draft § 9-107A).

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~~ a signed 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~~ a signed 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~~

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

(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~~ a signed record that releases the securities intermediary or commodity intermediary from any further obligation to comply with entitlement orders or directions originated by the secured party;

(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~~ a signed 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;~~

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

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

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

Reporter's Note

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

* * *

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

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

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

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

(3) Except as otherwise provided in paragraph (4), while negotiable tangible

documents, goods, instruments, or tangible money~~, or tangible chattel paper~~ is located in a jurisdiction, the local law of that jurisdiction governs:

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

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

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

(4) The local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in as-extracted collateral.

Reporter's Note

The revisions to draft § 9-301(3) clarify its application only to negotiable tangible (not electronic) documents and tangible (not electronic) money.

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Section 9-306A. Law Governing Perfection and Priority of Security Interests in Chattel Paper.

(a) **[Chattel paper evidenced by authoritative electronic copy.]** Except as provided in subsection (e), if chattel paper is evidenced only by an authoritative electronic copy of the chattel paper or is evidenced by an authoritative electronic copy and an authoritative tangible copy, the local law of the electronic chattel paper's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in the chattel paper.

(b) **[Electronic Chattel Paper's Jurisdiction.]** The following rules determine the electronic chattel paper's jurisdiction under this section:

(1) If the authoritative electronic copy of chattel paper, or a record attached to or logically associated with the electronic copy which is readily available for review, expressly

provides that a particular jurisdiction is the electronic chattel paper's jurisdiction for purposes of this part, this article, or the [Uniform Commercial Code], that jurisdiction is the electronic chattel paper's jurisdiction.

(2) If paragraph (1) does not apply and the rules of the system in which the electronic copy 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 part, this article, or the [Uniform Commercial Code], that jurisdiction is the electronic chattel paper's jurisdiction.

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

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

(5) If paragraphs (1) through (4) do not apply, the electronic chattel paper's jurisdiction is the jurisdiction in which the debtor is located.

(c) **[Relation of transaction to electronic chattel paper's jurisdiction not necessary.]** Subsections (a) and (b) apply even if a transaction does not bear any relation to the electronic chattel paper's jurisdiction.

(d) **[Chattel paper evidenced by authoritative tangible copy.]** If an authoritative tangible copy of a record evidences chattel paper and the chattel paper is not evidenced by an authoritative electronic copy, while an authoritative tangible copy of a record evidencing chattel paper is located in a jurisdiction, the local law of that jurisdiction governs:

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

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

(e) **[When perfection governed by law of jurisdiction where debtor is located.]** The local law of the jurisdiction in which the debtor is located governs perfection of a security interest in chattel paper by filing.

Reporter's Note

1. *Source of these provisions.* Draft § 9-306A(a) and (b) derive from Sections 8-110(e) and 9-305 on law governing perfection and priority of security interests in investment property (as do draft §§ 9-306B and 12-107).

2. *Applicability of this Section.* This section determines the law governing perfection and priority of security interests in chattel paper. Subsections (a), (b), and (c) apply to chattel paper that is evidenced by an authoritative electronic copy of the chattel paper, whether or not it also is evidenced by an authoritative tangible copy. Subsection (d) applies to chattel paper that is evidenced by an authoritative tangible copy but not evidenced by an authoritative electronic copy. Subsection (e) applies to perfection by filing for all chattel paper.

3. *Authoritative electronic copy: electronic chattel paper's jurisdiction.* Subsection (a) specifies the law governing perfection and priority of security interests in chattel paper evidenced by an authoritative electronic copy of the chattel paper, even if it is also evidenced by an authoritative tangible copy. Subject to subsection (e) on perfection by filing, the law governing perfection and priority is the local law of the electronic chattel paper's jurisdiction. Drawing on Sections 8-110 and 9-305, it is the authoritative electronic copy itself, records attached thereto or associated therewith, or the system in which the authoritative electronic copy is recorded that determines the electronic chattel paper's jurisdiction and, therefore, the governing law. Subsection (b) provides a "waterfall" of rules based on provisions that identify a particular jurisdiction as the electronic chattel paper's jurisdiction or alternatively that provide the governing law of the chattel paper or of the system in which the electronic copy is recorded. When no such identification or provision is made, it is the debtor's location that is the electronic chattel paper's jurisdiction.

4. *Rationale for subsection (a).* A major buyer of, or secured lender against, chattel paper

may arrange for authoritative electronic copies of chattel paper that it wishes to have assigned to it to be submitted into a system for the control and assignment of the chattel paper. The secured parties and lessors that will be assigning the chattel paper may be located in many different jurisdictions. As to assignments of the chattel paper by these secured parties and lessors, but for this section perfection and priority would be governed by the law of each assignor-debtor's location under Section 9-301(1). Under this section, however, the law of a single jurisdiction—the electronic chattel paper's jurisdiction—could govern perfection and priority with respect to all of the assignments. By avoiding the application of the laws of multiple jurisdictions to perfection and priority, this rule could substantially reduce transaction costs.

5. *Authoritative tangible copy.* Subsection (d) ties the choice-of-law rules to the location of the authoritative tangible copy when no authoritative electronic copy exists. In that circumstance, the local law of the jurisdiction where the authoritative tangible copy is physically located governs perfection of a security interest in the chattel paper by possession under Section 9-314A and priority. Like existing law, subsection (d) assumes that all the authoritative tangible copies are located in the same jurisdiction. However, assuming the secured party is in possession of all the tangible copies, even if the copies are located in more than one jurisdiction the situation is unlikely to be problematic.

6. *Perfection by filing.* Subsection (e) provides that the local law of the jurisdiction where the debtor is located governs perfection by filing for all chattel paper.

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

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

(b) **[When perfection governed by law of jurisdiction where debtor is located.]** The local law of the jurisdiction in which the debtor is located governs:

(1) perfection of a security interest in a controllable account, controllable electronic record, or controllable payment intangible by filing; and

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

Reporter's Note

1. *Perfection by control and priority.* Subsection (a) deals with perfection of a security interest in a controllable account, controllable electronic record, or controllable payment intangible other than by filing—i.e., perfection by control under draft § 12-105—and priority. For these purposes the governing law is that of the controllable electronic record's jurisdiction under draft § 12-107(c) and (d).

2. *Perfection by filing.* Under subsection (b) the local law of the jurisdiction of the debtor's location governs perfection of a security interest in a controllable account, controllable electronic record, or controllable payment intangible by filing (but not priority, as to which subsection (a) would apply).

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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.

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

* * *

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

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

~~(9)~~(10) in proceeds which is perfected under Section 9-315; or

~~(10)~~(11) that is perfected under Section 9-316.

Reporter's Note

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

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Section 9-312. Perfection of Security Interests in Chattel Paper, <u>Controllable Accounts, Controllable Electronic Records, Controllable Payment Intangibles,</u> Deposit Accounts, Negotiable Documents, Goods Covered by Documents, Instruments, Investment Property, Letter-of-Credit Rights, and Money; Perfection by Permissive Filing; Temporary Perfection Without Filing or Transfer of Possession.

(a) **[Perfection by filing permitted.]** A security interest in <u>chattel paper, controllable accounts, controllable electronic records, controllable payment intangibles,</u> ~~chattel paper, negotiable documents,~~ instruments, ~~or~~ investment property<u>, or negotiable documents</u> 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 <u>tangible</u> money may be perfected only by the secured party's taking possession under Section 9-313<u>; and</u>

<u>(4) a security interest in electronic money may be perfected only by control under Section 9-314</u>.

(c) **[Goods covered by negotiable document.]** While goods are in the possession of a bailee that has issued a negotiable document covering the goods:

(1) a security interest in the goods may be perfected by perfecting a security interest in the document; and

(2) a security interest perfected in the document has priority over any security interest that becomes perfected in the goods by another method during that time.

(d) **[Goods covered by nonnegotiable document.]** While goods are in the possession of a bailee that has issued a nonnegotiable document covering the goods, a security interest in the goods may be perfected by:

(1) issuance of a document in the name of the secured party;

(2) the bailee's receipt of notification of the secured party's interest; or

(3) filing as to the goods.

(e) **[Temporary perfection: new value.]** A security interest in certificated securities, negotiable documents, or instruments is perfected without filing or the taking of possession or control for a period of 20 days from the time it attaches to the extent that it arises for new value given under ~~an authenticated~~ <u>a signed</u> security agreement.

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Official Comment

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7. **Goods Covered by Document of Title.** Subsection (c) applies to goods in the possession of a bailee who has issued a negotiable document covering the goods. Subsection (d) applies to goods in the possession of a bailee who has issued a nonnegotiable document of title, including a document of title that is "non-negotiable" under Section 7-104. Section 9-313 governs perfection of a security interest in goods in the possession of a bailee who has not issued a document of title.

Subsection (c) clarifies the perfection and priority rules in former Section 9-304(2).

Consistently with the provisions of Article 7, subsection (c) takes the position that, as long as a negotiable document covering goods is outstanding, title to the goods is, so to say, locked up in the document. Accordingly, a security interest in goods covered by a negotiable document may be perfected by perfecting a security interest in the document. The security interest also may be perfected by another method, e.g., by filing. The priority rule in subsection (c) governs only priority between (i) a security interest in goods which is perfected by perfecting in the document and (ii) a security interest in the goods which becomes perfected by another method while the goods are covered by the document.

> **Example 1:** While wheat is in a grain elevator and covered by a negotiable warehouse receipt, Debtor creates a security interest in the wheat in favor of SP-1 and SP-2. SP-1 perfects by filing a financing statement covering "wheat." Thereafter, SP-2 perfects by filing a financing statement describing the warehouse receipt. Subsection (c)(1) provides that SP-2's security interest is perfected. Subsection (c)(2) provides that SP-2's security interest is senior to SP-1's.

> **Example 2:** The facts are as in Example 1, but SP-1's security interest attached and was perfected before the goods were delivered to the grain elevator. Subsection (c)(2) does not apply, because SP-1's security interest did not become perfected during the time that the wheat was in the possession of a bailee. Rather, the first-to-file-or-perfect priority rule applies. See Sections 9-322 and 7-503.

A secured party may become "a holder to whom a negotiable document of title has been duly negotiated" under Section 7-501. If so, the secured party acquires the rights specified by Article 7. Article 9 does not limit those rights, which may include the right to priority over an earlier-perfected security interest. See Section 9-331(a).

Subsection (d) takes a different approach to the problem of goods covered by a nonnegotiable document. Here, title to the goods is not looked on as being locked up in the document~~.~~ For example, a transferee that takes delivery of a nonnegotiable document receives, under Section 7-504(a), "the title and rights" of the transferor, but the transferee would not thereby become a "person entitled under the document" with a right to receive delivery of the goods from the bailee. ~~and the~~ The secured party may perfect its security interest directly in the goods by filing as to them. The subsection provides two other methods of perfection: issuance of the document in the secured party's name (as consignee of a straight bill of lading or the person to whom delivery would be made under a non-negotiable warehouse receipt) and receipt of notification of the secured party's interest by the bailee. Issuance (or reissuance) of the nonnegotiable document in the secured party's name would allow the secured party to become a "person entitled under the document." However, the bailee's receipt of notification would not confer on the secured party the status of a person entitled unless the notification resulted from an instruction under the document. See Section 7-102(a)(9) (defining "person entitled under the document") & Comment 6. Perfection under subsection (d) occurs when the bailee receives notification of the secured party's interest in the goods, regardless of who sends the notification. Receipt of notification is effective to perfect, regardless of whether the bailee responds. Unlike former Section 9-304(3), from which it derives, subsection (d) does not apply to goods in the possession of a bailee who has not issued a document of title. Section 9-313(c) covers that case and provides that perfection by possession as to goods not covered by a document requires the bailee's acknowledgment.

Subsection (a) makes clear that a security interest in negotiable documents (and other collateral mentioned there) may be perfected by filing, but it makes no mention of nonnegotiable documents. However, under the general rule of Section 9-310, a security interest in a nonnegotiable document can be perfected by filing. A security interest in an electronic document, negotiable or nonnegotiable, can be perfected by control under Section 7-106. Section 9-314(a). But a security interest in a nonnegotiable tangible document cannot be perfected by possession. Section 9-313(a). Although a perfected security interest in a nonnegotiable document might provide useful benefits for the secured party, it would not perfect a security interest in the goods. And by perfecting a security interest in the nonnegotiable document the secured party would not thereby become a "person entitled under the document." Indeed, unless the secured party also took delivery of the document (i.e., possession or control under Section 1-201(b)(15)), it would not obtain the rights of a transferee under Section 7-504(a).

* * *

Reporter's Note

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

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

(a) **[Perfection by possession or delivery.]** Except as otherwise provided in subsection (b), a secured party may perfect a security interest in ~~tangible negotiable documents,~~ goods, instruments, negotiable tangible documents, or 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.

* * *

(c) **[Collateral in possession of person other than debtor.]** With respect to collateral other than certificated securities and goods covered by a document, a secured party takes possession of collateral in the possession of a person other than the debtor, the secured party, or a lessee of the collateral from the debtor in the ordinary course of the debtor's business, when:

(1) the person in possession ~~authenticates~~ signs a record acknowledging that it holds possession of the collateral for the secured party's benefit; or

(2) the person takes possession of the collateral after having ~~authenticated~~ signed a record acknowledging that it will hold possession of collateral for the secured party's benefit.

Reporter's Note

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 draft § 9-314A.

Section 9-314. Perfection by Control.

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

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

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Reporter's Note

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

2. *Shared control between debtor and secured party.* Draft §§ 7-106 (control of electronic documents), 9-105A (control of electronic money), and 12-105 (control of controllable electronic records, on which control of controllable accounts and controllable payment intangibles under draft § 9-107A depends) contemplate the possibility that both a debtor and a secured party may have control of the relevant collateral. Shared control is also possible under draft § 9-105 (control of authoritative electronic records evidencing chattel paper). Such shared control between a debtor and secured party does not necessarily impair perfection of a security interest under this section or draft § 9-314A. For example, perfection would not be impaired even if the exercise of a power necessary for control requires exercise of the power by both the debtor and secured party. Consistent with Sections 9-104(b) and 8-106(f), perfection also would not be impaired if the debtor's and secured party's control permits either to transfer control without consent or action by the other. However, if the debtor could exercise such a power without consent or exercise by the secured party while the secured party could exercise the power only with the consent or exercise by the debtor, the shared control under those circumstances would not be sufficient for purposes of perfection of a security interest.

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 each authoritative tangible copy of the record evidencing the chattel paper and obtaining control of each authoritative electronic copy 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.]** Section 9-313(c) and (f) through (i) applies to perfection by possession of an authoritative tangible copy of a record evidencing chattel paper.

Reporter's Note

1. *"Authoritative copy."* This draft section provides that to perfect a security interest in

chattel paper other than by filing, a secured party must obtain control of all authoritative electronic copies and take possession of all authoritative tangible 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 are "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, provided that 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. S*ubsection (c) makes specified subsections of Section 9-313 applicable to possession of tangible authoritative copies of records evidencing chattel paper.

4. *Shared control.* As to shared control of an authoritative electronic copy of a record evidencing chattel paper (see Section 9-105(c)(2)) by a debtor and a secured party and the relevance to perfection of a security interest, see Section 9-314, Reporter's Note 2.

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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), 9-306A(e), or 9-306B(b) remains perfected until the earliest of:

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

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

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

* * *

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

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

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

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

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Reporter's Note

1. *Change in location of debtor.* Subsection (a) has been amended to refer to additional provisions providing for perfection by filing to be governed by the law of the jurisdiction in which the debtor is located, *See* draft §§ 9-306A and 9-306B.

2. *Changes in controllable electronic record's jurisdiction and electronic chattel paper's jurisdiction.* Changes in the controllable electronic record's jurisdiction and the electronic chattel paper's jurisdiction have been added to subsection (f) to conform to the treatment for other collateral subject to similar rules on governing law. *See* draft §§ 9-306B and 12-107.

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

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(b) **[Buyers that receive delivery.]** Except as otherwise provided in subsection (e), a buyer~~, other than a secured party,~~ of ~~tangible chattel paper, tangible documents,~~ goods, instruments, <u>tangible documents,</u> 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~~ <u>Subject to subsections (f), (g), (h), and (i), a</u> licensee of a general intangible or a buyer, other than a secured party, of collateral other than ~~tangible chattel paper,~~ <u>electronic money,</u> tangible documents, goods, instruments, or 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:

(1) receives delivery of each authoritative tangible copy of the record evidencing the chattel paper; and,

(2) if each authoritative electronic copy of the record evidencing the chattel paper can be subjected to control under Section 9-105, obtains control of each authoritative electronic copy.

(g) **[Buyers of electronic documents.]** A buyer of an electronic document takes free of a security interest if, without knowledge of the security interest and before it is perfected, the buyer gives value and, if each authoritative electronic copy of the document can be subjected to control under Section 7-106, obtains control of each authoritative electronic copy.

(h) **[Buyers of controllable electronic records.]** A buyer of a controllable electronic record takes free of a security interest if, without knowledge of the security interest and before it is perfected, the buyer gives value and obtains control of the controllable electronic record .

(i) **[Buyers of controllable accounts and controllable payment intangibles.]** A buyer, other than a secured party, of a controllable account or a controllable payment intangible takes free of a security interest if, without knowledge of the security interest and before it is perfected, the buyer gives value and obtains control of the controllable account or controllable payment intangible.

Reporter's Note

1. *New rule for buyers of chattel paper.* The new take-free rule in subsection (f) for buyers of chattel paper reflects the corresponding changes in the definition of chattel paper and methods of perfection. *See* draft §§ 9-102(a)(11) (defining "chattel paper"); 9-314A (perfection by possession and control). Note that subsection (f) applies only to a buyer of chattel paper

"other than a Secured party," and most buyers of chattel paper are secured parties. *See* UCC §§ 9-109(a)(3) (Article 9 applies to a sale of chattel paper); 1-201(b)(35) (defining "security interest" to include the interest of a buyer of chattel paper). However, Article 9 does not apply to "a sale of . . . chattel paper , . . as part of a sale of the business out of which , . . [the chattel paper] arose" and subsection (f) would apply to a buyer of chattel paper in a such a sale of business transaction.

Given the addition of new subsection (f) and the removal of chattel paper from subsection (a), the phrase "other than a secured party" has been deleted from subsection (a). Buyers of the remaining types of collateral covered by subsection (a) are not secured parties.

2. *Control of electronic records evidencing chattel paper.* Some systems for electronic copies of records evidencing chattel paper do not provide for an assignee to obtain control of electronic copies under Section 9-105. For this reason, subsection (f) provides that a buyer must obtain control of authoritative electronic copies of records evidencing chattel paper as a condition for taking free only if the electronic copies can be subjected to control.

3. *Control of electronic documents.* As mentioned in Note 2 for chattel paper, a system for electronic documents also may not provide for a transferee to obtain control of authoritative electronic copies of an electronic document. Subsection (g) provides that a buyer must obtain control of authoritative electronic copies of the document as a condition for taking free only if the electronic copies can be subjected to control.

4. *Control of controllable electronic records, controllable accounts, and controllable payment intangibles.* Consistent with the treatment of electronic copies of records evidencing chattel paper and electronic documents in subsections (f) and (g), subsection (h) conditions the take-free rule for a buyer of a controllable electronic record on the buyer's obtaining control of the electronic record. Similarly, under subsection (i), the take-free rule for a buyer, other than a secured party, of a controllable account or controllable payment intangible is conditioned on the buyer's obtaining control of the account or payment intangible.

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

Reporter's Note

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

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

(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 each authoritative tangible copy of the record evidencing the chattel paper ~~or~~ and obtains control under Section 9-105 of each authoritative electronic copy of the record evidencing the chattel paper ~~under Section 9-105~~; and

(2) the ~~chattel paper does~~ authoritative copies of the record evidencing the chattel paper do not indicate that ~~it has~~ the copies have 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 each authoritative tangible copy of the record evidencing the chattel paper ~~or~~ and obtains control under Section 9-105 of each authoritative electronic copy of the record evidencing the chattel paper ~~under Section 9-105~~ in good faith, in the ordinary course of the purchaser's business, and without knowledge that the purchase violates the rights of the secured party.

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Reporter's Note

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

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

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

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

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

Official Comment

* * *

3. * * *

The state-law Uniform Electronic Transactions Act (UETA) and the federal Electronic Signature in Global and National Commerce Act, 15 U.S.C. §§ 7001 *et seq*. (E-SIGN), provide certain rules for records referred to and defined as "transferable records." See UETA § 16 and E-SIGN 15 U.S.C. § 7021. When certain conditions have been met, those acts confer on a person the status of a "holder" (as defined in former Section 1-201(20), current Section 1-201(b)(21)) of an "equivalent record" under former Section 9-308 (now, in part, Section § 9-330) and the rights and defenses of a "purchaser" under that section, among other effects. E-SIGN also refers to the rights and defenses of a purchaser under current Section § 9-330. As a matter of the application of the Uniform Commercial Code, those are not the only sections of the Uniform Commercial Code that would logically be affected by UETA and E-SIGN. For example, the rights of a holder in due course under § 9-331(a) would also be covered by the application of those acts, when the conditions for applicability have been satisfied.

* * *

Reporter's Note

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

2. *Relationship to UETA and E-SIGN.* The proposed addition to the official comment addresses the relationship of this section to those laws.

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

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

(b) **[Transferee of electronic money.]** A transferee of electronic money takes the money free of a security interest 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 ~~unless the transferee acts~~ if the transferee receives the funds without acting in collusion with the debtor in violating the rights of the secured party.

Reporter's Note

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

New subsection (b) provides a rule for electronic money that complements draft subsection (a) by conditioning the takes-free rule on the transferee obtaining control.

2. *Transferees of funds from deposit account.* Similarly, the revisions to subsection (c) (formerly subsection (b)) make a corresponding change for a transfer of funds from a deposit account. To qualify for the take-free protection under subsection (c), the transferee must "receive[] the funds without acting in collusion [etc.] . . ." The draft amendments to Section 9-332(a) and (c) are intended to clarify what is implicit under the original text. Although "funds" is not defined in the UCC, if deposit accounts with a central bank or another bank were to become money, as defined in Section 1-201(b)(24), transfers from such deposit accounts would be covered by subsection (c) and not subsection (b). *See* draft § 9-102(a)(54A) (defining "money" for purposes of Article 9 to exclude deposit accounts).

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 from the deposit account 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 perfected 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).

5. *Temporal aspect of collusion test.* In order for a transferee to take free of a security interest under this section the transferee must receive delivery of tangible money, obtain control of electronic money, or receive funds from a deposit account without acting in collusion. Whether the transferee is acting without collusion is determined as of the time of delivery to the transferee or obtaining control or receipt of funds by the transferee.

* * *

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) <u>and (l)</u>, 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~~ <u>signed</u> by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.

(b) **[When notification ineffective.]** Subject to ~~subsection~~ <u>subsections</u> (h) <u>and (l)</u>, notification is ineffective under subsection (a):

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

(2) to the extent that an agreement between an account debtor and a seller of a payment intangible limits the account debtor's duty to pay a person other than the seller and the

limitation is effective under law other than this article; or

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

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

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

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

(c) **[Proof of assignment.]** Subject to ~~subsection~~ <u>subsections</u> (h) <u>and (l)</u>, 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).

* * *

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

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

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

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

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

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

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

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

Reporter's Note

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

* * *

Section 9-601. Rights After Default; Judicial Enforcement; Consignor or Buyer of Accounts, Chattel Paper, Payment Intangibles, or Promissory Notes.

* * *

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

* * *

Section 9-605. Unknown Debtor or Secondary Obligor.

<u>(a)</u> **[When no duty owed by secured party.]** ~~A~~ <u>Except as provided in subsection (b), a</u> 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.

<u>(b) **[When secured party owes duty to debtor notwithstanding subsection (a).]** A secured party owes a duty based on its status as a secured party to a person that is a debtor if, at the time the secured party obtains control of collateral that is a controllable account, controllable electronic record, or controllable payment intangible, the secured party knows that the information specified in subsection (a)(1)(A), (B), or (C) is not provided by the collateral, a record attached to or logically associated with the collateral, or the system in which the collateral is recorded.</u>

Reporter's Note to Draft §§ 9-605 and 9-628

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. In many cases these debtors may be aware that their identities are unknown to their secured parties. By failing to make their identities and contact information known, these debtors may be knowingly impairing the ability of their secured parties to comply with their duties under Article 9. However, such debtor complicity notwithstanding, if secured parties were relieved of their duties in these circumstances, arguably it would conflict with the policy of Section 9-602, which prohibits a waiver or variance of many rights of debtors and duties of secured parties.

Comment 2 to Section 9-628 observes, "[w]ithout 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.” That comment also notes that “[t]he broadened definition of the term ‘debtor’ underscores the need for these provisions.” For example, a debtor may dispose of collateral subject to a security interest, resulting in the transferee becoming a debtor, but the secured party may have no knowledge of the disposition or that the transferee has become a debtor. In that situation the secured party will have no means of giving notice to or accounting to the transferee debtor. Sections 9-605 and 9-628 contemplate such situations by relieving the secured party of its duties to the debtor.

The draft amendments to Sections 9-605 and 9-628 reflect the policy that a secured party should not be free to avoid statutory duties or absolve itself from liability to a debtor when the secured party knows that the collateral, records attached to or logically associated with the collateral, and the system in which the collateral is recorded do not provide the secured party with the information necessary to fulfill its statutory duties. As discussed in the following paragraph, the secured party’s knowledge that it may not be able to comply with its duties enables the secured party to protect itself from being in breach of these duties. (A person has knowledge of or knows a fact if it has “actual knowledge.” Section 1-202(b).) The exceptions from the exculpatory protections otherwise afforded to secured parties are determined by the secured party’s knowledge at the time the secured party obtains control of a controllable account, controllable electronic record, or controllable payment intangible.

Obtaining control serves as a rough proxy for the context in which a secured party may know that it may be unable to comply with its duties, usually because the transferor is pseudonymous. The carve-out from the exculpatory protection is limited to duties owed to a debtor—the transferor of a controllable account, controllable electronic record, or controllable payment intangible over which the secured party obtains control. The secured party in such situations could protect itself by choosing not to enter into a transaction in which it might be unable to comply with its statutory duties or by conditioning its participation on disclosure of the debtor’s identity and contact information. Ideally, systems providing for the transfer of controllable electronic records would provide mechanisms that would permit compliance with such duties (such as methods of communication and making payments that would preserve a debtor’s pseudonymity, where that is desired). The amendments to Sections 9-605 and 9-608 provide incentives for system design that would allow for compliance with Article 9 duties.

Secured parties that enter into transactions with knowledge that they may not be able to comply with their Article 9 duties do so at their own peril. Of course, if a secured party possesses or is able to obtain the information necessary to comply with its duties, there is no need for the exculpation from those duties. Note, however, that the limitation on a secured party’s relief from duties and liability relates only to secured transactions involving controllable accounts, controllable electronic records, or controllable payment intangibles. Designing systems for these assets that would afford secured parties with opportunities to comply with their Article 9 duties, as suggested above, could eliminate the risks to secured parties and also provide for the protection of debtors’ rights.

* * *

Section 9-610. Disposition of Collateral After Default.

(a) **[Disposition after default.]** After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.

(b) **[Commercially reasonable disposition.]** Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms.

(c) **[Purchase by secured party.]** A secured party may purchase collateral:

(1) at a public disposition; or

(2) at a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

* * *

Official Comment

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9. **"Recognized Market."** A "recognized market," as used in subsection (c)<u>(2),</u> ~~and~~ Section 9-611(d), <u>and Section 9-627(b)(1) and (2),</u> is one in which the items sold are fungible and ~~prices are not subject to individual negotiation. For example, the New York Stock Exchange is a recognized market. A market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or are disposed of through dealer auctions.~~ <u>which generally produces market prices that are not lower than those that would be expected to result from (i) commercially reasonable dispositions to persons other than the secured party, (ii) commercially reasonable dispositions made with otherwise required notifications to the debtor or other affected persons, or (iii) dispositions otherwise made in a commercially reasonable manner. (As used here, "fungible" items are those that are considered interchangeable in the relevant market and not only items that are strictly "identical" to the other items.) The intended goals of the recognized market exceptions are to ensure that neither the debtor nor other affected parties would be disadvantaged by the special treatment given to recognized markets and to facilitate the efficiencies and cost savings that the special treatment may provide. The purpose of including in subsection (c)(2) collateral that is "the subject of widely distributed standard price quotations" and the criteria for</u>

determining whether price quotations meet this standard in subsection (c)(2) are the same as for a recognized market, although the availability of such standard price quotations may be based on, but distributed independently of, a "market" in which acquisitions and dispositions are made. Although a recognized market need not be subject to direct or indirect (e.g., self-regulatory) regulation or supervision, the existence of regulatory requirements or guidelines that are designed to arrive at prices consistent with those contemplated by subsection (c)(2) may provide useful guidance for applying the regulated market standard.

Traditionally, it has been understood that a market in which prices are individually negotiated is not a recognized market, even if the items are the subject of widely disseminated price guides (such as the Kelly Blue Book for automobiles) or are disposed of through specialized auctions (such as those conducted for dealers in livestock and automobiles). However, this does not suggest that such dispositions of livestock or automobiles, for example, could not be commercially reasonable.

The New York Stock Exchange, NASDAQ, the Chicago Mercantile Exchange, and ICE Futures U.S., Inc. are examples of recognized markets. Such exchanges generally involve centralized systems that match buy and sell orders submitted by agents whose principals are not known to each other. Trading environments generally referred to as "over-the-counter" or "OTC" markets, however, typically have involved prospective buyers and sellers that can know each other and have direct communication in order to make trades. Unlike typical exchanges, OTC markets normally do involve the individual negotiation of a price. See Carl S. Bjerre, *Investment Securities*, 71 Bus. Law. 1311, 1316-17 (2016) (contrasting exchanges and typical OTC markets for equity securities and explaining that OTC markets have tended to feature thinner markets with less liquidity and more variability of pricing).

In considering the recognized market exceptions, it is important to appreciate that recognized markets and other systems that produce equivalent "widely distributed standard price quotations" are not limited to traditional exchanges, such as those mentioned above. In particular, the exchange-OTC dichotomy no longer offers such a reliable, bright-line test for determining status as a recognized market or as a source of widely distributed standard price quotations. To be sure, some OTC markets do not qualify for the exceptions. However, recent years have witnessed a variety of new trading platforms, the use of new technologies, and new sources of providing and consuming information. In particular, there now exist markets, in particular for debt securities (including United States Treasury securities), that might be classified as OTC markets under the traditional taxonomy, but which qualify for the exceptions as recognized markets or as sources of data for widely distributed standard price quotations. Market participants rely on prices provided by these markets to the same extent and for the same purposes (including in connection with default and enforcement of security interests) as they rely on prices generated by traditional securities and commodities exchanges. These prices are widely available from business publications and online sources as well as from private subscription-based service providers. It can safely be assumed that these financial markets and the data that they provide to the public will continue to evolve. The touchstone for determining whether a market structure is a recognized market or one that produces equivalent price quotations is a functional one. It is not based on the "type" of market (e.g., "exchange," "OTC," or other classification). It is based on whether the market or distribution provides reliable and trusted data on prices consistent with purposes of subsection (c)(2) and the corresponding provisions of Sections 9-611 and 9-627.

Reporter's Note

Contexts of "recognized market" exceptions. With the exception of Section 9-627(b)(1), the special treatment afforded by the relevant sections involving a "recognized market" rely on prices determined in such a market but do not involve dispositions actually made on a recognized market. The draft official comment therefore does not limit its discussion to such dispositions and uses neutral references to "exceptions" and "special treatment" that the relevant sections provide.

Reporter's Note

No change. No change is proposed to Section 9-610.

Section 9-611. Notification Before Disposition of Collateral.

(a) **["Notification date."]** In this section, "notification date" means the earlier of the date on which:

(1) a secured party sends to the debtor and any secondary obligor ~~an authenticated~~ a signed notification of disposition; or

(2) the debtor and any secondary obligor waive the right to notification.

(b) **[Notification of disposition required.]** Except as otherwise provided in subsection (d), a secured party that disposes of collateral under Section 9-610 shall send to the persons specified in subsection (c) a reasonable authenticated notification of disposition.

(c) **[Persons to be notified.]** To comply with subsection (b), the secured party shall send ~~an authenticated~~ a signed notification of disposition to:

(1) the debtor;

(2) any secondary obligor; and

(3) if the collateral is other than consumer goods:

(A) any other person from which the secured party has received, before the notification date, ~~an authenticated~~ a signed notification of a claim of an interest in the collateral;

(B) any other secured party or lienholder that, 10 days before the notification date, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

(i) identified the collateral;

(ii) was indexed under the debtor's name as of that date; and

(iii) was filed in the office in which to file a financing statement against the debtor covering the collateral as of that date; and

(C) any other secured party that, 10 days before the notification date, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in Section 9-311(a).

(d) **[Subsection (b) inapplicable: perishable collateral; recognized market.]** Subsection (b) does not apply if the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market.

(e) **[Compliance with subsection (c)(3)(B).]** A secured party complies with the requirement for notification prescribed by subsection (c)(3)(B) if:

(1) not later than 20 days or earlier than 30 days before the notification date, the secured party requests, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name in the office indicated in subsection (c)(3)(B); and

(2) before the notification date, the secured party:

(A) did not receive a response to the request for information; or

(B) received a response to the request for information and sent ~~an~~

~~authenticated~~ a signed notification of disposition to each secured party or other lienholder named in that response whose financing statement covered the collateral.

Official Comment

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7. **Recognized Market; Perishable Collateral.** New subsection (d) makes it clear that there is no obligation to give notification of a disposition in the case of perishable collateral or collateral customarily sold on a recognized market (e.g., marketable securities). ~~Former Section 9-504(3) might be read (incorrectly) to relieve the secured party from its duty to notify a debtor but not from its duty to notify other secured parties in connection with dispositions of such collateral.~~ As to what constitutes a recognized market, see Section 9-610, Comment 9.

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Section 9-614. Contents and Form of Notification Before Disposition of Collateral: Consumer-Goods Transaction. In a consumer-goods transaction, the following rules apply:

* * * L;

NOTICE OF OUR PLAN TO SELL PROPERTY[6]

__[*Name and address of any obligor who is also a debtor*]___

Subject: ____[*Identification of Transaction*]___

We have your ___[*describe collateral*]___, because you broke promises in our agreement.

[*For a public disposition:*]

We will sell ___[*describe collateral*]____at public sale. A sale could include a lease or license.

[6] In this form of Notice new language added to the official text is indicated by double underscore. Simple underscore indicates blanks to be completed by users of the form.

The sale will be held as follows:

Date: ________________

Time: ________________

Place: ________________

You may attend the sale and bring bidders if you want.

[*For a private disposition:*]

We will sell ___[*describe collateral*]___ at private sale sometime after ___[*date*]___. A sale could include a lease or license.

The money that we get from the sale (after paying our costs) will reduce the amount you owe. If we get less money than you owe, you ___[*will or will not, as applicable*]___ still owe us the difference. If we get more money than you owe, you will get the extra money, unless we must pay it to someone else.

You can get the property back at any time before we sell it by paying us the full amount you owe (not just the past due payments), including our expenses. To learn the exact amount you must pay, call us at ___[*telephone number*]___.

If you want us to explain to you in [writing] [or] [writing or in an electronic document] [or] [in an electronic document] how we have figured the amount that you owe us, you may call us at ___[*telephone number*]___ [or write us at ___[*secured party's address*]___] [or ___[*description of electronic communication method*]___] and request [a written explanation] [or] [a written explanation or an explanation in an electronic document] [or] [an explanation in an electronic document]. [We will charge you $ _____ for the explanation if we sent you another written explanation of the amount you owe us within the last six months.]

If you need more information about the sale call us at ___[*telephone number*]___] [or write us at ___[*secured party's address*]___] [or ___[*description of electronic communication method*]___].

We are sending this notice to the following other people who have an interest in ___[*describe collateral*]___ or who owe money under your agreement:

___[*Names of all other debtors and obligors, if any*]

[End of Form]

Legislative Note: *The paragraph beginning with "If you want us to explain . . ." includes three sets of alternatives for the sender of the form of Notice to adopt. First, the user of the form may insert any one of the three alternative modes for the explanation (writing, writing and electronic document, or electronic document). Second, the sender of the form may include either, both, or neither of the two alternative methods (writing or electronic communication) in addition to telephone for the recipient of the Notice to communicate with the sender. Third, the sender of the form must refer to the mode or modes for the explanation inserted pursuant to the first set of alternatives mentioned above.*

* * *

Reporter's Note

In furtherance of medium neutrality, references to "electronic document" and "electronic communication method" have been added to the form.

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Section 9-616. Explanation of Calculation of Surplus or Deficiency.

(a) **[Definitions.]** In this section:

(1) "Explanation" means a ~~writing~~ record that:

(A) states the amount of the surplus or deficiency;

(B) provides an explanation in accordance with subsection (c) of how the secured party calculated the surplus or deficiency;

(C) states, if applicable, that future debits, credits, charges, including additional credit service charges or interest, rebates, and expenses may affect the amount of the surplus or deficiency; and

(D) provides a telephone number or mailing address from which additional information concerning the transaction is available.

(2) "Request" means a record:

(A) ~~authenticated~~ signed by a debtor or consumer obligor;

(B) requesting that the recipient provide an explanation; and

(C) sent after disposition of the collateral under Section 9-610.

(b) **[Explanation of calculation.]** In a consumer-goods transaction in which the debtor is entitled to a surplus or a consumer obligor is liable for a deficiency under Section 9-615, the secured party shall:

(1) send an explanation to the debtor or consumer obligor, as applicable, after the disposition and:

(A) before or when the secured party accounts to the debtor and pays any surplus or first makes ~~written~~ demand in a record on the consumer obligor after the disposition for payment of the deficiency; and

(B) within 14 days after receipt of a request; or

(2) in the case of a consumer obligor who is liable for a deficiency, within 14 days after receipt of a request, send to the consumer obligor a record waiving the secured party's right

to a deficiency.

(c) **[Required information.]** To comply with subsection (a)(1)(B), ~~a writing~~ <u>an explanation</u> must provide the following information in the following order:

(1) the aggregate amount of obligations secured by the security interest under which the disposition was made, and, if the amount reflects a rebate of unearned interest or credit service charge, an indication of that fact, calculated as of a specified date:

(A) if the secured party takes or receives possession of the collateral after default, not more than 35 days before the secured party takes or receives possession; or

(B) if the secured party takes or receives possession of the collateral before default or does not take possession of the collateral, not more than 35 days before the disposition;

(2) the amount of proceeds of the disposition;

(3) the aggregate amount of the obligations after deducting the amount of proceeds;

(4) the amount, in the aggregate or by type, and types of expenses, including expenses of retaking, holding, preparing for disposition, processing, and disposing of the collateral, and attorney's fees secured by the collateral which are known to the secured party and relate to the current disposition;

(5) the amount, in the aggregate or by type, and types of credits, including rebates of interest or credit service charges, to which the obligor is known to be entitled and which are not reflected in the amount in paragraph (1); and

(6) the amount of the surplus or deficiency.

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Reporter's Note

In furtherance of medium neutrality, references to "writing" and "written" have been changed to refer to a "record."

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Section 9-627. Determination of Whether Conduct Was Commercially Reasonable.

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(b) **[Dispositions that are commercially reasonable.]** A disposition of collateral is made in a commercially reasonable manner if the disposition is made:

(1) in the usual manner on any recognized market;

(2) at the price current in any recognized market at the time of the disposition; or

(3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

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Official Comment

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4. **"Recognized Market."** As in Sections 9-610(c) and 9-611(d), the concept of a "recognized market" in subsections (b)(1) and (2) is quite limited; it applies only to markets in which there are standardized price quotations for property that is essentially fungible, such as (but not limited to) ~~stock~~ securities and commodities exchanges. See Section 9-610, Comment 9 (discussing standards for a "recognized market").

* * *

Reporter's Note

No change. No change is proposed to Section 9-627.

Section 9-628. Nonliability and Limitation on Liability of Secured Party; Liability of Secondary Obligor.

(a) **[Limitation of liability of secured party for noncompliance with article.]** ~~Unless~~ Subject to subsection (f), 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.]** ~~A~~ Subject to subsection (f), 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.

* * *

(f) **[When secured party owes duty to debtor notwithstanding subsection (b).]** A secured party owes a duty based on its status as a secured party to a person that is a debtor if, at the time the secured party obtains control of collateral that is a controllable account, controllable electronic record, or controllable payment intangible, the secured party knows that it will not be provided with the information specified in subsection (b)(1)(A), (B), or (C) by the collateral, a record attached to or logically associated with the collateral, or the system in which the collateral is recorded.

Reporter's Note

See the Reporter's Note to draft § 9-605.

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ARTICLE 12

CONTROLLABLE ELECTRONIC RECORDS

Reporter's Prefatory Note to Article 12

1. *Introduction to controllable electronic records.* New UCC Article 12, which deals with controllable electronic records, and the conforming amendments to Articles 1 and 9, in particular, 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 more broadly than to electronic (intangible) assets that are created using existing technologies such as distributed ledger technology (DLT), including blockchain technology, which powers transactions in bitcoin and other digital assets. It also aspires to apply to electronic assets that may be created using technologies that have yet to be developed, or even imagined.

The adoption of DLT has underscored two important trends in electronic commerce. First, 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 virtual currencies such as bitcoin (or, more precisely "transaction outputs" generated by the Bitcoin protocol) as a medium of exchange and store of value. Second, people are using the creation or transfer of electronic records to transfer rights to receive payment, rights to receive performance of other obligations (*e.g.*, services or delivery of goods), and other interests in personal and real property.

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, the Article 12 rules would make controllable electronic records 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 (a UTXO) 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 and as a condition for achieving a non-temporal priority of a security interest. 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.

2. *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.[7] A *controllable electronic record* is a record that is stored in an electronic medium[8] and that 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.[9] 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 that governs control for some types of electronic records (including provisions on control for some types which are proposed to be modified in this draft) is sufficient. These electronic records are excluded from Article 12.[10]

3. *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.[11] Law other than Article 12 would determine whether a person acquires any rights in a controllable electronic record and so would be eligible to be a purchaser.

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

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[7] *See* UCC § 1-201(b)(31).
[8] *See* draft § 12-102(a)(2) (defining "electronic record.".
[9] *E.g.*, UCC § 7-106 (electronic documents of title); § 8-106 (four different types of investment property, each with a different definition of "control"); § 9-104 (deposit accounts); § 9-105 (electronic chattel paper).
[10] *See* draft § 12-102(a)(1) (defining "controllable electronic record").
[11] "'Purchase' means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property." UCC § 1-201(b)(29).
[12] 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).

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.[13] Draft Article 12 refers to these purchasers as *qualifying purchasers*. Qualifying purchasers are purchasers that obtain control of a controllable electronic record for value, in good faith, and without notice of any claim of a property interest in the controllable electronic record. Like a holder in due course of a negotiable instrument, a qualifying purchaser of a controllable electronic record takes the controllable electronic record free of property claims.

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

- Law other than Article 12 generally would determine whether *S* is the owner of the bitcoin.

- Law other than Article 12 would resolve issues concerning the formation of the contract of sale between *B* and *S* and the obligations of the parties under the contract.

- Law other than Article 12 would determine what steps are necessary for *B* to acquire rights in the bitcoin.[14]

- By acquiring rights in the bitcoin by sale, *B* would become a *purchaser* of the bitcoin within the meaning of UCC Article 1.

- Article 12 provides that if *B* becomes a purchaser, *B* will 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.

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

- Just as a buyer of goods can obtain possession from a seller that has no rights in the goods, *B* can obtain control of the bitcoin, even if *S* "stole" it from the owner.

- If *B* obtains control of the bitcoin for value, in good faith, and without notice of any claim of a property interest, *B* would be a *qualifying purchaser*.

- Even if *B* would not have acquired any rights in the bitcoin under non-Article 12

[13] 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.
[14] 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).

law, as an Article 12 qualifying purchaser, *B* would acquire the bitcoin free of all claims of a property interest in the bitcoin. In the unlikely event that *O* could locate *B*, *B* would defeat *O*'s claim of ownership and own the bitcoin free and clear. (The same result would obtain if *B* bought a negotiable instrument from a thief under circumstances where *B* became a holder in due course.)

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

a. *The general rules.*

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

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

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

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

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

Suppose that the contract of sale between *B* and *S* is evidenced by a controllable electronic record that *B* sells to *P*. Under draft § 12-104(d), *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* will become a *qualifying purchaser* and, as such, would acquire its rights *in the controllable electronic record* free of any claim of a property right under draft § 12-104.

But the controllable electronic record itself may or may not be a valuable asset. In this example, unlike bitcoin, the record 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 even though under non-Article 12 law *P* would (as posited) acquire the right to receive delivery of the goods, *P* would not acquire that right free of property claims unless non-Article 12 law were to provide otherwise.

b. *The exceptions: controllable accounts 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 in other property as a result of acquiring an interest in the record. This "other" law includes UCC Article 9.

The draft provides an important exception to this 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."[15]

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

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

[15] *See* draft § 9-102(b) (defining "controllable account" and "controllable payment intangible").

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

Official Comment

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

Section 12-102. Definitions.

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

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

(2) "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.

(3) "Transferable record" means:

(A) "Transferable record" as defined in the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 *et seq.*[, as amended]; or

(B) "Transferable record" as defined in [cite to Uniform Electronic Transactions Act Section 16(a)].

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

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

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

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

Reporter's Note

1. *Source of these provisions*. Subsection (a)(1), defining "qualifying purchaser," derives from Section 3-302(a)(2), which defines "holder in due course" of a negotiable instrument.

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

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

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

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

Under draft § 12-104(a), not only a purchaser of a controllable electronic record but also a purchaser of a controllable account or controllable payment intangible may be a qualifying purchaser. Moreover, a purchaser of a controllable account or a controllable payment intangible may be a qualified purchaser even if the purchaser does not also purchase the controllable electronic record that evidences the account or payment intangible. However, to obtain control of the controllable account or controllable payment intangible, a requirement for of qualifying purchaser status, the purchaser must obtain control of that controllable electronic record. Draft § 9-107A.

4. *'Transferable record."* This definition facilitates the exclusion of transferable records from the definition of controllable electronic records.

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

Section 12-103. Relationship to Article 9 and Consumer Laws.

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

(b) **[Applicable consumer law and other laws.]** A transaction subject to this article is subject to any applicable rule of law 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].

Reporter's Note

1. *Source of these provisions*. Subsection (a) 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, e.g.,* draft § 9-331. Subsection (b) is copied from Section 9-201.

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

Section 12-104. Rights in Controllable Account, Controllable Electronic Record, and Controllable Payment Intangible.

(a) **[Applicability of section to controllable account and controllable payment intangible.]** This section applies to the acquisition and purchase of rights in a controllable account or controllable payment intangible, including the rights and benefits of a purchaser and a qualifying purchaser under subsections (d), (e), (g), and (h), in the same manner this section applies to a controllable electronic record.

(b) **[Control of controllable account and controllable payment intangible.]** For purposes of determining whether a purchaser of a controllable account or a controllable payment intangible is a qualifying purchaser, the purchaser obtains control of the account or payment intangible if it obtains control of the controllable electronic record that evidences the account or payment intangible.

(c) **[Applicability of other law to acquisition of rights.]** 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 the person acquires.

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

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

(f) **[Limitation of rights of qualifying purchaser in other property.]** Except as provided in subsections (a) and (e) for controllable accounts and controllable payment intangibles or law other than 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) **[No-action protection for qualifying purchaser.]** An action may not be asserted against a qualifying purchaser based on both a purchase by the qualifying purchaser of a controllable electronic record and a claim of a property right in another controllable electronic record, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory.

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

Reporter's Note

1. *Source of these provisions.* Subsection (d) derives from Section 2-403(1) (concerning the rights of a purchaser).

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

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

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

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

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

4. *Purchaser and transferor under subsection (d): shelter principle and resulting controllable electronic records.* Subsection (d) 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 might 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 resulting controllable electronic record is the unspent transaction output (UTXO) generated by a transaction in bitcoin. Subsection (d) should be construed broadly to encompass such transfers and resulting derivative controllable electronic records acquired by a purchaser. Because subsection (d) addresses the rights of a purchaser in the "purchased" asset and not the "transferred" asset, this construction is wholly consistent with the statutory text.

Notwithstanding the broad subsection (d) shelter principle, which provides that a purchaser acquires "all rights" of the transferor, those rights are subject to the reach of Section 1-304. Under that section a contract or duty under the UCC imposes an overarching "obligation of good faith in its performance and enforcement." UCC § 1-304. In this context, "performance and enforcement" include the exercise of rights under the UCC, such as the rights conferred on a purchaser by the subsection (d) shelter principle. *See* UCC § 1-304, Comment 2. For example, consider a qualifying purchaser of a controllable electronic record, controllable account, or controllable payment intangible who then sells that asset to a person who is not a qualifying purchaser. If the second purchaser had previously engaged in fraudulent or illegal activity in connection with the purchased asset or an asset to which the purchased asset is attributable, the purchaser's exercise of rights under subsection (d) as to the purchased asset may be in breach of its obligation of good faith. Section 3-203(b) states this result directly with respect to a transferee of a negotiable instrument if the transferee previously engaged in fraud or illegality with respect to the same instrument. UCC § 3-203(b). The same result would apply under subsection (d). However, unlike negotiable instruments, many controllable electronic records are fungible. Subsection (d) relies on the application of the general obligation of good faith under Section 1-304 to reach the appropriate result.

5. *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. However, as a purchaser of the controllable accounts and controllable payment intangibles, Secured Party could benefit from the take-free rule in subsection (e) (discussed in Note 6). Having taken control of the specific controllable account, Secured Party may be a qualifying purchaser. Even if Secured Party were not a qualifying purchaser of the controllable account, its security interest in the account over which it obtained control would, however, have priority over a conflicting security interest that was perfected by a method other than control. Draft § 9-326A.

6. *The take-free rule.* Subsection (e) makes controllable electronic records and, under subsection (a), controllable accounts and controllable payment intangibles, highly negotiable. Subsection (d) 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, controllable account, or controllable payment intangible takes free of all claims of a property right in the purchased controllable electronic record, account, or 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. Draft § 12-104(c). 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, subsection (e) would enable a purchaser that obtains control from a hacker and that otherwise meets the definition of "qualifying purchaser" (for value, in good faith, and without notice of property claims) to take the controllable electronic record (or any purchased 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. Of course, if the qualifying 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. *See* Draft § 12-104(d) (purchaser of a limited interest); *cf.* UCC § 3-302(e).

7. *Subsection (g)—the "no-action" rule.* Subsection (g) applies in the situation (explained in Note 4) in which the "resulting" controllable electronic record (or controllable account or controllable payment intangible) purchased by a qualifying purchaser is not the "same" record,

account, or payment intangible that was transferred. In such a situation, a person claiming a property right in the transferred asset may asset a claim against a purchaser of the "resulting" asset even though the claimant is *not* asserting a claim of a *property right* in the purchased asset. If the claim is based on both the purchaser's purchase of the acquired asset and the claimant's rights in the transferred asset, subsection (g) protects the qualified purchaser from liability to the claimant based on any theory. The qualified purchaser's protection from the assertion of such a claim does not depend on any proof that the purchased asset is somehow "traceable" to the transferred asset.

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

8. "*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 (and, under subsection (a), controllable accounts and controllable payment intangibles). One might argue that the inclusion of controllable accounts and controllable payment intangibles in the scope of subsection (e) is unnecessary. By taking a controllable electronic record free of property claims, the argument would be that a person takes 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. It limits the application of the take-free rule in subsection (e) to controllable electronic records and, through the application of subsection (a), controllable accounts and controllable payment intangibles. Under subsection (f), except as provided in subsection (a) and (e), a qualifying purchaser takes rights to payment (other than controllable accounts and controllable payment intangibles), 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 provides to the contrary. The reference in subsection (f) to "law other than this article" contemplates that another article of the UCC might provide a contrary rule for some types of property that might be tethered to a controllable electronic record.

9. *Creating the functional equivalent of a negotiable instrument.* Two defining characteristics of an Article 3 negotiable instrument are that a holder in due course (i) takes free of claims of a property or possessory right to the instrument (Section 3-306) and (ii) 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 qualifying purchaser could acquire the controllable account or controllable payment intangible free of any claim of a property interest. As regards the second characteristic, 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. However, there are parties to a controllable account or controllable payment intangible. Accordingly, Sections 9-404 and 9-403 would determine whether a purchaser of the controllable account or controllable payment intangible takes free of a defense. 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) **[General rule: control of controllable electronic record.]** A person has control of a controllable electronic record if:

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

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

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

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

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

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

(b) **[Presumption of exclusivity of certain powers.]** If a person has the powers that are specified in subsection (a)(1)(B), the powers are presumed to be exclusive.

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

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

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

(d) **[No requirement to acknowledge.]** A person that has control under this section is not required to acknowledge that it has control on behalf of another person.

(e) **[No duties or confirmation.]** If a person acknowledges that it has or will obtain control on behalf of another person, unless the person otherwise agrees or law other than this article otherwise provides, the person does not owe any duty to the other person and is not required to confirm the acknowledgment to another person.

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

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

(2) the person shares the power with another person.

Reporter's Note

1. *Why "control" matters.* Control serves two major functions in Article 12. An electronic record is a "controllable electronic record" and is subject to the provisions of this article only if it can be subjected to control under this section. *See* draft § 12-102(a)(1) (defining "controllable electronic record"). And only a person having control of a controllable electronic

record is eligible to become a qualifying purchaser and so to take free of claims of a property interest in the controllable electronic record or any controllable account or controllable payment intangible evidenced by the controllable electronic record and to receive protection from the "no-action" rule. *See* draft § 12-104(e) and (g).

In addition, draft amendments to Article 9 provide that obtaining control of a controllable electronic record is one method by which to perfect a security interest in the controllable electronic record or any controllable account or controllable payment intangible evidenced by the controllable electronic record. 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. *See* draft §§ 9-107A; 9-314. Moreover, a security interest perfected by control has priority over a conflicting security interest that was perfected by a method other than control. Draft § 9-326A.

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 subsection (a)(1). A person would have the powers described in that subsection 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 those powers. 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.

3. "*Benefit.*" Subsections (a)(1)(A) and (a)(1)(B)(i) condition control of a controllable electronic record on a person's relationship to the benefit of the controllable electronic record.

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, the benefit afforded by control of a bitcoin is that it can be held or disposed of (sold or spent). And control of a controllable electronic record evidencing a controllable account or controllable payment intangible affords the benefit of 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 subsection (a)(1)(A), or to prevent others from availing themselves of substantially all the benefit from a controllable electronic record under subsection (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(b)(31 (defining "record"). 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 subsection (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 will have the exclusive power to prevent others from availing themselves of substantially all the benefit from the controllable electronic record and thereby will satisfy the condition in subsection (a)(1)(B)(i).

5. *Exclusive powers*. Unlike the power in subsection (a)(1)(A), the powers in subsection (a)(1)(B)(i) and (a)(1)(B)(ii) must be held exclusively by the person claiming control in order to establish control. However, once it is established that a person has received those powers, subsection (b) provides a presumption of exclusivity. Consequently, a person asserting control need not prove exclusivity in order to make out a *prima facie* case. Application of the presumption will be governed also by Section 1-206 (effects of a presumption under the UCC) and applicable non-UCC law (including rules of procedure and evidence). In addition, subsection (f) contains two qualifications of the term "exclusive" as used in subsection (a)(1)(B). A power can be "exclusive" under subsection (a)(1)(B) even if one or both of these qualifications apply.

Subsection (f)(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, records associated with the controllable electronic record, and the protocols of any system in which the controllable electronic record is recorded. For example, a transfer of control resulting from a program that is a part of a system's protocol is inherent in the controllable electronic record and does not impair the exclusivity of the power of the person in control of the record. Subsection (f)(1) also contemplates that the potential for the system to otherwise modify (or even destroy) controllable electronic records would not impair the exclusivity.

> **Example 1.** Pursuant to the governance apparatus of a system (Propofolium) for a cryptocurrency (propofol), an upgrade to the system was made that modified the consensus mechanism for determining the effectiveness of transfers of propofols within the system. Although this change did not divest any holder of propofols of its control, it prospectively modified the system for all propofols. The adoption of this change and the potential for such a change (or any other change) are functions of the attributes of the system and, consequently, of all propofols. Neither this change nor such potential impaired the exclusivity, for purposes of subsection (a)(1), of the powers of a person in control of propofols.

Subsection (f)(2) allows for a person in control to share a power with another person without impairing the exclusivity of the power. One effect of subsection (f)(2) is that, under a multi-signature (multi-sig) agreement, any person that is readily identifiable under subsection (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.

> **Example 2.** Pursuant to a multi-sig arrangement, control of propofols (in the system described in Example 1) is shared by Campbell, Elizabeth, Mia, and Natasha. Under the multi-sig arrangement, the exercise of powers over the propofols requires action by three of the four persons having control. None of the participants acting alone has the power to exercise the relevant powers. Subsection (e)(2) makes clear that all four participants have control over the propofols and exclusivity is not impaired by the shared control under the multi-sig arrangement.

A multi-sig arrangement for a controllable electronic record, such as that described in Example 2, may provide enhanced security. For example, if the power of one participant is compromised by a "hacker," the required actions by the other participants would prevent the hacker from exercising unauthorized power over the record. Although the hacker might possess the power along with the remaining multi-sig participants, those participants would continue to have control. A multi-sig structure also may protect against the misuse of a record by ensuring that actions by multiple persons are required for exercising power over the record.

As to shared control by a debtor and a secured party and the relevance to perfection of a security interest, see Section 9-314, Reporter's Note 2.

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

7. *Readily identify*. Subsection (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 readily to identify itself as the person having the requisite powers. This subsection 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. Consistent with the subsection (b) presumption of exclusivity, proof that a person has the powers specified in section (a)(1) does not require proof of exclusivity—i.e., proof of a negative (that no one else has such powers). The means of identification mentioned in subsection (a)(2) derive from Section 3-110(c). Subsection (a)(2) adds "cryptographic key" as an example of a way in which a person may be identified.

8. *Control through 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 subsection (f)(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 achieves 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) if 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. Under Section 9-313(c) the acknowledgment must be in a signed record. These provisions appear to derive from practices involving bailees of tangible property, such as goods, chattel paper, and certificated securities.

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

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

Subsection (c) qualifies this method of obtaining control by providing that the acknowledging person must be one "other that the transferor of an interest in the electronic record." Section 9-313(c) expressly provides in this context that an acknowledging person having possession of goods must be a person "other than the debtor." The official comments to Section 8-106 are to the same effect in the context of control of a security entitlement. UCC § 8-106(d)(3), comment 4. The same policy that underpins the inapplicability of this method of control to an acknowledgment by a debtor applies as well to a transferor that is not an Article 9 debtor. Control is intended to be a proxy for and a functional equivalent of the transfer of physical possession of goods. In general, a person can obtain control through control by an agent, as noted above. However, an acknowledgment by a *debtor or transferor* that acts as an agent of a secured party or other transferee would be ineffective. This corresponds to the policy underlying Section 9-313 that "the debtor cannot qualify as an agent for the secured party for purposes of the secured party's taking possession." UCC § 9-313, comment 3.

The combined operation of subsections (c) and (f)(2) 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. Alternatively, a person in control may wish to permit a system administrator to transfer control to another person under specified conditions without participation by the person in control. And, of course, a person in control may wish to delegate the power to transfer control to an agent or fiduciary.

9. *No requirement to acknowledge, no duties, and no requirement to confirm acknowledgment*. Subsections (d) and (e) derive from Section 9-313(f) and (g). Subsection (d)

makes clear that a person that has control under this section has no duty to acknowledge that it has or will obtain control on behalf of another person. Arrangements for a person to acknowledge that it has or will obtain control on behalf of another person are not standardized. Accordingly, subsection (e) leaves to the agreement of the parties and to any other applicable law any duties of a person that does acknowledge that it has or will obtain control on behalf of another person and provides that a person making an acknowledgment is not required to confirm the acknowledgment to another person.

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

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

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

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

(b) **[Effect of notification.]** Subject to subsection (d), 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 signed 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.

(c) **[Discharge following effective notification.]** After receipt of a notification that complies with subsection (b), the account debtor may discharge its obligation by paying in accordance with the notification and may not discharge the obligation by paying a person that formerly had control.

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

(1) unless, before the notification is sent, an 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 a signed record to a commercially reasonable method by which a person may furnish reasonable proof that control has been transferred;

(2) to the extent an agreement between an account debtor and 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:

(A) divide a payment;

(B) make less than the full amount of an installment or other periodic payment; or

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

(e) **[Proof of transfer of control.]** Subject to subsection (h), if requested by the account debtor, the person giving the notification seasonably shall furnish reasonable proof, using the agreed method, that control of the controllable electronic record has been transferred. Unless the person complies with the request, the account debtor may discharge its obligation by paying a person that formerly had control, even if the account debtor has received a notification under subsection (b).

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

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

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

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

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

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

Reporter's Note

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

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

intangible”). Section 9-406 would continue to apply in other respects and to all other account debtors. As to the relationship between this section and Section 9-406, see Note 5.

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), subject to subsection (b), 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 an effective 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 signed 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 reasonable 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 (e) contains a similar provision. On the account debtor’s request, the person giving the notification must seasonably furnish reasonable proof that control of the controllable electronic record has been transferred. If the person does not comply with the request, the account debtor may ignore the notification and discharge its obligation by a paying a person formerly in control.

"Reasonable proof" requires evidence that would be understood by a typical account debtor to whom it is proffered as demonstrating to a reasonably high probability that control of the controllable electronic record has been transferred to the transferee. Subsection (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 (f). 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 (e) requires that reasonable proof be provided "using the agreed method." Subsection (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 a signed record, before the notification was sent. If parties did not so agree, the notification is ineffective under subsection (d)(1).

An account debtor may agree to participate in a system providing for the control of controllable accounts or controllable payment intangibles. If the system is programmed to provide for notification to the account debtor upon the transfer of control, the account debtor's agreement and the operation of the system may satisfy the requirements of subsections (d)(1), (e), and (f).

4. *Additional considerations for account debtors.* The requirement in subsection (e) that reasonable proof be furnished using the "agreed method" provides considerable protection for account debtors upon receipt of a notification of assignment and making a request for proof. There are, however, other considerations that are of importance to account debtors but are beyond the scope of the frameworks provided by Articles 9 and 12. One such consideration is the potential involvement of pseudonymous payees, which may raise issues such as compliance with anti-money laundering regulations and sanctions compliance. These are examples of issues that a well-structured program for controllable accounts and controllable payment intangibles might address.

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

Section 12-107. Governing Law.

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

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

(c) **[Controllable electronic record's jurisdiction.]** The following rules determine a controllable electronic record's jurisdiction under 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 [Uniform Commercial Code], 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 [Uniform Commercial Code], that jurisdiction is the controllable electronic record's jurisdiction.

(3) If paragraphs (1) and (2) do not apply 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 paragraphs (1) through (3) do 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 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.

(5) If paragraphs (1) through (4) do not apply, the controllable electronic record's jurisdiction is the District of Columbia.

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

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

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

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

Reporter's Note

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

2. *Practical limitations on determination of governing law.* This section relating to the

law governing the matters covered by Article 12 must confront substantial practical limitations. These limitations arise primarily from two factors. First, as described below, this section relies primarily on a "waterfall" of alternatives for determining a controllable electronic record's jurisdiction. The waterfall depends on express provisions of a controllable electronic record or the system in which it is recorded. Many electronic records and systems that currently exist do not contain these provisions. As explained in Note 5, the expectation is that over time electronic records and related systems will adopt these provisions in reliance on this section so as to create certainty as to the governing law. Second, in the absence of these provisions, at the bottom of the waterfall the controllable electronic record's jurisdiction is the District of Columbia. *See* Note 5, below.

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

4. *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 for a controllable electronic record or the system in which the record is recorded.

Paragraphs (1) through (4) of the subsection (c) waterfall each relies on information available from a controllable electronic record, an attached or associated record, or rules of a system in which the record is recorded. A controllable electronic record's jurisdiction is determined by one of these sources that "expressly provide[s]" that a jurisdiction is the controllable electronic record's jurisdiction or that a particular jurisdiction's law is the governing law. These paragraphs refer to attached or associated records or system rules that are "readily available." They also assume that the controllable electronic record is itself readily available to anyone choosing to deal with the record. These provisions are based on the assumption that the relevant express provision will be available to an interested person without the imposition of unreasonable burdens.

5. *Bottom of the waterfall: District of Columbia.* Currently, 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 (some permissioned systems being exceptions). (One hopes that once Article 12 and accompanying amendments are widely adopted, systems will adapt and the waterfall will become more generally viable for identifying a controllable electronic record's jurisdiction.) Consequently, subsection (c)(5) addresses a problem that does not normally exist in the context of Sections 8-110 and 9-305. The likely choice for the bottom of the waterfall ordinarily might be the location of the debtor. That approach would follow the role of the location of a debtor under Sections 9-301 and 9-307. However, that location may not readily be determined by parties to a transaction, primarily because in many cases involving controllable electronic records the transferor is not known to or easily discoverable by a purchaser. *See* Reporter's Prefatory Note 1 to Article 12. Consequently, Subsection (c)(5) resolves this dilemma by providing that the controllable electronic record's jurisdiction is the District of Columbia (DC).

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

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

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

ANNEX A

TRANSITION PROVISIONS FOR 2022 AMENDMENTS TO UNIFORM COMMERCIAL CODE—EMERGING TECHNOLOGIES

Reporter's Prefatory Note to Annex A—Transition Provisions

Unlike previous UCC revisions, the Emerging Technologies amendments pose special challenges. The amendments add a new Article 12, covering new classes of property, and provide extensive revisions to Article 9. They also include amendments to every other UCC article (save Article 6). Consequently, earlier transition provisions do not provide an adequate template for addressing such a broad set of amendments.

This annex draws substantially on Article 9, Part 7, the transition provisions applicable to the 1999 revisions to Article 9. In particular, the substantial amendments to Article 9 and the new Article 12 require special attention to post-effective date perfection and priority issues.

PART 1

GENERAL PROVISIONS

Section A-101. Effective Date.

This [Act] takes effect on **[the effective date of this [Act]]**.

Legislative Note:

A state should insert the actual date on which this [Act] takes effect in each place where "[the effective date of this [Act]]" appears in the text of the statute. A state should insert the uniform date for adjustments, [January] [July] 1, 2025, or, if later, the date one year after the effective date of this [Act], in each place where "[the adjustment date]" appears in the text. The one-year period between the effective date and the adjustment date is important. It is intended primarily to provide sufficient time for a person to achieve perfection or priority following the effective date or for a person with an established priority in property to protect its priority before the priority may otherwise be lost on the adjustment date.

Official Comment

A uniform law as complex as the Emerging Technologies amendments to the Uniform Commercial Code necessarily gives rise to difficult problems and uncertainties during the transition to the new law. As is customary for uniform laws, these amendments are based on the general assumption that all States will have enacted substantially identical versions. While always important, uniformity is particularly important to the success of these amendments, especially those to Article 9 and the new Article 12 and conforming amendments relating to each.

Article 9, Part 7, provided that several material changes in the law would be given effect one year after a "uniform" effective date. (As it turned out, all but a few states enacted the 1999 amendments with the uniform effective date.). However, for practical reasons many states may wish to provide an effective date for this [Act] that is consistent with their usual timing for effectiveness of legislation. For that reason, this annex does not provide for a uniform effective date but does provide for a uniform adjustment date on which several material provisions (in particular, new priority rules that would override pre-effective-date established priorities) would apply. However, if the uniform adjustment date is less than one year after the effective date for a state's adoption of these amendments, then the state should adopt an adjustment date that is one year after the state's effective date. In these official comments to this annex, references to the "adjustment date" mean the uniform adjustment date or such later date.

The law, other than the Uniform Commercial Code, of a state adopting this [Act] determines the time of day on the state's effective date on which this [Act] takes effect.

Reporter's Note

Uniform adjustment date. As indicated in the Legislative Note and the official comment to this section, the proposed January/July 1 adjustment date is based on current expectations as to the timing of enactments of the UCC revisions by a substantial number of states and the need to allow for the adjustment date to be at least one year after enactment. Before these revisions are finalized, it will be necessary to determine whether January 1 or July 1, 2025, is the preferred uniform adjustment date.

Section A-102. Definitions.

(a) **[Annex A Definition.]** In this annex "Article 12 property" means a controllable account, a controllable electronic record, and a controllable payment intangible**.**

(b) **[Definitions in other articles.]** The following definitions in the [Uniform Commercial Code] apply to this annex.

"Controllable account". Section 9-102

"Controllable electronic record". Section 12-102

"Controllable payment intangible". Section 9-102

"Electronic money". Section 9-102.

"Financing statement". Section 9-102.

(c) **[Article 1 definitions and principles.]** Article 1 contains general definitions and principles of construction and interpretation applicable throughout this annex.

PART 2

GENERAL TRANSITION PROVISION

Section A-201. [Savings Clause.] Except as provided in Part 3, a transaction validly entered into before [the effective date of this [Act]] and the rights, duties, and interests flowing from the transaction remain valid thereafter and may be terminated, completed, consummated, or enforced as required or permitted by law other than the [Uniform Commercial Code**] or, if applicable, the [**Uniform Commercial Code**], as though this [Act] had not taken effect.**

Official Comment

1. **Source of this provision**. This Section is drawn from former Section 10-102(2) (now withdrawn).

2. **In general: Prospective application.** This section is a savings clause that provides in general for the prospective application of the amendments to the Uniform Commercial Code and the preservation of the validity of pre-effective-date transactions and the rights, duties, and interests flowing from those transactions. Part 3 provides exceptions to this prospective application for Articles 9 and new Article 12.

3. **Prospective application: Examples.**

"Conspicuous." Section 1-201(b)(10) provides a revised definition of "conspicuous" and extensive new official comments. The new definition applies to a record that becomes a part of the relevant transaction after the effective date.

"Hybrid transaction" and "hybrid lease." Revisions to Sections 2-102 and 2A-102 address a sale of goods that is a part of a "hybrid transaction" and a lease of goods that is part of a "hybrid lease." See Sections 2-106(5) (defining "hybrid transaction) and 2A-103(1)(aa) (defining "hybrid lease"). These revisions apply to transactions entered into after the effective date.

4. **Revisions reflecting continuation of pre-effective-date precedents.** Several revisions are intended to clarify and reaffirm understandings of pre-effective-date interpretations of the Uniform Commercial Code and are not intended to modify some pre-effective-date judicial interpretations. Examples include (i) the amendment to Section 3-104, which clarifies that neither a choice-of-law nor a choice-of-forum clause prevents a promise from being a negotiable

instrument, (ii) the amendments to Section 4A-201, which indicate that a security procedure may impose an obligation on both the receiving bank and the customer and may involve the use of symbols, sounds, or biometrics, (iii) the clarifying revision of Section 5-116, (iv) the new definitions of "assignee" and "assignor" in draft § 9-102(a)(6A) and (6B), and (v) clarification of the attachment of a security interest in consumer goods as proceeds or commingled goods and in a commercial tort claim as proceeds in draft § 9-204(c). However, this transition rule will be important in situations in which the controlling pre-effective-date case law is not consistent with the amended provisions.

PART 3

ADDITIONAL TRANSITION PROVISIONS FOR ARTICLES 9 AND 12

Section A-301. Savings Clause.

(a) **[Pre-effective-date transactions, liens, or interests.]** Except as otherwise provided in this part, Article 9 as amended by this [Act] and Article 12 apply to a transaction, lien, or other interest in property, even if the transaction, lien, or interest was entered into, created, or acquired before **[the effective date of this [Act]]**.

(b) **[Continuing validity]** Except as otherwise provided in subsection (c) and Sections A-302 through A-306:

(1) a transaction, lien, or interest in property that was not governed by the [Uniform Commercial Code] and was validly entered into, created, or transferred before [**the effective date of** this [Act]], and would be subject to Article 9 as amended by this [Act] or Article 12 if it had been entered into, created, or transferred after [**the effective date of** this [Act]], and the rights, duties, and interests flowing from the transaction, lien, or interest in property remain valid after [**the effective date of** this [Act]]; and

(2) the transaction, lien, or interest in property may be terminated, completed, consummated, and enforced as required or permitted by this [Act] or by the law that otherwise would apply if this [Act] had not taken effect.

(c) [**Pre-effective-date proceedings.]** This [Act] does not affect an action, case, or proceeding commenced before [**the effective date of** this [Act]].

Official Comment

1. **Source of these provisions.** This section derives from Section 9-702.

2. **Pre-effective-date transactions, liens, and interests.** Subsection (a) contains the general rule that Article 9 as amended by this [Act] (as used in these official comments to Annex A, "revised Article 9") and Article 12 generally apply to transactions, liens (including security interests), and interests in property, even if entered into, created, or acquired before the effective date. Thus, for example, secured transactions entered into under Article 9 before amendment by this [Act] (as used in these official comments to Annex A, "former Article 9") must be terminated, completed, consummated, and enforced under this [Act]. However, other provisions in this part provide exceptions to this general rule.

3. **[Pre-effective-date transactions not governed by pre-effective-date Uniform Commercial Code.]** Subsection (b) is an exception to the general rule. It applies to valid, pre-effective-date transactions, liens, and other interests in property that were not governed by the former Uniform Commercial Code but would be governed by this [Act] if they had been entered into or created after this [Act] takes effect. Under subsection (b), these valid transactions, such as the sale of a controllable electronic record, retain their validity under this article and may be terminated, completed, consummated, and enforced as required or permitted by the law that otherwise would apply had this [Act] not taken effect or, to the extent not inconsistent with that law, this [Act].

3. **Judicial proceedings commenced before effective date.** As is usual in transition provisions, this subsection (c) provides that this this [Act], does not affect litigation pending on the effective date.

Section A-302. Security Interest Perfected Before Effective Date.

(a) **[Continuing perfection: perfection requirements satisfied.]** A security interest that is enforceable and perfected immediately before [**the effective date of** this [Act]] is a perfected security interest under this [Act] if, on **[the effective date of this [Act]]**, the applicable requirements for enforceability and perfection under this [Act] are satisfied without further action.

(b) **[Continuing perfection: perfection requirements not satisfied.]** If, immediately before **[the effective date of this [Act]]**, a security interest is enforceable and perfected, but the applicable requirements for enforceability or perfection under this [Act], are not satisfied on **[the**

effective date of this [Act]], the security interest:

(1) is a perfected security interest until the earlier of the time perfection would have ceased under the law in effect immediately before **[the effective date of this [Act]]** or [[January] [July]] 1, 2025;

(2) remains enforceable thereafter only if the security interest satisfies the requirements for enforceability under Section 9-203 before the [the adjustment date]; and

(3) remains perfected thereafter only if the applicable requirements for perfection under this [Act] are satisfied before the [the adjustment date].

Official Comment

1. **Source of these provisions**. This section derives from Section 9-703.

2. **Perfected security interests under former Article 9 and revised Article 9.** This section deals with security interests that are perfected under former Article 9 immediately before this [Act] takes effect. Subsection (a) provides, not surprisingly, that if the security interest would be a perfected security interest under revised Article 9 (i.e., if the transaction satisfies revised Article 9's requirements for enforceability (attachment) and perfection), no further action need be taken for the security interest to be a perfected security interest.

> **Example 1:** A pre-effective-date security agreement and financing statement, filed in the appropriate filing office, covered "all accounts and general intangibles now owned or hereafter acquired." After the effective date the debtor acquired controllable accounts, controllable electronic records, and controllable payment intangibles. The security interest in the after-acquired collateral is enforceable and perfected under both former and revised Article 9. The controllable accounts are accounts, the controllable electronic records and controllable payment intangibles are general intangibles, and filing is an appropriate method of perfection for that collateral under both versions of Article 9.

Other examples of methods of perfection under former Article 9 that also would achieve perfection under revised Article 9 include perfection in electronic documents under former and amended Section 7-106 and perfection in electronic chattel paper under former Section 9-105 and perfection in chattel paper evidenced by authoritative electronic records under amended Section 9-105.

3. **Security interests enforceable and perfected under former Article 9 but unenforceable or unperfected under revised Article 9.** Subsection (b) deals with security interests that are enforceable and perfected under former Article 9 immediately before this [Act] takes effect but do not satisfy the requirements for enforceability (attachment) or perfection

under revised Article 9. These security interests are perfected security interests until the earlier of the time perfection would have ceased under the law in effect immediately before this [Act] takes effect and the adjustment date. If the security interest satisfies the requirements for attachment and perfection within that period, the security interest remains perfected thereafter. If the security interest satisfies only the requirements for attachment within that period, the security interest becomes unperfected on the adjustment date.

> **Example 2:** A pre-effective-date security agreement signed by Debtor in favor of Secured Party covers, among other things, "all money . . . and general intangibles now owned or hereafter acquired." Secured Party filed a proper financing statement in the appropriate filing office covering "All personal property." Debtor owns electronic money, spitcoin, issued by the government of El Cuspidouro. Under former Article 9 the electronic money might be characterized as a general intangible if "money" were to be construed (at least for purposes of Article 9) to include only tangible money as to which perfection is possible by possession. See former Section 9-312(b)(3). Alternatively, even if the spitcoin is money, perfection might be possible by filing under the baseline rule of Section 9-310, inasmuch as the spitcoin (an intangible) cannot be possessed. Assume, therefore, that under former Article 9 Secured Party's security interest in the spitcoin is perfected by filing. Assume also that spitcoin can be subjected to control under Section 9-105A. As to the spitcoin owned by the debtor before the effective date, under subsection (b) the security interest would remain perfected until the adjustment date but would become unperfected under revised Article 9 on the adjustment date unless earlier perfected by control. This is so because a security interest in electronic money that can be subject to control under Section 9-105A, such as spitcoin, may be perfected only by control under revised Article 9. Sections 9-312(b)(4); 9-314(a). The security interest in any spitcoin acquired by the debtor after the effective date would be unperfected until the secured party obtains control.

> **Example 3:** Secured Party has a pre-effective-date security interest in a security entitlement perfected by control pursuant to Sections 9-106 and 8-106(d)(3), based on control held by Kontroal Phreeque LLC (KP) on behalf of Secured Party. Even in the highly unlikely event that following the effective date the secured party could not prove that KP acknowledged its control on behalf of the secured party in conformity with revised Section 8-106(d)(3), its security interest would nevertheless remain perfected beyond the adjustment date. Perfection by control for a security entitlement under Section 9-106 depends on control under 8-106 and, under draft § A-301(a), Part 3 of this annex, including subsection (b), does not apply to transactions under Article 8. As to financial assets acquired and becoming a part of the security entitlement after the effective date, however, revised Articles 8 and 9 would apply. Secured Party could perfect its security interest in those financial assets through a complying acknowledgment by KP or by filing.

4. **Interpretation of pre-effective-date security agreements.** Section 9-102 defines "security agreement" as "an agreement that creates or provides for a security interest." Under Section 1-201(3), an "agreement" is a "bargain of the parties in fact." If parties to a pre-effective-date security agreement describe the collateral by using a term defined in former Article 9 in one way and defined in revised Article 9 in another way, in most cases it should be presumed that the

bargain of the parties contemplated the meaning of the term under former Article 9. Definitions of terms relating to collateral which have been amended in revised Article 9 are "account," chattel paper," "instrument," "money," and "general intangible." A different result might be appropriate, for example, if a security agreement explicitly contemplated future changes in the Article 9 definitions of types of collateral–e.g., "'Accounts' means 'accounts' as defined in the Uniform Commercial Code Article 9 of [State X], *as that definition may be amended from time to time*." Whether a different interpretive approach is appropriate in any given case depends on the bargain of the parties, as determined by applying ordinary principles of contract law.

Section A-303. Security Interest Unperfected Before Effective Date.

A security interest that is enforceable immediately before **[the effective date of this [Act]]** but which would be unperfected at that time:

(1) remains an enforceable security interest until the [the adjustment date];

(2) remains enforceable thereafter if the security interest becomes enforceable under Section 9-203 on **[the effective date of this [Act]]** or before the [the adjustment date]; and

(3) becomes perfected:

(A) without further action, on **[the effective date of this [Act]]** if the applicable requirements for perfection under this [Act] are satisfied before or at that time; or

(B) when the applicable requirements for perfection are satisfied if the requirements are satisfied after that time.

Official Comment

1. **Source of these provisions.** This Section derives from section 9-704.

2. **Pre-effective-date enforceable but unperfected security interests.** This section deals with security interests that are enforceable but unperfected (i.e., subordinate to the rights of a person who becomes a lien creditor) under former Article 9 or other applicable law immediately before this [Act] takes effect. These security interests remain enforceable until the adjustment date, and thereafter if the appropriate steps for attachment under revised Article 9 are taken before the adjustment date. (This section's treatment of enforceability is the same as that of draft § A-302.) The security interest becomes a perfected security interest on the effective date if, at that time, the security interest satisfies the requirements for perfection under revised Article 9. If the security interest does not satisfy the requirements for perfection until sometime thereafter, it becomes a perfected security interest at that later time.

Example 1: Prior to the effective date Debtor obtained a loan from Secured Party and signed a security agreement covering "all cryptocurrencies now owned or hereafter acquired." The security interest attached to various cryptocurrencies owned by Debtor, including 1,000 happicoins held by debtor on the happicoins blockchain platform. Debtor then transferred the 1,000 happicoins to Secured Party on the blockchain. Although the happicoins are general intangibles, Secured Party failed to file a financing statement necessary to perfect its security interest under former Article 9.

Under revised Article 9, the happicoins would be controllable electronic records and the transfer of the happicoins to Secured Party would give Secured Party "control" of the happicoins as provided in draft § 12-105. Before revised Article 9 (i.e., including revised Sections 9-107A and 9-314) and Article 12 became effective, Secured Party's security interest was unperfected as noted above. Upon the effective date, however, the security interest became perfected by control as a result of the pre-effective-date transfer of control to Secured Party.

Example 2. Prior to the effective date Debtor obtained a loan from Secured Party and signed a security agreement covering certain specified deposit accounts and "all documents and chattel paper now owned or hereafter acquired by Debtor." The security interest attached to the deposit accounts and to various documents and chattel paper owned by Debtor. Persons in control of certain electronic chattel paper, electronic documents, and deposit accounts included in the collateral acknowledged that they had control of that collateral on behalf of Secured Party. Assuming that an agency relationship cannot be established between these acknowledging persons and Secured Party, it is perhaps arguable that Secured Party's security interest in the relevant collateral was unperfected because Secured Party did not have control under former Sections 7-106, 9-104, and 9-105. However, because the pre-effective-date acknowledgments would give Secured Party control under the revised sections, its security interest, even if not perfected pre-effective date, became perfected by control on the effective date.

Section A-304. Effectiveness of Actions Taken Before Effective Date.

(a) **[Pre-effective-date action; attachment and perfection before adjustment date.]** If action, other than the filing of a financing statement, is taken before **[the effective date of this [Act]]** and the action would have resulted in perfection of the security interest had the security interest become enforceable before **[the effective date of this [Act]]**, the action is effective to perfect a security interest that attaches under this [Act] before [the adjustment date]. An attached security interest becomes unperfected on [the adjustment date] unless the security interest becomes a perfected security interest under this [Act] before [the adjustment date].

(b) **[Pre-effective-date filing.]** The filing of a financing statement before **[the effective date of this [Act]]** is effective to perfect a security interest on **[the effective date of this [Act]]** to the extent the filing would satisfy the applicable requirements for perfection under this [Act].

(c) **[Pre-effective-date enforceability actions.]** The taking of an action before **[the effective date of this [Act]]** is sufficient for the enforceability of a security interest on **[the effective date of this [Act]]** if the action would satisfy the applicable requirements for enforceability under this [Act].

Official Comment

1. **Source of these provisions.** Subsections (a) and (b) of this Section derive from Section 9-705. Subsection (c) is new.

2. **General.** This section addresses primarily the situation in which the perfection step or requirement for enforceability is taken under former Article 9 or other applicable law before the effective date of this [Act], but the security interest does not attach until after that date.

3. **Perfection other than by filing.** Subsection (a) applies when the perfection step is a step other than the filing of a financing statement. If the step that would be a valid perfection step under former Article 9 or other law is taken before this [Act] takes effect, and if a security interest attaches before the adjustment date, then the security interest becomes a perfected security interest upon attachment. However, the security interest becomes unperfected on the adjustment date unless the requirements for attachment and perfection under revised Article 9 are satisfied within that period.

4. **Perfection by filing: ineffective filings made effective.** Subsection (b) deals with financing statements that were filed under former Article 9 and which would not have perfected a security interest under the former Article, but which would perfect a security interest under revised Article 9. Under subsection (b), such a financing statement is effective to perfect a security interest to the extent it complies with revised Article 9. Subsection (b) applies regardless of the reason for the filing. When this [Act] takes effect, the filing becomes effective to perfect a security interest assuming the filing satisfies the perfection requirements under revised Article 9).

> **Example 1.** Prior to the effective date Debtor obtained a loan from Secured Party and signed a security agreement covering, among other collateral, "money," "accounts," "chattel paper," and "general intangibles." Secured Party filed a financing statement covering "all assets." If, under the applicable former Article 9 as interpreted by the courts, electronic currency was "money" as defined in former Section 1-201 even though as an intangible it could not be possessed, then under the applicable former Section 9-

312(b)(3), filing a financing statement was not an effective method of perfection. Assume, however, that under revised Article 1, the electronic currency is not "money," and is instead a general intangible. Under revised Article 9, filing is an effective method of perfection. Upon the effective date of revised Article 9, the security interest became perfected by the pre-effective-date filed financing statement.

Example 2. Prior to the effective date Debtor obtained a loan from Secured Party and signed a security agreement covering, among other collateral, "accounts," "chattel paper," and "general intangibles." Secured Party filed a financing statement covering "accounts." Under the applicable former Article 9, a certain right to payment was chattel paper because it was a lease of specific goods, even though the transaction also covered, and the lessee's monetary obligation also related to, various other assets and various services. Because the filed financing statement covered only accounts, the security interest in the chattel paper was unperfected. Under revised Article 9, however, the right to payment was an "account," and not chattel paper, because the lessee's right to possession and use of the goods was not "the predominant purpose of the transaction." draft § 9-102(a)(11)(B)(ii). Upon the effective date the security interest became perfected by the pre-effective-date filed financing statement covering accounts.

3. **Enforceability of security interest: unenforceable security interest made enforceable.**

Example 3. Under the facts of Example 1, draft § A-303, Comment 2, instead of authenticating a security agreement Debtor agreed orally to grant to Secured Party a security interest in the happicoins. It follows that under former Article 9 Secured Party's security interest was unenforceable and did not attach to the happicoins. Former Section 9-203(b). However, upon the effective date of revised Article 9, Secured Party had control of the happicoins under revised Article 9. At that time the security interest became enforceable and attached under Section 9-203(b)(3)(D) and also was perfected by control.

Section A-305. Priority.

(a) **[Determination of priority.]** Subject to subsections (b) and (c), this [Act] determines the priority of conflicting claims to collateral.

(b) **[Established priorities.]** Subject to subsection (c), if the relative priorities of claims to collateral were established before **[the effective date of this [Act]]**, [former Article 9] determines priority.

(c) **[Determination of certain priorities on adjustment date.]** On [the adjustment date], to the extent that the relative priorities determined by this [Act] modify the relative priorities established before **[the effective date of this [Act]]**, the relative priorities of claims to Article 12 property and electronic money which were established before **[the effective date of this [Act]]** cease to apply.

Official Comment

1. **Source of these provisions.** This section derives from Section 9-709.

2. **Law governing priority and established priorities.** Ordinarily, revised Article 9 determines the priority of conflicting claims to collateral under subsection (a). However, when the relative priorities of the claims were established before the effective date, former Article 9 governs under subsection (b). Subsection (c) provides an exception to subsection (b).

> **Example 1.** In 2021, prior to the effective date, Debtor obtained a loan from Secured Party and signed a security agreement covering "all cryptocurrency and money now owned or hereafter acquired." The security interest attached to various cryptocurrencies owned by Debtor, including 1,000 happicoins held by Debtor on the happicoins blockchain platform. Secured Party promptly filed a financing statement covering "all general intangibles, including cryptocurrencies, now owned or hereafter acquired by Debtor." In 2022, also prior to the effective date, Debtor obtained a loan from Lender and signed a security agreement covering "all cryptocurrency now owned or hereafter acquired." Although the happicoins are general intangibles, Lender failed to file a financing statement. Because the priorities of the claims were established before the effective date, former Article 9 governs. Secured Party's perfected security interest has priority over Lender's unperfected security interest under former Section 9-322(a)(2).

> **Example 2.** The facts are the same as in Example 1, except that Debtor transferred control of the 1,000 happicoins to Lender on the blockchain in 2022 *before* the effective date. Because Lender failed to file a financing statement and control was not a method of perfection under former Article 9, Lender's security interest was unperfected immediately prior to the effective date. However, because under revised Article 9 the happicoins are controllable electronic records and Lender has "control" of the happicoins under Section 12-105, Lender's security interest became perfected on the effective date. Nevertheless, because the priorities of Secured Party's and Lender's security interests were established before the effective date, Secured Party's security interest continues to have priority after the effective date. (However, see Example 4 for the shift of priority on the adjustment date.)

> **Example 3.** The facts are the same as in Example 1, except that in 2023, *after* the effective date, Debtor transferred control of the 1,000 happicoins to Lender on the blockchain. Under revised Article 9, the happicoins were controllable electronic records and the transfer of control of the happicoins gave Lender "control" of the happicoins as provided in draft § 12-105. The affirmative step of transferring control established anew the relative priority of the conflicting claims after the effective date. Revised Article 9

determines priority and Lender's security interest has priority under draft § 9-326A. Moreover, Lender also may also have priority as a qualifying purchaser under draft §§ 12-104(e) and 9-331.

One consequence of the rule on established priorities in subsection (b) is that the mere taking effect of this [Act] does not of itself adversely affect the priority of conflicting claims to collateral, as Example 2 illustrates. However, as Example 3 illustrates, relative priorities that are "established" before the effective date do not necessarily remain unchanged following the effective date. Of course, unlike priority contests among security interests, some priorities are established permanently, e.g., the rights of a buyer of property who took free of a security interest under former Article 9.

3. **Modification of established priorities on adjustment date.**

Subsection (c) provides an exception to the respect that subsection (b) affords to pre-effective-date established priorities, but only for security interests in Article 12 property—controllable accounts, controllable electronic records, and controllable payment intangibles—and electronic money.

Example 4. The facts are the same as in Example 2. Lender's security interest became perfected by control on the effective date, Secured party's established priority continued to apply under subsection (b). Under subsection (c), however, on the adjustment date the priorities shifted. Secured Party's established priority ceased to apply and Lender's perfection by control gave Lender priority under revised draft § 9-326A.

4. **Transfers of collateral after the effective date.**

Example 5. The facts are the same as in Example 2. In 2023, *after* the effective date, Debtor acquired an additional 500 happicoins. The security interests of both Secured Party and Lender attached to the happicoins pursuant to the after-acquired property clauses in their respective security agreements. Secured party's security interest was perfected by its earlier financing statement filing. Lender promptly perfected its security interest by Debtor's transfer of control of the happicoins to Lender. Lender's security interest perfected by control gave Lender priority under draft § 9-326A. Unlike the situation in Example 2, however, as to the newly acquired happicoins the priorities were not established prior to the effective date. Before the effective date neither creditor could have had a "perfected" security interest in happicoins in which Debtor had not yet acquired rights.

Example 6. The facts are the same as in Example 1. In 2023, *after* the effective date, Debtor transferred 750 spitcoins, an electronic money, to Beier. Beier promptly obtained control of the spitcoins under draft § 9-105A. Secured Party's security interest in the spitcoins, which were either money not capable of being possessed or general intangibles under former Article 9, are assumed to be perfected by filing. See draft § A-302, Comment 3, Example 2. Because there was no wrongful collusion with Debtor (indeed, Beier had no knowledge or notice of Secured Party's security interest), Beier took the spitcoin free of Secured Party's security interest under Section 9-332(b).

Section A-306. Priority of Claims When Priority Rules of Article 9 Do Not Apply.

(a) **[Determination of priority.]** Subject to subsections (b) and (c), Article 12 determines the priority of conflicting claims to Article 12 property when the priority rules of Article 9 do not apply.

(b) **[Established priorities.** Subject to subsection (c), when the priority rules of Article 9 do not apply and the relative priorities of claims to Article 12 property were established before **[the effective date of this [Act]]**, law other than Article 12 determines priority.

(c) **[Determination of certain priorities on adjustment date]** When the priority rules of Article 9 do not apply, to the extent that the relative priorities determined by this [Act] modify the relative priorities established before **[the effective date of this [Act]]**, on [the adjustment date] the relative priorities of claims to Article 12 property which were established before **[the effective date of this [Act]]** cease to apply.

Official Comment

1. **Source of these provisions.** This section derives from Section 9-709 and, in part, from Section 8-510.

2. **Applicability of this section to Article 12 property.** Although this section applies to Article 12 property (controllable accounts, controllable electronic records, and controllable payment intangibles) when the priority rules of Article 9 do not apply, it applies primarily to controllable electronic records. Its application to controllable accounts and controllable payment intangibles is quite limited because Article 9 applies to most sales of accounts and payment intangibles (as well as to security interests in that property that secure an obligation). Section 9-109(a)(3). There is a very limited exception for sales of accounts and payment intangibles in connection with sales of the busines out of which they arose. Section 9-109(d)(4).

3. **Law governing priority and established priorities.** Ordinarily, when the priority rules of Article 9 do not apply, Article 12 determines the priority of conflicting claims to Article 12 property under subsection (a). However, when the relative priorities of the claims were established before the effective date, under subsection (b) law other than Article 12 governs.

Subsection (c) provides an exception to subsection (b).

4. **Law governing priority and established priorities.**

> **Example 1.** In 2021, prior to the effective date, Aiko owned 500 happicoins (a cryptocurrency consisting of controllable electronic records) over which Aiko had control (within the meaning of draft § 12-105) on the happicoin blockchain. In December 2021 Aiko sold the 500 happicoins to Barbara for $10,000 cash. Aiko provided Barbara with a signed memorandum acknowledging the sale and Aiko's receipt of the purchase price and agreeing to hold the happicoins for Barbara pending Barbara's further instructions.
>
> In January 2022 (also prior to the effective date), Aiko sold the same 500 happicoins to Molly for $12,000 cash. Aiko provided Molly with a signed memorandum similar to the one Aiko had provided to Barbara. Assume that, under the non-Uniform Commercial Code applicable law, Barbara remained the owner of the happicoins and under that law Molly obtained no interest in the happicoins pursuant to the purported sale because Aiko had retained no interest and had nothing to transfer to Molly. Because the priorities of the claims of Aiko, Barbara, and Molly were established before the effective date, under subsection (a) those priorities remained in effect after the effective date.
>
> **Example 2.** The facts are the same as in Example 1, except that *before* the effective date, Aiko transferred control of the happicoins to Molly on the happicoins blockchain. Again, assume that under the non-Uniform Commercial Code applicable law that transfer had no legal effect. After the effective date the relative priorities are unchanged from those described in Example 1 because the relative priorities were established before the effective date and subsection (b) applies.
>
> **Example 3.** The facts are the same as in Example 1, except that *after* the effective date, Aiko transferred control of the happicoins to Molly on the happicoins blockchain. Under Article 12, the happicoins were controllable electronic records and the transfer of control of the happicoins gave Molly "control" of the happicoins as provided in draft § 12-105. Because (it is assumed) Molly met the requirements for a "qualifying purchaser" under draft § 12-104(e), Molly acquired the happicoins free of Barbara's property claim. The affirmative step of transferring control after the effective date established anew the relative priority of the conflicting claims after the effective date. Under draft § A-301(a), Article 12 applies to the pre-effective-date transactions and property interests and subsection (a) of this section applies.

5. **Modification of established priorities on adjustment date.** Subsection (c) provides an exception to the respect that subsection (b) affords to pre-effective-date established priorities.

> **Example 4.** The facts are the same as in Example 2. However, on the adjustment date the established priorities change. Because (it is assumed) Molly met the requirements for a "qualifying purchaser" under draft § 12-104(e), on the adjustment date Molly acquired the happicoins free of Barbara's property claim. Under draft § A-301(a), Article 12 applies to the pre-effective-date transactions and property interests and subsection (a) of

this section applies.

6. **Transfers after the effective date.**

Example 5. The facts are the same as in Example 1, except that *after* the effective date Aiko sold and transferred control of the happicoins to Jacob on the happicoins blockchain. Because (it is assumed) Jacob met the requirements for a "qualifying purchaser" under draft § 12-104(e), Jacob acquired the happicoins free of Barbara's and Molly's property claims. Note that Jacob took the happicoins free of conflicting claims in the post-effective date acquisition immediately upon acquisition as a qualifying purchaser. Jacob's priority was established after the effective date and was not deferred until the adjustment date, as was the case for Molly's rights in Example 4.