FINAL BILL REPORT
SSB 5077

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Synopsis as Enacted

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).

Senate Committee on Law & Justice
House Committee on Civil Rights & Judiciary

Background: Uniform Law Commission. The Uniform Law Commission (ULC) is a state-supported, nonpartisan, nonprofit organization that drafts and proposes specific statutory language that may be adopted by states.

The Uniform Commercial Code. The Uniform Commercial Code (UCC) is a model code drafted by the ULC in collaboration with the American Law Institute (ALI). The UCC provides a consistent and integrated framework of rules to deal with commercial transactions. All 50 states have adopted the UCC. Since its original promulgation in 1951, the various articles of the UCC have been revised to adapt to changing business practices and developments in the law.

Article 1. Article 1 contains general definitions that apply throughout the UCC unless otherwise provided in another article. Article 1 contains many general principles that apply as default rules to all other articles of UCC unless contrary provisions are specified in those articles.

Article 2. Article 2 governs the sale of goods. It provides default rules that apply when two parties have not comprehensively addressed common issues in a written contract.

Article 2A. Article 2A governs the leases of personal property, such as machinery, equipment, and vehicles.

Article 3. Article 3 contains provisions governing negotiable instruments. In general terms,

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a negotiable instrument is an unconditional promise or order to pay a fixed amount of money, such as a promissory note or a personal check, with or without interest or other charges.

Article 4A. Article 4A governs the rights and responsibilities of parties to a funds transfer executed by or through financial institutions, and includes standards for the issuance, acceptance, execution and enforceability of payment orders. Article 4A also addresses the liabilities of the financial institutions involved in such transactions.

Article 5. Article 5 governs letters of credit. A letter of credit is a promise, or authorization, to honor a demand for payment. The letter of credit may be issued to a customer of a bank, for instance, and contain conditions upon which the bank promises to honor a demand for payment.

Article 7. Article 7 governs documents of title for personal property, including warehouse receipts, bills of lading, and other documents typically used for commercial trade. 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.

Article 8. Article 8 governs transfers of investment securities, including stocks and bonds, mutual fund shares, and United States government securities.

A security entitlement is a property right that a person acquires in the context of a securities account with a securities intermediary. This term includes an investor's account with a broker, and a brokerage firm's account with a depository institution. A security entitlement guarantees an entitlement holder a priority in the financial assets held in that account over the securities intermediary or the creditors of the securities intermediary.

Article 9A. Article 9A governs the creation and operation of security interests in various types of personal property and fixtures. Article 9A provides methods of creating and filing a security interest, and the way a security interest may be perfected. Perfection of a security interest allows a secured creditor to obtain priority over other creditors who have a security interest in the same collateral. Perfection can be achieved by filing a financing statement that indicates the debtor, the secured party, and the property subject to the security interest. Other methods to perfect a security interest include possessing or controlling the collateral.

Proposed 2018 Amendments to the Uniform Commercial Code Article 9A. The “pick-your-partner" principle recognizes that co-owners of small businesses have a substantial interest in determining who the other co-owners are, and divides ownership interests into two parts—an economic interest and a governance interest. An economic interest includes the right to share in any profits and is generally freely transferable personal property. A governance interest includes the right to participate in management decisions and is generally not transferable without the consent of the other co-owners. Only the transferable economic interest may generally be used as collateral in a secured transaction without the consent of the other co-owners.

In 2018, the ULC approved amendments to Article 9A that expressly exempts partnership and LLC interests from the general rule of free transferability and permits restrictions on the transfer of a co-owner's governance interest.

<u>Proposed 2022 Amendments to the Uniform Commercial Code.</u> In July 2022, the ULC approved amendments to the UCC to address emerging technologies. A new Article 12 addresses certain types of digital assets called controllable electronic records (CERs), which include virtual, non-fiat currencies—for example, cryptocurrency; non-fungible tokens; and digital assets in which specific payment rights are embedded. The amendments provide new default rules to govern transactions involving these new technologies so they are capable of being transferred in such a way to cut off competing property claims. The amendments also address security interests in electronic, fiat money; clarifies the UCC's applicability to mixed transactions involving both goods and services; and contain revisions unrelated to technological developments.

Summary: <u>General.</u> *Terminologies.* Various UCC provisions are amended to replace terms that applied only to transactions on paper.

<u>Article 1.</u> *Definitions.* The definition of money is amended to clarify that governmentally created forms of money may be tangible or electronic, and that pre-existing virtual, non-fiat currencies are not money for purposes of the UCC. The definition of signed is expanded to apply not only to a signature in writing, but also to an electronic signature. Examples of what is conspicuous are deleted and replaced with a totality of the circumstances standard. The definition of person is amended to provide that a protected series of a series organization is a person under the UCC.

<u>Articles 2 and 2A.</u> *Hybrid Transactions and Leases.* A hybrid transaction is defined as a single transaction 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.

A hybrid lease is defined as a single transaction 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.

Absent the parties' agreement otherwise, Article 2 and 2A rules will apply to a hybrid transaction or hybrid lease, respectively, if the sale—Article 2 —or lease of goods—Article 2A—is the predominant purpose of the transaction. If the sale or lease of goods is not the predominant purpose of the transaction, the UCC rules will apply only to aspects of the transaction that involve the sale or lease of goods. The finance lease provisions of Article 2A will apply if a lease is a finance lease, regardless of whether the lease-of-goods aspects predominate.

<u>Article 3.</u> *Negotiable Instruments.* A choice-of-law or choice-of-forum clause included in a

negotiable instrument does not affect the negotiability of the instrument.

An image of a negotiable instrument may be substituted for the actual instrument in accordance with federal banking regulations. 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.

<u>Article 4A.</u> *Security Procedures for Funds Transfer.* A security procedure for a funds transfer may require symbols, sounds, or biometrics. Merely verifying an email address, IP address, or telephone number is not a security procedure.

<u>Article 5.</u> *Bank Branches.* A branch of a bank is still considered a separate bank even if a letter of credit issued by a bank indicates multiple addresses.

<u>Article 7.</u> *Electronic Document of Title.* Perfection of a security interest in an electronic document may occur through control. 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. The person must have the exclusive powers to prevent others from adding or changing an identified person to which each authoritative electronic copy has been issued or transferred and to transfer control of each authoritative copy. A person may obtain control of an electronic document of title through another person.

<u>Article 8.</u> *Investment Securities.* A controllable account, controllable electronic record, or controllable payment intangible is not a financial asset unless the intermediary and the person entitled otherwise agree. A purchaser can obtain control of a security entitlement through another person. The local law of the issuer’s jurisdiction or securities intermediary’s jurisdiction governs even if a matter or transaction bears no relation to that jurisdiction.

<u>Article 9A.</u> *Deposit Accounts.* Perfection of a security interest in a deposit account may be obtained through control. A secured party may obtain control of a deposit account through another person, other than the debtor. Clarifications are made so that a transferee of funds from a deposit account can take free of a security interest.

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.

To obtain control of one or more authoritative electronic copies 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.

Electronic Money. 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.

Clarifications are made so that a transferee of money, whether tangible or electronic, can take free of a security interest in the money.

Controllable Electronic Records, Controllable Accounts, and Controllable Payment Intangibles. 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, which can be demonstrated pursuant to Article 12.

Security Interest Attachment as Proceeds. A security interest may attach to consumer goods as proceeds or as commingled goods, to commercial tort claims as proceeds, or under an after-acquired property clause to proceeds of consumer goods or commercial tort claims, regardless of an after-acquired property clause that purports otherwise.

Additional Duties of Secured Parties. Forms notifying a debtor of disposition of collateral and property are updated.

A secured party who has control of an electronic copy of a record evidencing chattel paper, an electronic documents document of title, electronic money, or a controllable electronic record, must transfer such control to a debtor or a person designated by a debtor within ten days of receiving a signed demand by the debtor, if there are no outstanding secured obligations.

Buyers Take Free. Buyers, other than secured parties, of chattel paper, electronic documents, controllable electronic records, controllable accounts, and controllable payment intangibles, generally take free of a security interest if the buyer gives values and obtains control without knowledge of the security interest before it is perfected. A lender with control of digital assets has a perfected security interest with priority over the interests of any other lenders who do not have control.

<u>Proposed 2018 Amendments to Article 9A.</u> *Governance Interests.* Transfers of governance interests in a general partnership, limited partnership, or limited liability company, may be restricted.

<u>Article 12.</u> *Controllable Electronic Records.* Article 12 governing CERs is adopted. 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.

A controllable account means an account evidenced by a CER that provides that the account debtor undertakes to pay the person that has control of the CER.

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.

If a CER is purchased, the purchaser 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 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 have the exclusive power to prevent others from availing themselves of 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. A person must be able to identify itself as the person having such exclusive powers, such as by an identifying number, account number, or cryptographic key. A person may also obtain control of a CER through another person.

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.

An account debtor may discharge its obligation by paying a person 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.

Governing Law. For a CER that expressly provides its jurisdiction, perfection, other than by filing a financing statement, 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 is located in the District of Columbia.

Transitional Provisions. 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 this act if the priorities would otherwise be affected by the changes in this act.

Statutory Construction. Nothing in the bill may be construed to support, endorse, create, or implement a national digital currency.

Votes on Final Passage:

Senate	49	0	
House	70	28	(House amended)
Senate	46	1	(Senate concurred)

Effective: January 1, 2024