
Civil Rights & Judiciary Committee

SSB 5077

Brief Description: Concerning the uniform commercial code.

Sponsors: Senate Committee on Law & Justice (originally sponsored by Senators Pedersen and Wagoner; by request of Uniform Law Commission).

Brief Summary of Substitute Bill

- Amends general provisions and definitions that apply throughout the Uniform Commercial Code (UCC) to replace and update terms that applied only to transactions on paper.
- Amends UCC articles governing sales, leases, negotiable instruments, fund transfers, letters of credit, documents of title, investment securities, and secured transactions to address emerging technologies and to clarify the UCC's applicability to hybrid transactions.
- Establishes a new article in the UCC governing controllable electronic records.

Hearing Date: 3/21/23

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Background:

The Uniform Commercial Code.

The Uniform Commercial Code (UCC) is a model code drafted by the Uniform Law Commission (ULC) in collaboration with the American Law Institute. The UCC provides a comprehensive framework of laws to govern all commercial transactions and has been adopted in substantially the same form in all 50 states. The UCC is organized into 10 substantive articles, each article governing a separate area of the law. Since its original promulgation in 1951, the

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various articles of the UCC have been revised to adapt to changing business practices and developments in the law.

Article 1—Definitions and General Provisions.

Article 1 of the UCC provides definitions and general provisions which, in the absence of conflicting provisions, apply as default rules covering transactions and matters otherwise covered under a different article of the UCC. Issues covered under Article 1 include: principles of interpretation; parties' power to choose applicable law and vary rules by agreement; waiver of claim or right after breach; and other general rules governing commercial transactions.

Article 2—Sales of Goods.

Article 2 of the UCC governs sales of goods and provides default rules that apply where the parties to a contract have not comprehensively addressed common issues in a written contract. Article 2 defines key terms, such as "sale" and "contract for sale," and addresses issues such as: contract formation and modification; delegation of performance and assignment of rights; and performance, breach, and repudiation.

Additionally, Article 2 provides that a contract for the sale of goods for the price of \$500 or more is not enforceable unless there is some writing sufficient to indicate that a contract for sale has been made between the parties.

Article 2A—Leases.

Article 2A governs the leases, including finance leases, of personal property, such as machinery, equipment, and vehicles. Similar to a contract for the sale of goods under Article 2, a lease contract where the total payments to be made exceed \$1,000 is unenforceable unless there is a writing sufficient to indicate that a lease contract has been made between the parties and to describe the goods leased and the lease term.

Article 3—Negotiable Instruments.

Article 3 of the UCC governs negotiable instruments, such as checks and promissory notes, that have independent value because they are negotiable, meaning that they can be transferred to another person and remain enforceable against the person who originally made the promise to pay.

The definition of "negotiable instrument" contains several requirements that must be met in order for a promise or order to pay to be considered a negotiable instrument within the scope of Article 3. Additionally, subject to specified exceptions, a 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."

A negotiable instrument may be issued by making the first delivery of the instrument by the person promising or ordering payment to a holder or nonholder for the purpose of giving rights on the instrument to any person.

Article 4—Bank Deposits and Collections.

Article 4 governs bank deposits and collections, and provides rules for check processing and automated interbank collections.

Article 4A—Funds Transfers.

Article 4A governs funds transfers and establishes the rights and responsibilities of the parties to a funds transfer, including the parties' payment obligations and allocation of risk of loss for unauthorized or improperly executed payment orders.

Under Article 4A, a "payment order" is an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay a fixed or determinable amount of money to a beneficiary. Various security procedures may be established by agreement of a customer and a receiving bank for the purpose of verifying a payment order or a communication amending or canceling a payment order, or to detect an error in the transmission or the context of the payment order or communication.

Article 5—Letters of Credit.

Article 5 of the UCC governs letters of credit, defined as an undertaking by an "issuer" of the credit to a "beneficiary," the individual who gets paid, on behalf of an "applicant," the individual to whom credit is extended by the issuer. Commonly, the issuer is a bank or a similar financial institution, the applicant is a customer of that bank, and the beneficiary is someone with whom the applicant is doing business and who wants assurance that he or she will be paid.

A letter of credit may be issued in any form that is a record authenticated by a signature, or in accordance with the agreement of the parties or standard practices of financial institutions that regularly issue letters of credit.

Under Article 5, the liability of an issuer is governed by the law of the jurisdiction chosen by the issuer or the jurisdiction in which the issuer is located. For the purpose of jurisdiction and choice of law, 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 located.

Article 7—Warehouse Receipts, Bills of Lading, and Other Documents of Title.

Article 7 governs warehouse receipts, bills of lading, and other electronic and tangible documents of title that are essential components of the system of storing and shipping goods in commerce. Documents of title represent the rights to the items being shipped and stored. The transfer of the document of title transfers rights in the goods.

A person with an electronic document of title transfers the document by transferring control. Under Article 7 general test of control, 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. Article 7 rules for determining whether a system satisfies this requirement and whether a person

has control permit the existence of only one unique and identifiable authoritative copy of the document.

Article 8—Investment Securities.

Article 8 provides a legal structure for the system of holding securities, such as stocks and bonds, mutual fund shares, and United States government securities, through intermediaries and sets forth rules concerning the system through which securities are held.

Article 8 specifies the rules for determining whether certain obligations and interests are securities or financial assets and when a purchaser has control of a security or security entitlement. Additionally, Article 8 provides that the local law of the issuer's jurisdiction or the securities intermediary's jurisdiction governs the validity of a security, acquisition of a security entitlement from the securities intermediary, and other specified matters and transactions under Article 8.

Article 9—Secured Transactions and Chattel Paper.

Article 9 of the UCC (Article 9A in Washington) provides a statutory framework that governs the creation and operation of security interests in various types of personal property or fixtures. A security interest is the interest of a creditor in property of a debtor used to secure payment of a debt.

Article 9 provides methods of creating and filing a security interest and the manner in which a security interest may be "perfected." Perfection of a security interest is the means by which a secured creditor obtains priority over other creditors who have a security interest in the same collateral. One common method of perfection is by the filing of a financing statement that indicates the debtor, the secured party, and the property subject to the security interest. Article 9 also provides remedies and procedures in the event that a debtor defaults on an obligation.

Proposed 2018 Amendments to Article 9 of the Uniform Commercial Code.

In 2018 the ULC proposed to revise Article 9 provisions that relate to transactions involving the pledge of property as collateral for a loan and that make certain restrictions on the transfer of property to be pledged as collateral generally ineffective.

The 2018 amendments recognize the "pick-your-partner principle" that provides that co-owners of small businesses have a substantial interest in determining who the other co-owners are. The pick-your-partner principle divides an ownership interest into two parts: an economic interest, which includes the right to share in any profits and is generally transferable; and a governance interest, which includes the right to participate in management decisions and is generally not transferable without the consent of the other co-owners.

The 2018 amendments create an exception to the rules that make transfers of property pledged as collateral ineffective and expressly exempt interests in a partnership or a limited liability company from the general rule of free transferability.

Proposed 2022 Amendments to the Uniform Commercial Code and the Addition of Article 12. The 2022 amendments to the UCC address emerging technologies, providing updated rules for commercial transactions involving virtual currencies, distributed ledger technologies (including blockchain), artificial intelligence, and other technological developments.

The amendments revise almost every article of the UCC and add a new Article 12 addressing certain types of digital assets defined as "controllable electronic records," such as certain virtual (non-fiat) currencies, nonfungible tokens, and digital assets in which specified payment rights are embedded. The amendments provide new default rules to govern transactions involving these new technologies, including "take-free" rules that protect innocent parties who accept in good faith digital assets in exchange for value without knowledge of any competing property claims to the assets.

Additionally, the amendments clarify the UCC's applicability to mixed transactions involving both goods and services and contain miscellaneous clarifying revisions unrelated to technological developments.

Summary of Bill:

The 2018 amendments to Article 9 and the 2022 amendments to the Uniform Commercial Code (UCC) are adopted. Various UCC provisions are amended to replace terms that applied only to transactions on paper, and extensive other revisions are made to almost all UCC articles. New Article 12 is created.

Article 1—Definitions.

Several key definitions applicable throughout the UCC are modified:

- "Money" is amended to clarify that the term does not include a medium of exchange in an electronic record, such as virtual currencies, that existed and operated as a medium of exchange before it was authorized or adopted as a medium of exchange by a government.
- "Sign" or "signed" is expanded to apply not only to a signature in writing, but also to an electronic signature.
- Examples of what is a "conspicuous" contract term are deleted; instead, whether a particular term is "conspicuous" is determined by the totality of the circumstances.
- "Person" includes a protected series of a series organization.

Article 2—Sales of Goods and Hybrid Transactions.

The scope of Article 2 is expanded to apply to "hybrid transactions," defined as transactions involving a sale of goods and:

- the provision of services;
- a lease of other goods; or
- a sale, lease, or license of property other than goods.

Article 2 applies to hybrid transactions if the sale of goods is the predominant purpose of the

transaction. If the sale-of-goods aspects do not predominate, Article 2 applies only to the sale-of-goods aspects of the transaction.

A contract for the sale of goods for the price of \$500 or more is not enforceable unless there is a record (rather than writing) sufficient to indicate that a contract for sale has been made between the parties.

Article 2A—Leases and Hybrid Leases.

The scope of Article 2A is expanded to apply to "hybrid leases," defined as transactions involving a lease of goods and:

- the provision of services;
- a sale of other goods; or
- a sale, lease, or license of property other than goods.

Article 2A applies to hybrid leases if the lease-of-goods aspects predominate. Otherwise, Article 2A applies to the lease-of-goods aspects only. If a hybrid lease includes a finance lease, the finance lease provisions of Article 2A apply to those aspects of the hybrid lease regardless of whether the lease-of-goods aspects predominate.

A lease contract where the total payments to be made exceed \$1,000 is unenforceable unless there is a record (rather than writing) sufficient to indicate that a lease contract has been made between the parties.

Article 3—Negotiable Instruments.

The definition of "negotiable instrument" is modified to provide that a choice-of-law or a choice-of-forum clause contained in an instrument is an exception to the prohibition on including "any other undertaking" and does not affect the negotiability of the instrument.

In addition to issuing by delivery, if agreed by the payee, the person promising or ordering payment may issue a negotiable instrument by transmission of an image of an item and information derived from the item permitting the depository bank to process the item as an electronic check under federal law. The obligation of a party to pay a check is not discharged solely by destruction of the check in connection with the process of submitting the information and image of the check for payment.

Article 4A—Funds Transfers.

The definition of "payment order" is modified by replacing a reference to "electronically, or in writing" with "in a record." The definition of "security procedure" is clarified to provide that the use of symbols, sounds, and biometrics may constitute a security procedure, but that requiring a payment order to be sent from a known email address, IP address, or telephone number is not by itself a security procedure.

Article 5—Letters of Credit.

The requirement that a letter of credit be issued in an authenticated record is removed, and

instead, a letter of credit may be issued in any form that is a signed record.

For the purpose of jurisdiction and choice of law, a branch of a bank is considered to be located at the address indicated in the branch's letter of credit or, if more than one address is indicated, the address of the branch from which the letter of credit was issued.

Article 7—Documents of Title.

Additional rules for determining whether a person has control of an electronic document of title are specified and allow for either a single authoritative copy or multiple authoritative copies.

To obtain control of an electronic document of title a person must be able to identify each electronic copy as authoritative or nonauthoritative and identify itself as the person to which each authoritative electronic copy has been issued or transferred. In addition, the person must have the exclusive powers to:

- prevent others from adding or changing an identified person to whom each authoritative electronic copy has been issued or transferred; and
- transfer control of each authoritative copy.

Once it is established that a person has received these powers, a presumption of exclusivity applies. A power is exclusive even if it is shared with another person unless the person can exercise the power only with the other person's cooperation. A person's shared power is not exclusive if the other person can exercise the power alone, without exercise of the power by the person.

Circumstances under which a person may obtain control of an electronic document of title through the control of another person are added to Article 7.

Article 8—Investment Securities.

A controllable account or controllable payment intangible (digital assets created in the revised Article 9A) and a controllable electronic record (a digital asset created in the new Article 12) are not financial assets under Article 8, unless otherwise expressly agreed upon by a securities intermediary holding property for another person in a securities account and the other person.

A purchaser may obtain control of a security entitlement if another person has control, and the person acknowledges that it has control on the purchaser's behalf. The local law of the issuer's jurisdiction or the securities intermediary's jurisdiction governs matters and transactions specified in Article 8 even if a matter or transaction bears no relation to that jurisdiction.

Article 9A.

The 2018 amendments to Article 9 are adopted to provide that transfers of governance interests in a general partnership, limited partnership, or limited liability company may be restricted.

The 2022 amendments are adopted to make numerous revisions throughout Article 9A to definitions, requirements for control, rules governing perfection and priority of security interests,

and take-free and choice-of-law provisions.

Deposit Accounts.

Perfection of a security interest in a deposit account may be obtained through control. In addition to existing requirements for control, a secured party may obtain control of a deposit account if another person, other than the debtor, has control and acknowledges that it has control on behalf of the secured party.

A transferee of funds from a deposit account can take the funds free of a security interest if the transferee receives possession of the money without acting in collusion with the debtor in violating the rights of the secured parties.

Chattel Paper.

The definition of chattel paper is modified to refer to the right to payment evidenced by a record. The term is also modified so that a right to payment from a hybrid lease transaction is treated as a chattel paper if the acquisition of the right to use and possession of the goods is the predominant purpose of the transaction.

A security interest in chattel paper is perfected, and priority is achieved, by possession of each authoritative tangible copy of the record evidencing the chattel paper, and control of each authoritative electronic copy of the electronic record evidencing the chattel paper. Perfection of a security interest in a chattel paper may be, but is not required to be, by filing.

To obtain control of one or more authoritative 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 the authoritative copy. The purchaser must have the exclusive powers to prevent others from adding or changing an identified assignee and to transfer control of the authoritative copy. A purchaser may also obtain control of an electronic copy of a record evidencing chattel paper through another person.

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

The rules for the perfection and priority of security interests in chattel paper are determined by:

- the law of the jurisdiction in which the tangible record evidencing the chattel paper is located, for chattel paper evidenced wholly by a tangible record; and
- the law of the jurisdiction where the chattel paper is considered to be located, for chattel paper that does not consist wholly of chattel paper in tangible form.

If chattel paper in electronic form expressly provides its jurisdiction, perfection and priority are governed by the law of that jurisdiction. Otherwise, the governing law is that whose law governs the system in which the chattel paper or electronic record thereof is recorded.

Electronic Money.

For the purposes of security interests, money does not include a deposit account or money in an electronic form that cannot be subjected to control. "Electronic money" is defined as money in an electronic form.

Money, for the purposes of security interests, does not include deposit accounts, or electronic money that cannot be subject to control. A security interest in tangible money may only be perfected through possession. Electronic money is defined as money in an electronic form. If electronic money is not credited to a deposit account, a security interest in electronic money may be perfected only through control.

To obtain control of electronic money, a person must be able to avail itself of substantially all the benefit of the electronic money. The purchaser must have the exclusive power to prevent others from availing themselves of all the benefit from the electronic money and to transfer control of the electronic money. A person must be able to identify itself as the person having such exclusive powers. A person may also obtain control of electronic money through another person.

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.

Controllable Accounts, Controllable Payment Intangibles, and Controllable Electronic Records. A controllable account means an account evidenced by a controllable electronic record (CER), a term defined in the new Article 12, that provides that the account debtor undertakes to pay the person that has control of the CER under Article 12. A controllable payment intangible means a payment intangible evidenced by a CER that provides that the account debtor undertakes to pay the person that has control of a CER.

Perfection of a security interest in controllable accounts, controllable electronic records, or controllable payment intangibles by filing is allowed, but not necessary. Otherwise, perfection of a security interest in these assets occur through control, as specified in Article 12.

A buyer, other than the secured party, of an electronic document, CER, controllable account, or controllable payment intangible, generally 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 each authoritative electronic copy, CER, controllable account, or controllable payment intangible.

Subject to specified exceptions, the local law of the CER's jurisdiction specified in Article 12 governs the perfection and priority of security interests in controllable accounts, controllable payment intangibles, and CERs.

Article 12—Controllable Electronic Records.

New Article 12 is adopted to govern CERs. A CER means a record stored in an electronic medium that can be subject to control. A CER 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 title, investment property, or a transferable record.

Control of a Controllable Electronic Record.

A person has control of a CER if 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 the ability to avail itself of substantially all the benefit of the electronic record.

The purchaser must also have the exclusive power to:

- prevent others from availing themselves of substantially all the benefit from the electronic record; and
- to transfer control of the electronic record to another person or cause another person to obtain control of another CER as a result of the transfer.

Once it is established that a person has received these powers, a presumption of exclusivity applies. A power is exclusive even if it is shared with another person unless the person can exercise the power only if the power is also exercised by the other person. A person's shared power is not exclusive if the other person can exercise the power alone, without exercise of the power by the person.

Circumstances under which a person may obtain control of a CER through the control of another person are specified.

Discharge of Account Debtor.

An account debtor may discharge its obligation on a controllable account or controllable payment intangible by paying the person that has control of the related CER at the time of payment or that formerly had control of the related CER.

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.

On the account debtor's request, the person giving the notification must furnish reasonable proof that control of the CER has been transferred. If the person does not comply with the request, the account debtor may ignore the notification and discharge its obligation by paying a person formerly in control.

Rights in a Controllable Account, Controllable Electronic Record, or Controllable Payment Intangible.

With some exceptions, a purchaser of a CER acquires an interest in all rights in the CER that the

transferor had, or had the power to transfer.

If the purchaser is a qualifying purchaser, the purchaser acquires its interest in the CER free from competing property claims to the CER. A qualifying purchaser is a purchaser that obtains control of a CER for value, in good faith, and without notice of a property claim to the CER. A limitation on this take-free rule is specified for certain CERs that carry with them rights to other assets, such as goods or rights to payment.

Governing Law.

As a general choice-of-law rule, the local law of a CER's jurisdiction governs the matters covered by Article 12, but an exception is specified for an account debtor's rights and duties, which are governed by the law applicable to the underlying obligation of the account debtor.

Drawing on analogous provisions in other UCC articles, several rules to determine a CER's jurisdiction are specified. If a CER expressly specifies its jurisdiction, perfection and priority are governed by the law of that jurisdiction. Otherwise, the CER's jurisdiction is the jurisdiction whose law governs the system in which the CER is recorded. If no express provision is made in the CER or the system, the CER's jurisdiction is the District of Columbia, regardless of whether or not Article 12 is in effect in the District of Columbia.

Transitional Provisions for Article 9A and Article 12.

Transitional provisions address security interests that are perfected under current Article 9A, but that are made unenforceable or unperfected under Article 9A as amended by the bill, as well as security interests unperfected prior to the effective date of the bill. An adjustment date of at least one year from the effective date of this act, or July 1, 2025, whichever is later, is established. Parties must take steps to satisfy any new perfection requirements by the adjustment date to preserve priorities already established on the effective date of the bill if the priorities would otherwise be affected by the adopted changes.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect on January 1, 2024.