

## PART 7

## TRANSITION

## § 9-701. Effective Date.

This [Act] takes effect on July 1, 2001.

**Official Comment**

A uniform law as complex as Article 9 necessarily gives rise to difficult problems and uncertainties during the transition to the new law. As is customary for uniform laws, this Article is based on the general assumption that all States will have enacted substantially identical versions. While always important, uniformity is essential to the success of this Article. If former Article 9 is in effect in some jurisdictions, and this Article is in effect in others, horrendous complications may arise. For example, the proper place in which to file to perfect a security interest (and thus the status of a particular security interest as perfected or unperfected) would depend on whether the matter was litigated in a State in which former Article 9 was in effect or a State in which this Article was in effect. Accordingly, this section contemplates that States will

adopt a uniform effective date for this Article. Any one State's failure to adopt the uniform effective date will greatly increase the cost and uncertainty surrounding the transition.

Other problems arise from transactions and relationships that were entered into under former Article 9 or under non-UCC law and which remain outstanding on the effective date of this Article. The difficulties arise primarily because this Article expands the scope of former Article 9 to cover additional types of collateral and transactions and because it provides new methods of perfection for some types of collateral, different priority rules, and different choice-of-law rules governing perfection and priority. This Section and the other sections in this Part address primarily this second set of problems.

## § 9-702. Savings Clause.

(a) **[Pre-effective-date transactions or liens.]** Except as otherwise provided in this part, this [Act] applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before this [Act] takes effect.

(b) **[Continuing validity.]** Except as otherwise provided in subsection (c) and Sections 9-703 through 9-709:

- (1) transactions and liens that were not governed by [former Article 9], were validly entered into or created before this [Act] takes effect, and would be subject to this [Act] if they had been entered into or created after this [Act] takes effect, and the rights, duties, and interests flowing from those transactions and liens remain valid after this [Act] takes effect; and
- (2) the transactions and liens 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 this [Act] takes effect.

### Official Comment

1. **Pre-Effective-Date Transactions.** Subsection (a) contains the general rule that this Article applies to transactions, security interests, and other liens within its scope (see Section 9-109), even if the transaction or lien was entered into or created before the effective date. Thus, secured transactions entered into under former Article 9 must be terminated, completed, consummated, and enforced under this Article. Subsection (b) is an exception to the general rule. It applies to valid, pre-effective-date transactions and liens that were not governed by former Article 9 but would be governed by this Article if they had been entered into or created after this Article takes effect. Under subsection

(b), these valid transactions, such as the creation of agricultural liens and security interests in commercial tort claims, retain their validity under this Article and may be terminated, completed, consummated, and enforced under this Article. However, these transactions also may be terminated, completed, consummated, and enforced by the law that otherwise would apply had this Article not taken effect.

2. **Judicial Proceedings Commenced Before Effective Date.** As is usual in transition provisions, subsection (c) provides that this Article does not affect litigation pending on the effective date.

## § 9-703. Security Interest Perfected Before Effective Date.

(a) **[Continuing priority over lien creditor: perfection requirements satisfied.]** A security interest that is enforceable immediately before this [Act] takes effect and would have priority over the rights of a person that becomes a lien creditor at that time is a perfected security interest under this [Act] if, when this [Act] takes effect, the applicable requirements for enforceability and perfection under this [Act] are satisfied without further action.

(b) **[Continuing priority over lien creditor: perfection requirements not satisfied.]** Except as otherwise provided in Section 9-705, if, immediately before this [Act] takes effect, a security interest is enforceable and would have priority over the rights of a person that becomes a lien creditor at that time, but the applicable requirements for enforceability or perfection under this [Act] are not satisfied when this [Act] takes effect, the security interest:

- (1) is a perfected security interest for one year after this [Act] takes effect;
- (2) remains enforceable thereafter only if the security interest becomes enforceable under Section 9-203 before the year expires; and
- (3) remains perfected thereafter only if the applicable requirements for perfection under this [Act] are satisfied before the year expires.

### Official Comment

1. **Perfected Security Interests Under Former Article 9 and This Article.** This section deals with security interests that are perfected (i.e., that are enforceable and have priority over the rights of a lien creditor) under former Article 9 or other applicable law immediately before this Article takes effect. Subsection (a) provides, not surprisingly, that if the security interest would be a perfected security interest under this Article (i.e., if the transaction satisfies

this Article's requirements for enforceability (attachment) and perfection), no further action need be taken for the security interest to be a perfected security interest.

2. **Security Interests Enforceable and Perfected Under Former Article 9 but Unenforceable or Unperfected Under This Article.** Subsection (b) deals with security interests that are enforceable and perfected under former Article 9 or other applicable law immediately before this Arti-

cle takes effect but do not satisfy the requirements for enforceability (attachment) or perfection under this Article. Except as otherwise provided in Section 9-705, these security interests are perfected security interests for one year after the effective 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 at the end of the one-year period.

**Example 1:** A pre-effective-date security agreement in a consumer transaction covers "all securities accounts." The security interest is properly perfected. The collateral description was adequate under former Article 9 (see former Section 9-115(3)) but is insufficient under this Article (see Section 9-108(e)(2)). Unless the debtor authenticates a new security agreement describing the collateral other than by "type" (or Section 9-203(b)(3) otherwise is satisfied) within the one-year period following the effective date, the security interest becomes unenforceable at the end of that period.

Other examples under former Article 9 or other applicable law that may be effective as attachment or enforceability steps but may be ineffective under this Article include an oral agreement to sell a payment intangible or possession by virtue of a notification to a bailee under former Section 9-305. Neither the oral agreement nor the notification would satisfy the revised Section 9-203 requirements for attachment.

**Example 2:** A pre-effective-date possessory security interest in instruments is perfected by a bailee's receipt of notification under former 9-305. The bailee has not, however, acknowledged that it holds for

the secured party's benefit under revised Section 9-313. Unless the bailee authenticates a record acknowledging that it holds for the secured party (or another appropriate perfection step is taken) within the one-year period following the effective date, the security interest becomes unperfected at the end of that period.

**3. 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 this Article 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.

**Example 3:** A pre-effective-date security agreement covers "all accounts" of a debtor. As defined under former Article 9, an "account" did not include a right to payment for lottery winnings. These rights to payment are "accounts" under this Article, however. The agreement of the parties presumptively created a security interest in "accounts" as defined in former Article 9. A different result might be appropriate, for example, if the security agreement explicitly contemplated future changes in the Article 9 definitions of types of collateral—e.g., "'Accounts' means 'accounts' as defined in the UCC Article 9 of [State X], as that definition may be amended from time to time." Whether a different approach is appropriate in any given case depends on the bargain of the parties, as determined by applying ordinary principles of contract construction.

## § 9-704. Security Interest Unperfected Before Effective Date.

A security interest that is enforceable immediately before this [Act] takes effect but which would be subordinate to the rights of a person that becomes a lien creditor at that time:

(1) remains an enforceable security interest for one year after this [Act] takes effect;

(2) remains enforceable thereafter if the security interest becomes enforceable under Section 9-203 when this [Act] takes effect or within one year thereafter; and

- (3) becomes perfected:
  - (A) without further action, when this [Act] takes effect 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

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 Article takes effect. These security interests remain enforceable for one year after the effective date, and thereafter if the appropriate steps for attachment under this Article are taken before the one-year period expires. (This section's treatment of enforceability is the same as that of Section 9-703.) 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 this Article. If the security interest does not satisfy the requirements for perfection until some-

time thereafter, it becomes a perfected security interest at that later time.

**Example:** A security interest has attached under former Article 9 but is unperfected because the filed financing statement covers "all of debtor's personal property" and controlling case law in the applicable jurisdiction has determined that this identification of collateral in a financing statement is insufficient. Upon the effective date of this Article, the financing statement becomes sufficient under Section 9-504(2). On that date the security interest becomes perfected. (This assumes, of course, that the financing statement is filed in the proper filing office under this Article.)

### § 9-705. Effectiveness of Action Taken Before Effective Date.

(a) **[Pre-effective-date action; one-year perfection period unless reperfected.]** If action, other than the filing of a financing statement, is taken before this [Act] takes effect and the action would have resulted in priority of a security interest over the rights of a person that becomes a lien creditor had the security interest become enforceable before this [Act] takes effect, the action is effective to perfect a security interest that attaches under this [Act] within one year after this [Act] takes effect. An attached security interest becomes unperfected one year after this [Act] takes effect unless the security interest becomes a perfected security interest under this [Act] before the expiration of that period.

(b) **[Pre-effective-date filing.]** The filing of a financing statement before this [Act] takes effect is effective to perfect a security interest to the extent the filing would satisfy the applicable requirements for perfection under this [Act].

(c) **[Pre-effective-date filing in jurisdiction formerly governing perfection.]** This [Act] does not render ineffective an effective financing statement that, before this [Act] takes effect, is filed and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in [former Section 9-103]. However, except as otherwise provided in subsections (d) and (e) and Section 9-706, the financing statement ceases to be effective at the earlier of:

- (1) the time the financing statement would have ceased to be effective under the law of the jurisdiction in which it is filed; or

(2) June 30, 2006.

(d) **[Continuation statement.]** The filing of a continuation statement after this [Act] takes effect does not continue the effectiveness of the financing statement filed before this [Act] takes effect. However, upon the timely filing of a continuation statement after this [Act] takes effect and in accordance with the law of the jurisdiction governing perfection as provided in Part 3, the effectiveness of a financing statement filed in the same office in that jurisdiction before this [Act] takes effect continues for the period provided by the law of that jurisdiction.

(e) **[Application of subsection (c)(2) to transmitting utility financing statement.]** Subsection (c)(2) applies to a financing statement that, before this [Act] takes effect, is filed against a transmitting utility and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in [former Section 9-103] only to the extent that Part 3 provides that the law of a jurisdiction other than the jurisdiction in which the financing statement is filed governs perfection of a security interest in collateral covered by the financing statement.

(f) **[Application of Part 5.]** A financing statement that includes a financing statement filed before this [Act] takes effect and a continuation statement filed after this [Act] takes effect is effective only to the extent that it satisfies the requirements of Part 5 for an initial financing statement.

#### Official Comment

1. **General.** This section addresses primarily the situation in which the perfection step is taken under former Article 9 or other applicable law before the effective date of this Article, but the security interest does not attach until after that date.

2. **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 Article takes effect, and if a security interest attaches within one year after this Article takes effect, then the security interest becomes a perfected security interest upon attachment. However, the security interest becomes unperfected one year after the effective date unless the requirements for attachment and perfection under this Article are satisfied within that period.

3. **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 (because, e.g., they did not accurately describe the collateral or were

filed in the wrong place), but which would perfect a security interest under this Article. Under subsection (b), such a financing statement is effective to perfect a security interest to the extent it complies with this Article. Subsection (b) applies regardless of the reason for the filing. For example, a secured party need not wait until the effective date to respond to the change this Article makes with respect to the jurisdiction whose law governs perfection of certain security interests. Rather, a secured party may wish to prepare for this change by filing a financing statement before the effective date in the jurisdiction whose law governs perfection under this Article. When this Article takes effect, the filing becomes effective to perfect a security interest (assuming the filing satisfies the perfection requirements of this Article). Note, however, that Section 9-706 determines whether a financing statement filed before the effective date operates to continue the effectiveness of a financing statement filed in another office before the effective date.

4. **Perfection by Filing: Change in Applicable Law or Filing Office.** Subsec-

tion (c) provides that a financing statement filed in the proper jurisdiction under former Section 9-103 remains effective for all purposes, despite the fact that this Article would require filing of a financing statement in a different jurisdiction or in a different office in the same jurisdiction. This means that, during the early years of this Article's effectiveness, it may be necessary to search not only in the filing office of the jurisdiction whose law governs perfection under this Article but also (if different) in the jurisdiction(s) and filing office(s) designated by Article 9. To limit this burden, subsection (c) provides that a financing statement filed in the jurisdiction determined by former Section 9-103 becomes ineffective at the earlier of the time it would become ineffective under the law of that jurisdiction or June 30, 2006. The June 30, 2006, limitation addresses some nonuniform versions of former Article 9 that extended the effectiveness of a financing statement beyond five years. Note that a financing statement filed before the effective date may remain effective beyond June 30, 2006, if subsection (d) (concerning continuation statements) or (e) (concerning transmitting utilities) or Section 9-706 (concerning initial financing statements that operate to continue pre-effective-date financing statements) so provides.

Subsection (c) is an exception to Section 9-703(b). Under the general rule in Section 9-703(b), a security interest that is enforceable and perfected on the effective date of this Article is a perfected security interest for one year after this Article takes effect, even if the security interest is not enforceable under this Article and the applicable requirements for perfection under this Article have not been met. However, in some cases subsection (c) may shorten the one-year period of perfection; in others, if the security interest is enforceable under Section 9-203, it may extend the period of perfection.

**Example 1:** On July 3, 1996, D, a State X corporation, creates a security interest in certain manufacturing equipment located in State Y. On July 6, 1996, SP perfects a security interest in the equipment under former Article 9 by filing in the office of the State Y Secretary of State. See former

Section 9-103(1)(b). This Article takes effect in States X and Y on July 1, 2001. Under Section 9-705(c), the financing statement remains effective until it lapses in July 2001. See former Section 9-403. Had SP continued the effectiveness of the financing statement by filing a continuation statement in State Y under former Article 9 before July 1, 2001, the financing statement would have remained effective to perfect the security interest through June 30, 2006. See subsection (c)(2). Alternatively, SP could have filed an initial financing statement in State X under subsection (b) or Section 9-706 before the State Y financing statement lapsed. Had SP done so, the security interest would have remained perfected without interruption until the State X financing statement lapsed.

**5. Continuing Effectiveness of Filed Financing Statement.** A financing statement filed before the effective date of this Article may be continued only by filing in the State and office designated by this Article. This result is accomplished in the following manner: Subsection (d) indicates that, as a general matter, a continuation statement filed after the effective date of this Article does not continue the effectiveness of a financing statement filed under the law designated by former Section 9-103. Instead, an initial financing statement must be filed under Section 9-706. The second sentence of subsection (d) contains an exception to the general rule. It provides that a continuation statement is effective to continue the effectiveness of a financing statement filed before this Article takes effect if this Article prescribes not only the same jurisdiction but also the same filing office.

**Example 2:** On November 8, 2000, D, a State X corporation, creates a security interest in certain manufacturing equipment located in State Y. On November 15, 2000, SP perfects a security interest in the equipment under former Article 9 by filing in office of the State Y Secretary of State. See former Section 9-103(1)(b). This Article takes effect in States X and Y on July 1, 2001. Under Section 9-705(c), the financing statement ceases to be effective in November, 2005, when it lapses. See Sec-

tion 9-515. Under this Article, the law of D's location (State X, see Section 9-307) governs perfection. See Section 9-301. Thus, the filing of a continuation statement in State Y after the effective date would not continue the effectiveness of the financing statement. See subsection (d). However, the effectiveness of the financing statement could be continued under Section 9-706.

**Example 3:** The facts are as in Example 2, except that D is a State Y corporation. Assume State Y adopted former Section 9-401(1) (second alternative). State Y law governs perfection under Part 3 of this Article. (See Sections 9-301, 9-307.) Under the second sentence of subsection (d), the timely filing of a continuation statement in accordance with the law of State Y continues the effectiveness of the financing statement.

**Example 4:** The facts are as in Example 3, except that the collateral is equipment used in farming operations and, in accordance with former Section 9-401(1) (second alternative) as enacted in State Y, the financing statement was filed in State Y, in the office of the Shelby County Recorder of Deeds. Under this Article, a continuation statement must be filed in the office of the State Y Secretary of State. See Section 9-501(a)(2). Under the second sentence of subsection (d), the timely filing of a continuation statement in accordance with the law of State Y operates to continue a pre-effective-date financing statement only if the continuation statement is filed in the same office as the financing statement. Accordingly, the continuation statement is not effective in this case, but the financing statement may be continued under Section 9-706.

**Example 5:** The facts are as in Example 3, except that State Y enacted former Section 9-401(1) (third alternative). As required by former Section 9-401(1), SP filed financing statements in both the office of the State Y Secretary of State and the office of the Shelby County Recorder of Deeds. Under this Article, a continuation statement must be filed in the office of the State Y Secretary of State. See Section 9-501(a)(2). The timely filing of a

continuation statement in that office after this Article takes effect would be effective to continue the effectiveness of the financing statement (and thus continue the perfection of the security interest), even if the financing statement filed with the County Recorder lapses.

**6. Continuation Statements.** In some cases, this Article reclassifies collateral covered by a financing statement filed under former Article 9. For example, collateral consisting of the right to payment for real property sold would be a "general intangible" under the former Article but an "account" under this Article. To continue perfection under those circumstances, a continuation statement must comply with the normal requirements for a continuation statement. See Section 9-515. In addition, the pre-effective-date financing statement and continuation statement, taken together, must satisfy the requirements of this Article concerning the sufficiency of the debtor's name, secured party's name, and indication of collateral. See subsection (f).

**Example 6:** A pre-effective-date financing statement covers "all general intangibles" of a debtor. As defined under former Article 9, a "general intangible," would include rights to payment for lottery winnings. These rights to payment are "accounts" under this Article, however. A post-effective-date continuation statement will not continue the effectiveness of the pre-effective-date financing statement with respect to lottery winnings unless it amends the indication of collateral covered to include lottery winnings (e.g., by adding "accounts," "rights to payment for lottery winnings," or the like). If the continuation statement does not amend the indication of collateral, the continuation statement will be effective to continue the effectiveness of the financing statement only with respect to "general intangibles" as defined in this Article.

**Example 7:** The facts are as in Example 6, except that the pre-effective-date financing statement covers "all accounts and general intangibles." Even though rights to payment for lottery winnings are "general intangibles" under former Arti-

cle 9 and "accounts" under this Article, a post-effective-date continuation statement would continue the effectiveness of the pre-effective-date financing statement with respect to lottery winnings. There

would be no need to amend the indication of collateral covered, inasmuch as the indication ("accounts") satisfies the requirements of this Article.

**§ 9-706. When Initial Financing Statement Suffices to Continue Effectiveness of Financing Statement.**

(a) **[Initial financing statement in lieu of continuation statement.]** The filing of an initial financing statement in the office specified in Section 9-501 continues the effectiveness of a financing statement filed before this [Act] takes effect if:

- (1) the filing of an initial financing statement in that office would be effective to perfect a security interest under this [Act];
- (2) the pre-effective-date financing statement was filed in an office in another State or another office in this State; and
- (3) the initial financing statement satisfies subsection (c).

(b) **[Period of continued effectiveness.]** The filing of an initial financing statement under subsection (a) continues the effectiveness of the pre-effective-date financing statement:

- (1) if the initial financing statement is filed before this [Act] takes effect, for the period provided in [former Section 9-403] with respect to a financing statement; and
- (2) if the initial financing statement is filed after this [Act] takes effect, for the period provided in Section 9-515 with respect to an initial financing statement.

(c) **[Requirements for initial financing statement under subsection (a).]** To be effective for purposes of subsection (a), an initial financing statement must:

- (1) satisfy the requirements of Part 5 for an initial financing statement;
- (2) identify the pre-effective-date financing statement by indicating the office in which the financing statement was filed and providing the dates of filing and file numbers, if any, of the financing statement and of the most recent continuation statement filed with respect to the financing statement; and
- (3) indicate that the pre-effective-date financing statement remains effective.

**Official Comment**

1. **Continuation of Financing Statements Not Filed in Proper Filing Office Under This Article.** This section deals with continuing the effectiveness of financing statements that are filed in the proper State and office under former Article 9, but which would be filed in the wrong State or in the wrong office of the proper State under this Article. Section 9-705(d) provides that,

under these circumstances, filing a continuation statement after the effective date of this Article in the office designated by former Article 9 would not be effective. This section provides the means by which the effectiveness of such a financing statement can be continued if this Article governs perfection under the applicable choice-of-law rule: filing



an initial financing statement in the office specified by Section 9-501.

Although it has the effect of continuing the effectiveness of a pre-effective-date financing statement, an initial financing statement described in this section is not a continuation statement. Rather, it is governed by the rules applicable to initial financing statements. (However, the debtor need not authorize the filing. See Section 9-707.) Unlike a continuation statement, the initial financing statement described in this section may be filed any time during the effectiveness of the pre-effective-date financing statement—even before this Article is enacted—and not only within the six months immediately prior to lapse. In contrast to a continuation statement, which extends the lapse date of a filed financing statement for five years, the initial financing statement has its own lapse date, which bears no relation to the lapse date of the pre-effective-date financing statement whose effectiveness the initial financing statement continues. See subsection (b).

As subsection (a) makes clear, the filing of an initial financing statement under this section *continues* the effectiveness of a pre-effective-date financing statement. If the effectiveness of a pre-effective-date financing statement lapses before the initial financing statement is filed, the effectiveness of the pre-effective-date financing statement cannot be continued. Rather, unless the security interest is perfected otherwise, there will be a period during which the security interest is unperfected before becoming perfected again by the filing of the initial financing statement under this section.

If an initial financing statement is filed under this section before the effective date of this Article, it takes effect when this Article takes effect (assuming that it is ineffective under former Article 9). Note, however, that

former Article 9 determines whether the filing office is obligated to accept such an initial financing statement. For the reason given in the preceding paragraph, an initial financing statement filed before the effective date of this Article does not continue the effectiveness of a pre-effective-date financing statement unless the latter remains effective on the effective date of this Article. Thus, for example, if the effectiveness of the pre-effective-date financing statement lapses before this Article takes effect, the initial financing statement would not continue its effectiveness.

**2. Requirements of Initial Financing Statement Filed in Lieu of Continuation Statement.** Subsection (c) sets forth the requirements for the initial financing statement under subsection (a). These requirements are needed to inform searchers that the initial financing statement operates to continue a financing statement filed elsewhere and to enable searchers to locate and discover the attributes of the other financing statement. A single initial financing statement may continue the effectiveness of more than one financing statement filed before this Article's effective date. See Section 1-102(5)(a) (words in the singular include the plural). If a financing statement has been filed in more than one office in a given jurisdiction, as may be the case if the jurisdiction had adopted former Section 9-401(1), third alternative, then an identification of the filing in the central filing office suffices for purposes of subsection (c)(2). If under this Article the collateral is of a type different from its type under former Article 9—as would be the case, e.g., with a right to payment of lottery winnings (a “general intangible” under former Article 9 and an “account” under this Article), then subsection (c) requires that the initial financing statement indicate the type under this Article.

### § 9-707. Amendment of Pre-Effective-Date Financing Statement.

(a) [“**Pre-effective-date financing statement**”.] In this section, “Pre-effective-date financing statement” means a financing statement filed before this [Act] takes effect.

(b) [Applicable law.] After this [Act] takes effect, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or otherwise amend the information provided in, a pre-effective-date financing statement only in

accordance with the law of the jurisdiction governing perfection as provided in Part 3. However, the effectiveness of a pre-effective-date financing statement also may be terminated in accordance with the law of the jurisdiction in which the financing statement is filed.

(c) **[Method of amending: general rule.]** Except as otherwise provided in subsection (d), if the law of this State governs perfection of a security interest, the information in a pre-effective-date financing statement may be amended after this [Act] takes effect only if:

(1) the pre-effective-date financing statement and an amendment are filed in the office specified in Section 9-501;

(2) an amendment is filed in the office specified in Section 9-501 concurrently with, or after the filing in that office of, an initial financing statement that satisfies Section 9-706(c); or

(3) an initial financing statement that provides the information as amended and satisfies Section 9-706(c) is filed in the office specified in Section 9-501.

(d) **[Method of amending: continuation.]** If the law of this State governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement may be continued only under Section 9-705(d) and (f) or 9-706.

(e) **[Method of amending: additional termination rule.]** Whether or not the law of this State governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement filed in this State may be terminated after this [Act] takes effect by filing a termination statement in the office in which the pre-effective-date financing statement is filed, unless an initial financing statement that satisfies Section 9-706(c) has been filed in the office specified by the law of the jurisdiction governing perfection as provided in Part 3 as the office in which to file a financing statement.

#### Official Comment

1. **Scope of This Section.** This section addresses post-effective-date amendments to pre-effective-date financing statements.

2. **Applicable Law.** Determining how to amend a pre-effective-date financing statement requires one first to determine the jurisdiction whose law applies. Subsection (b) provides that, as a general matter, post-effective-date amendments to pre-effective-date financing statements are effective only if they are accomplished in accordance with the substantive (or local) law of the jurisdiction governing perfection under Part 3 of this Article. However, under certain circumstances, the effectiveness of a financing statement may be terminated in accordance with the substantive law of the jurisdiction in which the financing statement is filed. See Comment 5, below.

**Example 1:** D is a corporation organized under the law of State Y. It owns equipment located in State X. Under former Article 9, SP properly perfected a security interest in the equipment by filing a financing statement in State X. Under this Article, the law of State Y governs perfection of the security interest. See Sections 9-301, 9-307. After this Article takes effect, SP wishes to amend the financing statement to reflect a change in D's name. Under subsection (b), the financing statement may be amended in accordance with the law of State Y, i.e., in accordance with subsection (c) as enacted in State Y.

**Example 2:** The facts are as in Example 1, except that SP wishes to terminate the effectiveness of the State X filing. The first sentence of subsection (b) provides that the financing statement may be ter-

minated after the effective date of this Article in accordance with the law of State Y, i.e., in accordance with subsection (c) as enacted in State Y. However, the second sentence provides that the financing statement also may be terminated in accordance with the law of the jurisdiction in which it is filed, i.e., in accordance with subsection (e) as enacted in State X. If the pre-effective-date financing statement is filed in the jurisdiction whose law governs perfection (here, State Y), then both sentences would designate the law of State Y as applicable to the termination of the financing statement. That is, the financing statement could be terminated in accordance with subsection (c) or (e) as enacted in State Y.

**3. Method of Amending.** Subsection (c) provides three methods of effectuating a post-effective-date amendment to a pre-effective-date financing statement. Under subsection (c)(1), if the financing statement is filed in the jurisdiction and office determined by this Article, then an effective amendment may be filed in the same office.

**Example 3:** D is a corporation organized under the law of State Z. It owns equipment located in State Z. Before the effective date of this Article, SP perfected a security interest in the equipment by filing in two offices in State Z, a local filing office and the office of the Secretary of State. See former Section 9-401(1) (third alternative). State Z enacts this Article and specifies in Section 9-501 that a financing statement covering equipment is to be filed in the office of the Secretary of State. SP wishes to assign its power as secured party of record. Under subsection (b), the substantive law of State Z applies. Because the pre-effective-date financing statement is filed in the office specified in subsection (c)(1) as enacted by State Z, SP may effectuate the assignment by filing an amendment under Section 9-514 with the office of the Secretary of State. SP need not amend the local filing, and the priority of the security interest perfected by the filing of the financing statement would not be affected by the failure to amend the local filing.

If a pre-effective-date financing statement is filed in an office other than the one specified by Section 9-501 of the relevant jurisdiction, then ordinarily an amendment filed in that office is ineffective. (Subsection (e) provides an exception for termination statements.) Rather, the amendment must be effectuated by a filing in the jurisdiction and office determined by this Article. That filing may consist of an initial financing statement followed by an amendment, an initial financing statement together with an amendment, or an initial financing statement that indicates the information provided in the financing statement, as amended. Subsection (c)(2) encompasses the first two options; subsection (c)(3) contemplates the last. In each instance, the initial financing statement must satisfy Section 9-706(c).

**4. Continuation.** Subsection (d) refers to the two methods by which a secured party may continue the effectiveness of a pre-effective-date financing statement under this Part. The Comments to Sections 9-705 and 9-706 explain these methods.

**5. Termination.** The effectiveness of a pre-effective-date financing statement may be terminated pursuant to subsection (c). This section also provides an alternative method for accomplishing this result: filing a termination statement in the office in which the financing statement is filed. The alternative method becomes unavailable once an initial financing statement that relates to the pre-effective-date financing statement and satisfies Section 9-706(c) is filed in the jurisdiction and office determined by this Article.

**Example 4:** The facts are as in Example 1, except that SP wishes to terminate a financing statement filed in State X. As explained in Example 1, the financing statement may be amended in accordance with the law of the jurisdiction governing perfection under this Article, i.e., in accordance with the substantive law of State Y. As enacted in State Y, subsection (c)(1) is inapplicable because the financing statement was not filed in the State Y filing office specified in Section 9-501. Under subsection (c)(2), the financing statement may be amended by filing in the State Y filing office an initial financing statement

followed by a termination statement. The filing of an initial financing statement together with a termination statement also would be legally sufficient under subsection (c)(2), but Section 9-512(a)(1) may render this method impractical. The financing statement also may be amended under subsection (c)(3), but the resulting initial financing statement is likely to be very confusing. In each instance, the initial financing statement must satisfy Section 9-706(c). Applying the law of State Y, subsection (e) is inapplicable, because the financing statement was not filed in "this State," i.e., State Y.

This section affords another option to SP. Subsection (b) provides that the effectiveness of a financing statement may be ter-

minated either in accordance with the law of the jurisdiction governing perfection (here, State Y) or in accordance with the substantive law of the jurisdiction in which the financing statement is filed (here, State X). Applying the law of State X, the financing statement is filed in "this State," i.e., State X, and subsection (e) applies. Accordingly, the effectiveness of the financing statement can be terminated by filing a termination statement in the State X office in which the financing statement is filed, unless an initial financing statement that relates to the financing statement and satisfies Section 9-706(c) as enacted in State X has been filed in the jurisdiction and office determined by this Article (here, the State Y filing office).

### § 9-708. Persons Entitled to File Initial Financing Statement or Continuation Statement.

A person may file an initial financing statement or a continuation statement under this part if:

- (1) the secured party of record authorizes the filing; and
- (2) the filing is necessary under this part:
  - (A) to continue the effectiveness of a financing statement filed before this [Act] takes effect; or
  - (B) to perfect or continue the perfection of a security interest.

#### Official Comment

This section permits a secured party to file an initial financing statement or continuation statement necessary under this Part to continue the effectiveness of a financing statement filed before this Article takes effect or to perfect or otherwise continue the

perfection of a security interest. Because a filing described in this section typically operates to continue the effectiveness of a financing statement whose filing the debtor already has authorized, this section does not require authorization from the debtor.

### § 9-709. Priority.

(a) **[Law governing priority.]** This [Act] determines the priority of conflicting claims to collateral. However, if the relative priorities of the claims were established before this [Act] takes effect, [former Article 9] determines priority.

(b) **[Priority if security interest becomes enforceable under Section 9-203.]** For purposes of Section 9-322(a), the priority of a security interest that becomes enforceable under Section 9-203 of this [Act] dates from the time this [Act] takes effect if the security interest is perfected under this [Act] by the filing of a financing statement before this [Act] takes effect which would not have been effective to perfect the security interest under [former Article 9]. This subsection does not apply to conflicting security interests each of which is perfected by the filing of such a financing statement.

## Official Comment

1. **Law Governing Priority.** Ordinarily, this Article determines the priority of conflicting claims to collateral. However, when the relative priorities of the claims were established before this Article takes effect, former Article 9 governs.

**Example 1:** In 1999, SP-1 obtains a security interest in a right to payment for goods sold ("account"). SP-1 fails to file a financing statement. This Article takes effect on July 1, 2001. Thereafter, on August 1, 2001, D creates a security interest in the same account in favor of SP-2, who files a financing statement. This Article determines the relative priorities of the claims. SP-2's security interest has priority under Section 9-322(a)(1).

**Example 2:** In 1999, SP-1 obtains a security interest in a right to payment for goods sold ("account"). SP-1 fails to file a financing statement. In 2000, D creates a security interest in the same account in favor of SP-2, who likewise fails to file a financing statement. This Article takes effect on July 1, 2001. Because the relative priorities of the security interests were established before the effective date of this Article, former Article 9 governs priority, and SP-1's security interest has priority under former Section 9-312(5)(b).

**Example 3:** The facts are as in Example 2, except that, on August 1, 2001, SP-2 files a proper financing statement under this Article. Until August 1, 2001, the relative priorities of the security interests were established before the effective date of this Article, as in Example 2. However, by taking the affirmative step of filing a financing statement, SP-2 established anew the relative priority of the conflicting claims after the effective date. Thus, this Article determines priority. SP-2's security interest has priority under Section 9-322(a)(1).

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 unperfected 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.

One consequence of the rule in subsection (a) is that the mere taking effect of this Article does not of itself adversely affect the priority of conflicting claims to collateral.

**Example 4:** In 1999, SP-1 obtains a security interest in a right to payment for lottery winnings (a "general intangible" as defined in former Article 9 but an "account" as defined in this Article). SP-1's security interest is unperfected because its filed financing statement covers only "accounts." In 2000, D creates a security interest in the same right to payment in favor of SP-2, who files a financing statement covering "accounts and general intangibles." Before this Article takes effect on July 1, 2001, SP-2's perfected security interest has priority over SP-1's unperfected security interest under former 9-312(5). Because the relative priorities of the security interests were established before the effective date of this Article, former Article 9 continues to govern priority after this Article takes effect. Thus, SP-2's priority is not adversely affected by this Article's having taken effect.

Note that were this Article to govern priority, SP-2 would become subordinated to SP-1 under Section 9-322(a)(1), even though nothing changes other than this Article's having taken effect. Under Section 9-704, SP-1's security interest would become perfected; the financing statement covering "accounts" adequately covers the lottery winnings and complies with the other perfection requirements of this Article, e.g., it is filed in the proper office.

**Example 5:** In 1999, SP-1 obtains a security interest in a right to payment for lottery winnings—a "general intangible" (as defined under former Article 9). SP-1's security interest is unperfected because its filed financing statement covers only "accounts." In 2000, D creates a security interest in the same right to payment in favor of SP-2, who makes the same mistake and also files a financing statement covering only "accounts." Before this Arti-

cle takes effect on July 1, 2001, SP-1's unperfected security interest has priority over SP-2's unperfected security interest, because SP-1's security interest was the first to attach. See former Section 9-312(5)(b). Because the relative priorities of the security interests were established before the effective date of this Article, former Article 9 continues to govern priority after this Article takes effect. Although Section 9-704 makes both security interests perfected for purposes of this Article, both are unperfected under former Article 9, which determines their relative priorities.

**2. Financing Statements Ineffective Under Former Article 9 but Effective Under This Article.** If this Article determines priority, subsection (b) may apply. It deals with the case in which a filing that occurs before the effective date of this Article would be ineffective to perfect a security interest under former Article 9 but effective under this Article. For purposes of Section 9-322(a), the priority of a security interest that attaches after this Article takes effect and is perfected in this manner dates from the time this Article takes effect.

**Example 6:** In 1999, SP-1 obtains a security interest in D's existing and after-acquired instruments and files a financing statement covering "instruments." In 2000, D grants a security interest in its existing and after-acquired accounts in favor of SP-2, who files a financing statement covering "accounts." After this Article takes effect on July 1, 2001, one of D's account debtors gives D a negotiable note

to evidence its obligation to pay an overdue account. Under the first-to-file-or-perfect rule in Section 9-322(a), SP-1 would have priority in the instrument, which constitutes SP-2's proceeds. SP-1's filing in 1999 was earlier than SP-2's in 2000. However, subsection (b) provides that, for purposes of Section 9-322(a), SP-1's priority dates from the time this Article takes effect (July 1, 2001). Under Section 9-322(b), SP-2's priority with respect to the proceeds (instrument) dates from its filing as to the original collateral (accounts). Accordingly, SP-2's security interest would be senior.

Subsection (b) does not apply to conflicting security interests each of which is perfected by a pre-effective-date filing that was not effective under former Article 9 but is effective under this Article.

**Example 7:** In 1999, SP-1 obtains a security interest in D's existing and after-acquired instruments and files a financing statement covering "instruments." In 2000, D grants a security interest in its existing and after-acquired instruments in favor of SP-2, who files a financing statement covering "instruments." After this Article takes effect on July 1, 2001, one of D's account debtors gives D a negotiable note to evidence its obligation to pay an overdue account. Under the first-to-file-or-perfect rule in Section 9-322(a), SP-1 would have priority in the instrument. Both filings are effective under this Article, see Section 9-705(b), and SP-1's filing in 1999 was earlier than SP-2's in 2000. Subsection (b) does not change this result.

## APPENDIX I

### CONFORMING AMENDMENTS TO OTHER ARTICLES

#### § 1-105. Territorial Application of the Act; Parties' Power to Choose Applicable Law.

\* \* \*

(2) Where one of the following provisions of this Act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. Section 2-402.

Applicability of the Article on Leases. Sections 2A-105 and 2A-106.

Applicability of the Article on Bank Deposits and Collections. Section 4-102.

Governing law in the Article on Funds Transfers. Section 4A-507.

Letters of Credit. Section 5-116.

Bulk sales subject to the Article on Bulk Sales. Section 6-103. [*If a State adopts the repealer of Article 6, then this item should be deleted.*]

Applicability of the Article on Investment Securities. Section 8-110.

~~Perfection provisions of the Article on Secured Transactions. Section 9-103.~~

Law governing perfection, the effect of perfection or nonperfection, and the priority of security interests and agricultural liens. Sections 9-301 through 9-307.

Official Comment

\* \* \*

6. ~~Section 9-103~~ Sections 9-301 through 9-307 should be consulted as to the rules for

perfection of security interests and agricultural liens and the effects, the effect of perfection and nonperfection, and priority.

§ 1-201. General Definitions.

Subject to additional definitions contained in the subsequent Articles of this Act which are applicable to specific Articles or Parts thereof, and unless the context otherwise requires, in this Act:

\* \* \*

(9) “Buyer in ordinary course of business” means a person who that buys goods in good faith, and without knowledge that the sale to him is in violation of violates the ownership rights or security interest of a third party another person in the goods, and buys in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller’s own usual or customary practices. A person that sells oil, gas, or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind. “Buying” A buyer in ordinary course of business may be buy for cash, or by exchange of other property, or on secured or unsecured credit, and includes receiving may acquire goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under Article 2 may be a buyer in ordinary course of business. A person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt is not a buyer in ordinary course of business.

\* \* \*

(32) “Purchase” includes taking by sale, discount, negotiation, mortgage, pledge, lien, security interest, issue, or re-issue, gift, or any other voluntary transaction creating an interest in property.

\* \* \*

(37) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. ~~The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2-401) is limited in effect to a reservation of a "security interest".~~ The term also includes any interest of a consignor and a buyer of accounts, or chattel paper, which a payment intangible, or a promissory note in a transaction that is subject to Article 9. The special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 2-401 is not a "security interest", but a buyer may also acquire a "security interest" by complying with Article 9. ~~Unless a consignment is intended as security, reservation of title thereunder is not a "security interest", but a consignment in any event is subject to the provisions on consignment sales (Section 2-326).~~ Except as otherwise provided in Section 2-505, the right of a seller or lessor of goods under Article 2 or 2A to retain or acquire possession of the goods is not a "security interest", but a seller or lessor may also acquire a "security interest" by complying with Article 9. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2-401) is limited in effect to a reservation of a "security interest".

\* \* \*

#### Official Comment

\* \* \*

9. "Buyer in Ordinary Course of Business." From Section 1, Uniform Trust Receipts Act. The definition has been expanded to make clear the type of person protected. Its major significance lies in Section 2-403 and in the Article on Secured Transactions (Article 9).

~~The reference to minerals and the like makes clear that a buyer in ordinary course buying minerals under the circumstances described takes free of a prior mortgage created by the sellers. See Comment to Section 9-103.~~

~~A pawnbroker cannot be a buyer in ordinary course of business because the person from whom he buys goods (or acquires ownership after foreclosing an initial pledge) is typically an ordinary user and not a person engaged in selling goods of that kind.~~

The first sentence of paragraph (9) makes clear that a buyer from a pawnbroker cannot be a buyer in ordinary course of business. The second sentence tracks Section 6-102(1)(m). It explains what it means to buy "in the ordinary course." The penultimate sentence prevents a buyer that does not have the right to possession as against the

seller from being a buyer in ordinary course of business. Concerning when a buyer obtains possessory rights, see Sections 2-502 and 2-716. However, the penultimate sentence is not intended to affect a buyer's status as a buyer in ordinary course of business in cases (such as a "drop shipment") involving delivery by the seller to a person buying from the buyer or a donee from the buyer. The requirement relates to whether as against the seller the buyer or one taking through the buyer has possessory rights.

\* \* \*

32. "Purchase." Section 58, Uniform Warehouse Receipts Act; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. Rephrased: With the addition of taking "by . . . security interest," the revised definition makes explicit what formerly was implicit.

\* \* \*

37. "Security Interest." See Section 1, Uniform Trust Receipts Act. ~~The present definition is elaborated, in view especially of the complete coverage of the subject in Article 9. Notice that in view of the Article the~~



~~term includes the interest of certain outright buyers of certain kinds of property. Section 1-201(37) is being amended at the same time that the Article on Leases (Article 2A) is being promulgated as an amendment to this Act. The definition of "security interest" was revised in connection with the promulgation of Article 2A and also to take account of the expanded scope of Article 9 as revised in the 1998 Official Text. It includes the interest of a consignor and the interest of a buyer of accounts, chattel paper, pay-~~

~~ment intangibles, or promissory notes. See Section 9-109. It also makes clear that, with certain exceptions, *in rem* rights of sellers and lessors under Articles 2 and 2A are not "security interests." Among the rights that are not security interests are the right to withhold delivery under Section 2-702(1), 2-703(a), or 2A-525, the right to stop delivery under Section 2-705 or 2A-526, and the right to reclaim under Section 2-507(2) or 2-702(2).~~

\* \* \*

### § 2-103. Definitions and Index of Definitions.

\* \* \*

(3) The following definitions in other Articles apply to this Article:

"Check". Section 3-104.

"Consignee". Section 7-102.

"Consignor". Section 7-102.

"Consumer goods". Section ~~9-109~~ 9-102.

"Dishonor". Section ~~3-507~~ 3-502.

"Draft". Section 3-104.

\* \* \*

### § 2-210. Delegation of Performance; Assignment of Rights.

\* \* \*

(2) ~~Unless~~ Except as otherwise provided in Section 9-406, unless otherwise agreed, all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance. A right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise.

(3) The creation, attachment, perfection, or enforcement of a security interest in the seller's interest under a contract is not a transfer that materially changes the duty of or increases materially the burden or risk imposed on the buyer or impairs materially the buyer's chance of obtaining return performance within the purview of subsection (2) unless, and then only to the extent that, enforcement actually results in a delegation of material performance of the seller. Even in that event, the creation, attachment, perfection, and enforcement of the security interest remain effective, but (i) the seller is liable to the buyer for damages caused by the delegation to the extent that the damages could not reasonably be prevented by the buyer, and (ii) a court having jurisdiction may grant other appropriate relief,

including cancellation of the contract for sale or an injunction against enforcement of the security interest or consummation of the enforcement.

\* \* \*

*Legislative Note: Succeeding subsections must be renumbered.*

#### Official Comment

3. Under subsection (2) rights which are no longer executory such as a right to damages for breach or a right to payment of an "account" as defined in the Article on Secured Transactions (Article 9) may be assigned although the agreement prohibits assignment. In such cases no question of delegation of any performance is involved. The assignment of a "contract right" as

~~defined in the Article on Secured Transactions (Article 9) is not covered by this subsection.~~ Subsection (2) is subject to Section 9-406, which makes rights to payment for goods sold ("accounts"), whether or not earned, freely alienable notwithstanding a contrary agreement or rule of law.

\* \* \*

### § 2-312. Warranty of Title and Against Infringement; Buyer's Obligation Against Infringement.

\* \* \*

#### Official Comment

\* \* \*

5. Subsection (2) recognizes that sales by sheriffs, executors, certain foreclosing lienors and persons similarly situated ~~are~~ may be so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right. This subsection does not touch upon and leaves open all questions of restitution arising in such cases, when a unique article so sold is reclaimed by a third party as the rightful owner.

Foreclosure sales under Article 9 are another matter. Section 9-610 provides that a disposition of collateral under that section includes warranties such as those imposed by this section on a voluntary disposition of property of the kind involved. Consequently, unless properly excluded under subsection (2) or under the special provisions for exclusion in Section 9-610, a disposition under Section 9-610 of collateral consisting of goods includes the warranties imposed by subsection (1) and, if applicable, subsection (3).

\* \* \*

### § 2-326. Sale on Approval and Sale or Return; Consignment Sales and Rights of Creditors.

(1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is

- (a) a "sale on approval" if the goods are delivered primarily for use, and
- (b) a "sale or return" if the goods are delivered primarily for resale.

(2) ~~Except as provided in subsection (3),~~ Goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

(3) ~~Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name~~

~~other than the name of the person making delivery, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as "on consignment" or "on memorandum". However, this subsection is not applicable if the person making delivery~~

- ~~(a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or~~
- ~~(b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or~~
- ~~(c) complies with the filing provisions of the Article on Secured Transactions (Article 9).~~

~~(4)(3) Any "or return" term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section of this Article (Section 2-201) and as contradicting the sale aspect of the contract within the provisions of this Article on parol or extrinsic evidence (Section 2-202).~~

#### Official Comment

1. A Both a "sale on approval" or and a "sale or return" is distinct should be distinguished from other types of transactions with which they frequently have frequently been confused. The type of "sale on approval," "on trial" or "on satisfaction" dealt A "sale on approval," sometimes also called a sale "on trial" or "on satisfaction," deals with a contract under which the seller undertakes a particular business risk in order to satisfy his its prospective buyer with the appearance or performance of the goods in question that are sold. The goods are delivered to the proposed purchaser but they remain the property of the seller until the buyer accepts them. The price has already been agreed. The buyer's willingness to receive and test the goods is the consideration for the seller's engagement to deliver and sell. The type of "sale or return" involved herein A "sale or return," on the other hand, typically is a sale to a merchant whose unwillingness to buy is overcome only by the seller's engagement to take back the goods (or any commercial unit of goods) in lieu of payment if they fail to be resold. A sale or return is a present sale of goods which may be undone at the buyer's option. Accordingly, subsection (2) provides that goods delivered on approval are not subject to the prospective buyer's creditors until acceptance, and goods delivered in a sale or return are

subject to the buyer's creditors while in the buyer's possession.

These two transactions are so strongly delineated in practice and in general understanding that every presumption runs against a delivery to a consumer being a "sale or return" and against a delivery to a merchant for resale being a "sale on approval."

2. The right to return goods for failure to conform to the contract of sale does not make the transaction a "sale on approval" or "sale or return" and has nothing to do with this section ~~and the following section or Section 2-327. The present This section is not concerned with remedies for breach of contract. It deals instead with a power given by the contract to turn back the goods even though they are wholly as warranted. This section nevertheless presupposes that a contract for sale is contemplated by the parties, although that contract may be of the particular character here described that this section addresses (i.e., a sale on approval or a sale or return).~~

~~Where the If a buyer's obligation as a buyer is conditioned not on its personal approval but on the article's passing a described objective test, the risk of loss by casualty pending the test is properly the seller's and proper return is at its expense.~~

On the point of "satisfaction" as meaning "reasonable satisfaction" where when an industrial machine is involved, this Article takes no position.

~~2. Pursuant to the general policies of this Act which require good faith not only between the parties to the sales contract, but as against interested third parties, subsection (3) resolves all reasonable doubts as to the nature of the transaction in favor of the general creditors of the buyer. As against such creditors words such as "on consignment" or "on memorandum", with or without words of reservation of title in the seller, are disregarded when the buyer has a place of business at which he deals in goods of the kind involved. A necessary exception is made where the buyer is known to be engaged primarily in selling the goods of others or is selling under a relevant sign law, or the seller complies with the filing provisions of Article 9 as if his interest were a security interest. However, there is no intent in this Section to narrow the protection afforded to third parties in any jurisdiction which has a selling Factors Act. The purpose of the ex-~~

~~ception is merely to limit the effect of the present subsection itself, in the absence of any such Factors Act, to cases in which creditors of the buyer may reasonably be deemed to have been misled by the secret reservation.~~

3. Subsection (4) (3) resolves a conflict in the pre-existing pre-UCC case law by recognition recognizing that an "or return" provision is so definitely at odds with any ordinary contract for sale of goods that where written agreements are if a written agreement is involved it the "or return" term must be contained in a written memorandum. The "or return" aspect of a sales contract must be treated as a separate contract under the Statute of Frauds section and as contradicting the sale insofar as questions of parol or extrinsic evidence are concerned.

4. Certain true consignment transactions were dealt with in former Sections 2-326(3) and 9-114. These provisions have been deleted and have been replaced by new provisions in Article 9. See, e.g., Sections 9-109(a)(4); 9-103(b) 9-103(d); 9-319.

## § 2-502. Buyer's Right to Goods on Seller's Repudiation, Failure to Deliver, or Insolvency.

(1) Subject to subsections (2) and (3) and even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of the immediately preceding section may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if:

- (a) in the case of goods bought for personal, family, or household purposes, the seller repudiates or fails to deliver as required by the contract; or
- (b) in all cases, the seller becomes insolvent within ten days after receipt of the first installment on their price.

(2) The buyer's right to recover the goods under subsection (1)(a) vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

(3) If the identification creating his special property has been made by the buyer he acquires the right to recover the goods only if they conform to the contract for sale.

### Official Comment

1. This section gives an additional right to the buyer as a result of identification of the goods to the contract in the manner provided in Section 2-501. The buyer is given a right to recover the goods on the seller's insolvency occurring, conditioned upon mak-

ing and keeping good a tender of any unpaid portion of the price, in two limited circumstances. First, the buyer may recover goods bought for personal, family, or household purposes if the seller repudiates the contract or fails to deliver the goods. Second, in any case, the buyer may recover the goods if the seller becomes insolvent within 10 days after he the seller receives the first installment on their price. The buyer's right to recover the goods under this section is an exception to the usual rule, under which the disappointed buyer must resort to an action to recover damages.

2. The question of whether the buyer also acquires a security interest in identified goods and has rights to the goods when insolvency takes place after the ten-day period provided in this section depends upon compliance with the provisions of the Article on Secured Transactions (Article 9).

3. Under subsection (2), the buyer's right to recover consumer goods under subsection (1)(a) vests upon acquisition of a special

property, which occurs upon identification of the goods to the contract. See Section 2-501. Inasmuch as a secured party normally acquires no greater rights in its collateral than its debtor had or had power to convey, see Section 2-403(1) (first sentence), a buyer who acquires a right to recover under this section will take free of a security interest created by the seller if it attaches to the goods after the goods have been identified to the contract. The buyer will take free, even if the buyer does not buy in ordinary course and even if the security interest is perfected. Of course, to the extent that the buyer pays the price after the security interest attaches, the payments will constitute proceeds of the security interest.

3. 4. Subsection (2) (3) is included to preclude the possibility of unjust enrichment, which ~~exists~~ would exist if the buyer were permitted to recover goods even though they were greatly superior in quality or quantity to that called for by the contract for sale.

## § 2-716. Buyer's Right to Specific Performance or Replevin.

(1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered. In the case of goods bought for personal, family, or household purposes, the buyer's right of replevin vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

### Official Comment

\* \* \*

3. The legal remedy of replevin is given to the buyer in cases in which cover is reasonably unavailable and goods have been identified to the contract. This is in addition to the buyer's right to recover identified goods ~~on the seller's insolvency (Section 2-502) under Section 2-502.~~ For consumer goods, the buyer's right to replevin vests upon the buyer's acquisition of a special property, which occurs upon identification of

the goods to the contract. See Section 2-501. Inasmuch as a secured party normally acquires no greater rights in its collateral than its debtor had or had power to convey, see Section 2-403(1) (first sentence), a buyer who acquires a right of replevin under subsection (3) will take free of a security interest created by the seller if it attaches to the goods after the goods have been identified to the contract. The buyer will take free, even if the buyer does not buy in ordinary course

and even if the security interest is perfected. Of course, to the extent that the buyer pays the price after the security interest attaches, the payments will constitute proceeds of the security interest.

\* \* \*

### § 2A-103. Definitions and Index of Definitions.

\* \* \*

(3) The following definitions in other Articles apply to this Article:

“Account”. Section ~~9-106~~ 9-102(a)(2).

“Between merchants”. Section 2-104(3).

“Buyer”. Section 2-103(1)(a).

“Chattel paper”. Section ~~9-105(1)(b)~~ 9-102(a)(11).

“Consumer goods”. Section ~~9-109(1)~~ 9-102(a)(23).

“Document”. Section ~~9-105(1)(f)~~ 9-102(a)(30).

“Entrusting”. Section 2-403(3).

~~“General intangibles”. Section 9-106.~~

“General intangible”. Section 9-102(a)(42).

“Good faith”. Section 2-103(1)(b).

“Instrument”. Section ~~9-105(1)(i)~~ 9-102(a)(47).

“Merchant”. Section 2-104(1).

“Mortgage”. Section ~~9-105(1)(j)~~ 9-102(a)(55).

“Pursuant to commitment”. Section ~~9-105(1)(k)~~ 9-102(a)(68).

“Receipt”. Section 2-103(1)(c).

“Sale”. Section 2-106(1).

“Sale on approval”. Section 2-326.

“Sale or return”. Section 2-326.

“Seller”. Section 2-103(1)(d).

\* \* \*

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

(1) As used in this section, “creation of a security interest” includes the sale of a lease contract that is subject to Article 9, Secured Transactions, by reason of Section ~~9-102(1)(b)~~ 9-109(a)(3).

(2) Except as provided in ~~subsections subsection (3) and (4)~~ Section 9-407, a provision in a lease agreement which (i) prohibits the voluntary or involuntary transfer, including a transfer by sale, sublease, creation or enforcement of a security interest, or attachment, levy, or other judicial process, of an interest of a party under the lease contract or of the lessor's residual interest in the goods, or (ii) makes such a transfer an event of default, gives rise to the rights and remedies

provided in subsection ~~(5)~~ (4), but a transfer that is prohibited or is an event of default under the lease agreement is otherwise effective.

~~(3) A provision in a lease agreement which (i) prohibits the creation or enforcement of a security interest in an interest of a party under the lease contract or in the lessor's residual interest in the goods, or (ii) makes such a transfer an event of default, is not enforceable unless, and then only to the extent that, there is an actual transfer by the lessee of the lessee's right of possession or use of the goods in violation of the provision or an actual delegation of a material performance of either party to the lease contract in violation of the provision. Neither the granting nor the enforcement of a security interest in (i) the lessor's interest under the lease contract or (ii) the lessor's residual interest in the goods is a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the lessee within the purview of subsection (5) unless, and then only to the extent that, there is an actual delegation of a material performance of the lessor.~~

~~(4)~~(3) A provision in a lease agreement which (i) prohibits a transfer of a right to damages for default with respect to the whole lease contract or of a right to payment arising out of the transferor's due performance of the transferor's entire obligation, or (ii) makes such a transfer an event of default, is not enforceable, and such a transfer is not a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract within the purview of subsection ~~(5)~~ (4).

~~(5)~~(4) Subject to ~~subsections~~ subsection (3) and ~~(4)~~ Section 9-407:

- (a) if a transfer is made which is made an event of default under a lease agreement, the party to the lease contract not making the transfer, unless that party waives the default or otherwise agrees, has the rights and remedies described in Section 2A-501(2);
- (b) if paragraph (a) is not applicable and if a transfer is made that (i) is prohibited under a lease agreement or (ii) materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract, unless the party not making the transfer agrees at any time to the transfer in the lease contract or otherwise, then, except as limited by contract, (i) the transferor is liable to the party not making the transfer for damages caused by the transfer to the extent that the damages could not reasonably be prevented by the party not making the transfer and (ii) a court having jurisdiction may grant other appropriate relief, including cancellation of the lease contract or an injunction against the transfer.

~~(6)~~ (5) A transfer of "the lease" or of "all my rights under the lease", or a transfer in similar general terms, is a transfer of rights and, unless the language or the circumstances, as in a transfer for security, indicate the contrary, the transfer is a delegation of duties by the transferor to the transferee. Acceptance by the transferee constitutes a promise by the transferee to perform those duties. The promise is enforceable by either the transferor or the other party to the lease contract.

(7)(6) Unless otherwise agreed by the lessor and the lessee, a delegation of performance does not relieve the transferor as against the other party of any duty to perform or of any liability for default.

(8)(7) In a consumer lease, to prohibit the transfer of an interest of a party under the lease contract or to make a transfer an event of default, the language must be specific, by a writing, and conspicuous.

#### Official Comment

1. Subsection (2) states a rule, consistent with Section ~~9-311~~ ~~9-401(b)~~, that voluntary and involuntary transfers of an interest of a party under the lease contract or of the lessor's residual interest, including by way of the creation or enforcement of a security interest, are effective, notwithstanding a provision in the lease agreement prohibiting the transfer or making the transfer an event of default. Although the transfers are effective, the provision in the lease agreement is nevertheless enforceable, but only as provided in subsection (5) ~~(4)~~. Under subsection (5) ~~(4)~~ the prejudiced party is limited to the remedies on "default under the lease contract" in this Article and, except as limited by this Article, as provided in the lease agreement, if the transfer has been made an event of default. Section 2A-501(2). Usually, there will be a specific provision to this effect or a general provision making a breach of a covenant an event of default. In those cases where the transfer is prohibited, but not made an event of default, the prejudiced party may recover damages; or, if the damage remedy would be ineffective adequately to protect that party, the court can order cancellation of the lease contract or enjoin the transfer. This rule that such provisions generally are enforceable is subject to ~~subsections (3) and (4)~~ subsection (3) and Section 9-407, which make such provisions unenforceable in certain instances.

2. ~~The first such instance is described in subsection (3).~~ Under Section 9-407, a provision in a lease agreement which prohibits the creation or enforcement of a security interest, including sales of lease contracts subject to Article 9 (Sections ~~9-102(1)(b)~~ and ~~9-104(f)~~ Section 9-109(a)(3)), or makes it an event of default is generally not enforceable, reflecting the policy of Section 9-406 and former Section 9-318(4). However, inasmuch as the creation of a security interest includes

~~the sale of a lease contract, if there are then unperformed duties on the part of the lessor/seller, there could be a delegation of duties in the sale, and, if such a delegation actually takes place and is of a material performance, a provision in a lease agreement prohibiting it or making it an event of default would be enforceable, giving rise to the rights and remedies stated in subsection (5). The statute does not define "material." The parties may set standards to determine its meaning. The term is intended to exclude delegations of matters such as accounting to a professional accountant and the performance of, as opposed to the responsibility for, maintenance duties to a person in the maintenance service industry.~~

3. ~~For similar reasons, the lessor is entitled to protect its residual interest in the goods by prohibiting anyone but the lessee from possessing or using them. Accordingly, under subsection (3) if there is an actual transfer by the lessee of its right of possession or use of the goods in violation of a provision in the lease agreement, such a provision likewise is enforceable, giving rise to the rights and remedies stated in subsection (5). A transfer of the lessee's right of possession or use of the goods resulting from the enforcement of a security interest granted by the lessee in its leasehold interest is a "transfer by the lessee" under this subsection.~~

4. Finally, subsection (3) protects against a claim that the creation or enforcement of a security interest in the lessor's interest under the lease contract or in the residual interest is a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on the lessee so as to give rise to the rights and remedies stated in subsection (5),



unless the transfer involves an actual delegation of a material performance of the lessor.

5. While it is not likely that a transfer by the lessor of its right to payment under the lease contract would impair at a future time the ability of the lessee to obtain the performance due the lessee under the lease contract from the lessor, if under the circumstances reasonable grounds for insecurity as to receiving that performance arise, the lessee may employ the provision of this Article for demanding adequate assurance of due performance and has the remedy provided in that circumstance. Section 2A-401.

6. Sections 9-206 and 9-318(1) through (3) also are relevant. Section 9-206 sanctions an agreement by a lessee not to assert certain types of claims or defenses against the lessor's assignee. Section 9-318(1) through (3) deal with, among other things, the other party's rights against the assignee where Section 9-206(1) does not apply. Since the definition of contract under Section 1-201(11) includes a lease agreement, the definition of account debtor under Section 9-105(1)(a) includes a lessee of goods. As a result, Section 9-206 applies to lease agreements, and there is no need to restate those sections in this Article. The reference to "defenses or claims arising out of a sale" in Section 9-318(1) should be interpreted broadly to include defenses or claims arising out of a lease inasmuch as that section codifies the common law rule with respect to contracts, including lease contracts.

7.3. Subsection (4) (3) is based upon Section 2-210(2) and Section 9-318(4) 9-406. It makes unenforceable a prohibition against transfers of certain rights to payment or a provision making the transfer an event of default. It also provides that such transfers do not materially impair the prospect of obtaining return performance by, materially change the duty of, or materially increase the burden or risk imposed on, the other party to the lease contract so as to give rise to the rights and remedies stated in subsection (5) (4). Accordingly, a transfer of a right to payment cannot be prohibited or made an event of default, or be one that materially impairs performance, changes duties or increases risk, if the right is already due or will become due without fur-

ther performance being required by the party to receive payment. Thus, a lessor can transfer the right to future payments under the lease contract, including by way of a grant of a security interest, and the transfer will not give rise to the rights and remedies stated in subsection (5) (4) if the lessor has no remaining performance under the lease contract. The mere fact that the lessor is obligated to allow the lessee to remain in possession and to use the goods as long as the lessee is not in default does not mean that there is "remaining performance" on the part of the lessor. Likewise, the fact that the lessor has potential liability under a "non-operating" lease contract for breaches of warranty does not mean that there is "remaining performance". In contrast, the lessor would have "remaining performance" under a lease contract requiring the lessor to regularly maintain and service the goods or to provide "upgrades" of the equipment on a periodic basis in order to avoid obsolescence. The basic distinction is between a mere potential duty to respond which is not "remaining performance," and an affirmative duty to render stipulated performance. Although the distinction may be difficult to draw in some cases, it is instructive to focus on the difference between "operating" and "non-operating" leases as generally understood in the marketplace. Even if there is "remaining performance" under a lease contract, a transfer for security of a right to payment that is made an event of default or that is in violation of a prohibition against transfer does not give rise to the rights and remedies under subsection (5) (4) if it does not constitute an actual delegation of a material performance under subsection (3) Section 9-407.

8.4. The application of either the rule of subsection (3) Section 9-407 or the rule of subsection (4) (3) to the grant by the lessor of a security interest in the lessor's right to future payment under the lease contract may produce the same result. Both subsections provisions generally protect security transfers by the lessor in particular because the creation by the lessor of a security interest or the enforcement of that interest generally will not prejudice the lessee's rights if it does not result in a delegation of the

lessor's duties. To the contrary, the receipt of loan proceeds or relief from the enforcement of an antecedent debt normally should enhance the lessor's ability to perform its duties under the lease contract. Nevertheless, there are circumstances where relief might be justified. For example, if ownership of the goods is transferred pursuant to enforcement of a security interest to a party whose ownership would prevent the lessee from continuing to possess the goods, relief might be warranted. See 49 U.S.C. § 1401(a) and (b) which places limitations on the operation of aircraft in the United States based on the citizenship or corporate qualification of the registrant.

9.5. Relief on the ground of material prejudice when the lease agreement does not prohibit the transfer or make it an event of default should be afforded only in extreme circumstances, considering the fact that the party asserting material prejudice did not insist upon a provision in the lease agreement that would protect against such a transfer.

10.6. Subsection (5) (4) implements the rule of subsection (2). Subsection (2) provides that, even though a transfer is effective, a provision in the lease agreement prohibiting it or making it an event of default may be enforceable as provided in subsection (5) (4). See *Brummund v. First National Bank of Clovis*, 656 P.2d 884, 35 U.C.C. Rep.Serv. (Callaghan) 1311 (N.Mex.1983), stating the analogous rule for Section 9-311. If the transfer prohibited by the lease agreement is made an event of default, then, under subsection 5(a) (4)(a), unless the default is waived or there is an agreement otherwise, the aggrieved party has the rights and remedies referred to in Section 2A-501(2), viz. those in this Article and, except as limited in the Article, those provided in the lease agreement. In the unlikely circumstance that the lease agreement prohibits the transfer without making a violation of the prohibition an event of default or, even if there is no prohibition against the transfer, and the transfer is one that materially impairs performance, changes duties, or increases risk (for example, a sublease or assignment to a party using the goods improperly or for an illegal purpose),

then subsection 5(b) (4)(b) is applicable. In that circumstance, unless the party aggrieved by the transfer has otherwise agreed in the lease contract, such as by assenting to a particular transfer or to transfers in general, or agrees in some other manner, the aggrieved party has the right to recover damages from the transferor and a court may, in appropriate circumstances, grant other relief, such as cancellation of the lease contract or an injunction against the transfer.

11.7. If a transfer gives rise to the rights and remedies provided in subsection (5) (4), the transferee as an alternative may propose, and the other party may accept, adequate cure or compensation for past defaults and adequate assurance of future due performance under the lease contract. Subsection (5) (4) does not preclude any other relief that may be available to a party to the lease contract aggrieved by a transfer subject to an enforceable prohibition, such as an action for interference with contractual relations.

12.8. Subsection (8) (7) requires that a provision in a consumer lease prohibiting a transfer, or making it an event of default, must be specific, written and conspicuous. See Section 1-201(10). This assists in protecting a consumer lessee against surprise assertions of default.

13.9. Subsection (6) (5) is taken almost verbatim from the provisions of Section 2-210(4) 2-210(5). The subsection states a rule of construction that distinguishes a commercial assignment, which substitutes the assignee for the assignor as to rights and duties, and an assignment for security or financing assignment, which substitutes the assignee for the assignor only as to rights. Note that the assignment for security or financing assignment is a subset of all security interests. Security interest is defined to include "any interest of a buyer of . . . chattel paper". Section 1-201(37). Chattel paper is defined to include a lease. Section 9-105(1)(b) 9-102. Thus, a buyer of leases is the holder of a security interest in the leases. That conclusion should not influence this issue, as the policy is quite different. Whether a buyer of leases is the holder of a commercial assignment, or an assignment for security or financing assignment should be

determined by the language of the assignment or the circumstances of the assignment.

### § 2A-307. Priority of Liens Arising by Attachment or Levy on, Security Interests in, and Other Claims to Goods.

(1) Except as otherwise provided in Section 2A-306, a creditor of a lessee takes subject to the lease contract.

(2) Except as otherwise provided in ~~subsections subsection~~ (3) and (4) and in Sections 2A-306 and 2A-308, a creditor of a lessor takes subject to the lease contract unless:

(a) the creditor holds a lien that attached to the goods before the lease contract became enforceable,

~~(b) the creditor holds a security interest in the goods and the lessee did not give value and receive delivery of the goods without knowledge of the security interest; or~~

~~(c) the creditor holds a security interest in the goods which was perfected (Section 9-303) before the lease contract became enforceable.~~

~~(3) A lessee in the ordinary course of business takes the leasehold interest free of a security interest in the goods created by the lessor even though the security interest is perfected (Section 9-303) and the lessee knows of its existence.~~

~~(4) A lessee other than a lessee in the ordinary course of business takes the leasehold interest free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the lease or more than 45 days after the lease contract becomes enforceable, whichever first occurs, unless the future advances are made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the 45-day period.~~

(3) Except as otherwise provided in Sections 9-317, 9-321, and 9-323, a lessee takes a leasehold interest subject to a security interest held by a creditor of the lessor.

#### Official Comment

\* \* \*

3. To take priority over the lease contract, and the interests derived therefrom, the creditor must come within ~~one of three exceptions the exception~~ stated within the rule. First, in subsection (2)(a) or within one of the provisions of Article 9 mentioned in subsection (3). Subsection (2) provides that where the creditor holds a lien (Section 2A-103(1)(r)) that attached before the lease contract became enforceable (Section 2A-301), the creditor does not take subject to the lease. ~~Second, subsection (2)(b) provides that when the creditor holds a security interest (Section 1-201(37)), whether or not perfect-~~

~~ed, the creditor has priority over a lessee who did not give value (Section 1-201(44)) and receive delivery of the goods without knowledge (Section 1-201(25)) of the security interest. As to other lessees, under subsection (2)(c) a secured creditor holding a perfected security interest before the time the lease contract became enforceable (Section 2A-301) does not take subject to the lease. With respect to this provision, the lessee in these circumstances is treated like a buyer so that perfection of a purchase money security interest does not relate back (Section 9-301). Subsection (3) provides that a lessee takes its leasehold interest subject~~

to a security interest except as otherwise provided in Sections 9-317, 9-321, or 9-323.

4. The rules of this section operate in favor of whichever party to the lease contract may enforce it, even if one party perhaps may not, e.g., under Section 2A-201(1)(b).

~~5. The rules stated in subsections (2)(b) and (c), and the rule in subsection (3), are is best understood by reviewing a hypothetical. Assume that a merchant engaged in the business of selling and leasing musical instruments obtained possession of a truck load of musical instruments on deferred payment terms from a supplier of musical instruments on January 6. To secure payment of such credit the merchant granted the supplier a security interest in the instruments; the security interest was perfected by filing on January 15. The merchant, as lessor, entered into a lease to an individual of one of the musical instruments supplied by the supplier; the lease became enforceable on January 10. Under subsection (2)(b) the lessee will prevail (assuming the lessee qualifies thereunder) unless subsection (c) provides otherwise. Under the rule stated in subsection (2)(c) a priority dispute between the supplier, as the lessor's secured creditor, and the lessee would be determined by ascertain-~~

~~ing on January 10 (the day the lease became enforceable) the validity and perfected status of the security interest in the musical instrument and the enforceability of the lease contract by the lessee. Nothing more appearing, under the rule stated in subsection (2)(c), the supplier's security interest in the musical instrument would not have priority over the lease contract. Moreover, subsection (2) states that its rules are subject to the rules of subsections (3) and (4). Under this hypothetical the lessee should qualify as a "lessee in the ordinary course of business". Section 2A-103(1)(c). Subsection (3) also makes clear that the lessee in the ordinary course of business will win even if he or she knows of the existence of the supplier's security interest.~~

6. Subsections (3) and (4), which are modeled on the provisions of Section 9-307(1) and (3), respectively, state two exceptions to the priority rule stated in subsection (2) with respect to a creditor who holds a security interest. The lessee in the ordinary course of business will be treated in the same fashion as the buyer in the ordinary course of business, given a priority dispute with a secured creditor over goods subject to a lease contract.

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

(1) In this section:

\* \* \*

(b) a "fixture filing" is the filing, in the office where a record of a mortgage on the real estate would be filed or recorded, of a financing statement covering goods that are or are to become fixtures and conforming to the requirements of Section 9-402(5) 9-502(a) and (b);

\* \* \*

### § 4-210. Security Interest of Collecting Bank in Items, Accompanying Documents and Proceeds.

\* \* \*

(c) Receipt by a collecting bank of a final settlement for an item is a realization on its security interest in the item, accompanying documents, and proceeds. So long as the bank does not receive final settlement for the item or give up possession of the item or accompanying documents for purposes other than

collection, the security interest continues to that extent and is subject to Article 9, but:

- (1) no security agreement is necessary to make the security interest enforceable (Section ~~9-203(1)(a)~~ 9-203(b)(3)(A));
- (2) no filing is required to perfect the security interest; and
- (3) the security interest has priority over conflicting perfected security interests in the item, accompanying documents, or proceeds.

### § 5-118. Security Interest of Issuer or Nominated Person.

(a) An issuer or nominated person has a security interest in a document presented under a letter of credit to the extent that the issuer or nominated person honors or gives value for the presentation.

(b) So long as and to the extent that an issuer or nominated person has not been reimbursed or has not otherwise recovered the value given with respect to a security interest in a document under subsection (a), the security interest continues and is subject to Article 9, but:

- (1) a security agreement is not necessary to make the security interest enforceable under Section 9-203(b)(3);
- (2) if the document is presented in a medium other than a written or other tangible medium, the security interest is perfected; and
- (3) if the document is presented in a written or other tangible medium and is not a certificated security, chattel paper, a document of title, an instrument, or a letter of credit, the security interest is perfected and has priority over a conflicting security interest in the document so long as the debtor does not have possession of the document.

#### Official Comment

1. This section gives the issuer of a letter of credit or a nominated person thereunder an automatic perfected security interest in a "document" (as that term is defined in Section 5-102(a)(6)). The security interest arises only if the document is presented to the issuer or nominated person under the letter of credit and only to the extent of the value that is given. This security interest is analogous to that awarded to a collecting bank under Section 4-210. Subsection (b) contains special rules governing the security interest arising under this section. In all other respects, a security interest arising under this section is subject to Article 9. See Section 9-109. Thus, for example, a security interest arising under this section may give rise to a security interest in proceeds under Section 9-315.

2. Subsection (b)(1) makes a security agreement unnecessary to the creation of a

security interest under this section. Under subsection (b)(2), a security interest arising under this section is perfected if the document is presented in a medium other than a written or tangible medium. Documents that are written and that are not an otherwise-defined type of collateral under Article 9 (e.g., an invoice or inspection certificate) may be goods, in which an issuer or nominated person could perfect its security interest by possession. Because the definition of document in Section 5-102(a)(6) includes records (e.g., electronic records) that may not be goods, subsection (b)(2) provides for automatic perfection (i.e., without filing or possession).

Under subsection (b)(3), if the document (i) is in a written or tangible medium, (ii) is not a certificated security, chattel paper, a document of title, an instrument, or a letter

of credit, and (iii) is not in the debtor's possession, the security interest is perfected and has priority over a conflicting security interest. If the document is a type of tangible collateral that subsection (b)(3) excludes from its perfection and priority rules, the issuer or nominated person must comply with the normal method of perfection (e.g., possession of an instrument) and is subject to the applicable Article 9 priority rules. Documents to which subsection (b)(3) applies may be important to an issuer or nominated person. For example, a confirmer who pays the beneficiary must be assured that its rights to all documents are not impaired. It will find it necessary to present all of the required documents to the issuer in order to be reimbursed. Moreover, when a nominated person sends documents to an issuer in connection with the nominated person's reimbursement, that activity is not a collection, enforcement, or disposition of collateral under Article 9.

One purpose of this section is to protect an issuer or nominated person from claims of a

beneficiary's creditors. It is a fallback provision inasmuch as issuers and nominated persons frequently may obtain and perfect security interests under the usual Article 9 rules, and, in many cases, the documents will be owned by the issuer, nominated person, or applicant.

#### UCC Article 6, Alternative A:

*Legislative Note: To take account of differences between former Article 9 and revised Article 9, a State that repeals Article 6 after revised Article 9 takes effect must make the following changes to Alternative A. First, inasmuch as revised Article 9 contains no counterpart of former Section 9-111, the reference to that section in Section 1 of the repealer should be deleted, and Section 4 of the repeal bill should allude to former Section 9-111. Second, the last entry in Section 1-105(2) should be amended as shown above in this Appendix.*

#### UCC Article 6, Alternative B:

### § 6-102. Definitions and Index of Definitions.

- (1) In this Article, unless the context otherwise requires:
- (a) "Assets" means the inventory that is the subject of a bulk sale and any tangible and intangible personal property used or held for use primarily in, or arising from, the seller's business and sold in connection with that inventory, but the term does not include:
- (i) fixtures (Section ~~9-313(1)(a)~~ 9-102(a)(41)) other than readily removable factory and office machines;
  - (ii) the lessee's interest in a lease of real property; or
  - (iii) property to the extent it is generally exempt from creditor process under nonbankruptcy law.

\* \* \*

- (2) The following definitions in other Articles apply to this Article:
- (a) "Buyer." Section 2-103(1)(a).
  - (b) "Equipment." Section ~~9-109(2)~~ 9-102(a)(33).
  - (c) "Inventory." Section ~~9-109(4)~~ 9-102(a)(48).
  - (d) "Sale." Section 2-106(1).
  - (e) "Seller." Section 2-103(1)(d).

\* \* \*

## § 6-103. Applicability of Article.

\* \* \*

- (3) This Article does not apply to:
- (a) a transfer made to secure payment or performance of an obligation;
  - (b) a transfer of collateral to a secured party pursuant to Section ~~9-503~~ 9-609;
  - (c) a sale disposition of collateral pursuant to Section ~~9-504~~ 9-610;
  - (d) retention of collateral pursuant to Section ~~9-505~~ 9-620;

\* \* \*

## § 7-503. Document of Title to Goods Defeated in Certain Cases.

(1) A document of title confers no right in goods against a person who before issuance of the document had a legal interest or a perfected security interest in them and who neither

- (a) delivered or entrusted them or any document of title covering them to the bailor or his nominee with actual or apparent authority to ship, store or sell or with power to obtain delivery under this Article (Section 7-403) or with power of disposition under this Act (Sections 2-403 and ~~9-307~~ 9-320) or other statute or rule of law; nor
- (b) acquiesced in the procurement by the bailor or his nominee of any document of title.

\* \* \*

## § 8-102. Definitions.

\* \* \*

## Official Comment

\* \* \*

7. "Entitlement holder." This term designates those who hold financial assets through intermediaries in the indirect holding system. Because many of the rules of Part 5 impose duties on securities intermediaries in favor of entitlement holders, the definition of entitlement holder is, in most cases, limited to the person specifically designated as such on the records of the intermediary. The last sentence of the definition covers the relatively unusual cases where a person may acquire a security entitlement under Section 8-501 even though the person may not be specifically designated as an entitlement holder on the records of the securities intermediary.

A person may have an interest in a security entitlement, and may even have the right

to give entitlement orders to the securities intermediary with respect to it, even though the person is not the entitlement holder. For example, a person who holds securities through a securities account in its own name may have given discretionary trading authority to another person, such as an investment adviser. Similarly, the control provisions in Section 8-106 and the related provisions in Article 9 are designed to facilitate transactions in which a person who holds securities through a securities account uses them as collateral in an arrangement where the securities intermediary has agreed that if the secured party so directs the intermediary will dispose of the positions. In such arrangements, the debtor remains the entitlement holder but has agreed that the secured party can initiate entitlement orders.

Moreover, an entitlement holder may be acting for another person as a nominee, agent, trustee, or in another capacity. Unless the entitlement holder is itself acting as a securities intermediary for the other person, in which case the other person would be an entitlement holder with respect to the securities entitlement, the relationship between an entitlement holder and another person for whose benefit the entitlement holder holds a securities entitlement is governed by other law.

8. "Entitlement order." This term is defined as a notification communicated to a securities intermediary directing transfer or redemption of the financial asset to which an entitlement holder has a security entitlement. The term is used in the rules for the indirect holding system in a fashion analogous to the use of the terms "indorsement" and "instruction" in the rules for the direct holding system. If a person directly holds a certificated security in registered form and

wishes to transfer it, the means of transfer is an indorsement. If a person directly holds an uncertificated security and wishes to transfer it, the means of transfer is an instruction. If a person holds a security entitlement, the means of disposition is an entitlement order. An entitlement order includes a direction under Section 8-508 to the securities intermediary to transfer a financial asset to the account of the entitlement holder at another financial intermediary or to cause the financial asset to be transferred to the entitlement holder in the direct holding system (e.g., the delivery of a securities certificate registered in the name of the former entitlement holder). As noted in Comment 7, an entitlement order need not be initiated by the entitlement holder in order to be effective, so long as the entitlement holder has authorized the other party to initiate entitlement orders. See Section 8-107(b).

\* \* \*

### § 8-103. Rules for Determining Whether Certain Obligations and Interests Are Securities or Financial Assets.

\* \* \*

(f) A commodity contract, as defined in Section 9-115 ~~9-102(a)(15)~~, is not a security or a financial asset.

### § 8-106. Control.

(a) A purchaser has "control" of a certificated security in bearer form if the certificated security is delivered to the purchaser.

(b) A purchaser has "control" of a certificated security in registered form if the certificated security is delivered to the purchaser, and:

(1) the certificate is indorsed to the purchaser or in blank by an effective indorsement; or

(2) the certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(c) A purchaser has "control" of an uncertificated security if:

(1) the uncertificated security is delivered to the purchaser; or

(2) the issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

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

(1) the purchaser becomes the entitlement holder; or

(2) the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder; or



(3) another person 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.

(e) If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control.

(f) A purchaser who has satisfied the requirements of subsection (c)(2) or (d)(2) has control, even if the registered owner in the case of subsection (c)(2) or the entitlement holder in the case of subsection (d)(2) retains the right to make substitutions for the uncertificated security or security entitlement, to originate instructions or entitlement orders to the issuer or securities intermediary, or otherwise to deal with the uncertificated security or security entitlement.

(g) An issuer or a securities intermediary may not enter into an agreement of the kind described in subsection (c)(2) or (d)(2) without the consent of the registered owner or entitlement holder, but an issuer or a securities intermediary is not required to enter into such an agreement even though the registered owner or entitlement holder so directs. An issuer or securities intermediary that has entered into such an agreement is not required to confirm the existence of the agreement to another party unless requested to do so by the registered owner or entitlement holder.

#### Official Comment

1. The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See Sections 8-303 (protected purchasers); 8-503(e) (purchasers from securities intermediaries); 8-510 (purchasers of security entitlements from entitlement holders); ~~115(4)~~ 9-314 (perfection of security interests); ~~9-115(5)~~ 9-328 (priorities among conflicting security interests).

Obtaining "control" means that the purchaser has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner.

\* \* \*

4. Subsection (d) specifies the means by which a purchaser can obtain control ~~over~~ of a security entitlement. ~~Two~~ Three mechanisms are possible, analogous to those provided in subsection (c) for uncertificated securities. Under subsection (d)(1), a purchaser has control if it is the entitlement holder. This subsection would apply whether the purchaser holds through the same intermediary that the debtor used, or has

the securities position transferred to its own intermediary. Subsection (d)(2) provides that a purchaser has control if the securities intermediary has agreed to act on entitlement orders originated by the purchaser if no further consent by the entitlement holder is required. Under subsection (d)(2), control may be achieved even though the ~~transferor~~ original entitlement holder remains listed as the entitlement holder. Finally, a purchaser may obtain control under subsection (d)(3) if another person has control and the person acknowledges that it has control on the purchaser's behalf. Control under subsection (d)(3) parallels the delivery of certificated securities and uncertificated securities under Section 8-301. Of course, the acknowledging person cannot be the debtor.

This section specifies only the minimum requirements that such an arrangement must meet to confer "control"; the details of the arrangement can be specified by agreement. The arrangement might cover all of the positions in a particular account or sub-account, or only specified positions. There is no requirement that the control party's right

to give entitlement orders be exclusive. The arrangement might provide that only the control party can give entitlement orders, or that either the entitlement holder or the control party can give entitlement orders. See subsection (f).

The following examples illustrate the rules application of subsection (d):

Example 1. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha also has an account with Able. Debtor instructs Able to transfer the shares to Alpha, and Able does so by crediting the shares to Alpha's account. Alpha Bank has control of the 1000 shares under subsection (d)(1). Although Debtor may have become the beneficial owner of the new securities entitlement, as between Debtor and Alpha, Able has agreed to act on Alpha's entitlement orders because, as between Able and Alpha, because Alpha Bank is has become the entitlement holder. See Section 8-506.

Example 2. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha Bank does not have an account with Able. Alpha Bank uses Beta as its securities custodian. Debtor instructs Able to transfer the shares to Beta, for the account of Alpha Bank, and Able does so. Alpha Bank has control of the 1000 shares under subsection (d)(1). As in Example 1, although Debtor may have become the beneficial owner of the new securities entitlement, as between Debtor and Alpha, Beta has agreed to act on Alpha's entitlement orders because, as between Beta and Alpha, because Alpha is has become the entitlement holder.

Example 3. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Debtor, Able, and Alpha Bank enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but

Alpha Bank also has the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 4. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Alpha Bank's Alpha's account at Clearing Corporation. As in Example 1, Alpha Bank has control of the 1000 shares under subsection (d)(1).

Example 5. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Alpha Bank does not have an account with Clearing Corporation. It holds its securities through Beta Bank, which does have an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Beta Bank's Beta's account at Clearing Corporation. Beta Bank credits the position to Alpha's account with Beta Bank. As in Example 2, Alpha Bank has control of the 1000 shares under subsection (d)(1).

Example 6. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into a pledge account, pursuant to an agreement under which Able will continue to receive dividends, distributions, and the like, but Alpha Bank has the right to direct dispositions. As in Example 3, Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 7. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation will act on

instructions from Alpha with respect to the XYZ Co. stock carried in Able's account, but Able will continue to receive dividends, distributions, and the like, and will also have the right to direct dispositions. As in Example 3, Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 8. Able & Co., a securities dealer, holds a wide range of securities through its account at Clearing Corporation. Able enters into an arrangement with Alpha Bank pursuant to which Alpha provides financing to Able secured by securities identified as the collateral on lists provided by Able to Alpha on a daily or other periodic basis. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation agrees that if at any time Alpha directs Clearing Corporation to do so, Clearing Corporation will transfer any securities from Able's account at Alpha's instructions. Because Clearing Corporation has agreed to act on Alpha's instructions with respect to any securities carried in Able's account, at the moment that Alpha's security interest attaches to securities listed by Able, Alpha obtains control of those securities under subsection (d)(2). There is no requirement that Clearing Corporation be informed of which securities Able has pledged to Alpha.

Example 9. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Beta Bank agrees with Alpha to act as Alpha's collateral agent with respect to the security entitlement. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta also has the right to direct dispositions. Because Able has agreed that it will comply with entitlement orders originated by Beta without further consent by Debtor, Beta has control of the security entitlement (see Example 3). Because Beta has control on behalf of Alpha, Alpha also has control under subsection (d)(3). It is not necessary

for Able to enter into an agreement directly with Alpha or for Able to be aware of Beta's agency relationship with Alpha.

\* \* \*

7. The term "control" is used in a particular defined sense. The requirements for obtaining control are set out in this section. The concept is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledge are not to be used as a basis for interpreting subsection (c)(2) or (d)(2). Those provisions are designed to supplant the concepts of "constructive possession" and the like. A principal purpose of the "control" concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.

The key to the control concept is that the purchaser has the ~~present~~ ability to have the securities sold or transferred without further action by the transferor. There is no requirement that the powers held by the purchaser be exclusive. For example, in a secured lending arrangement, if the secured party wishes, it can allow the debtor to retain the right to make substitutions, or to direct the disposition of the uncertificated security or security entitlement, or otherwise to give instructions or entitlement orders. (As explained in Section 8-102, Comment 8, an entitlement order includes a direction under Section 8-508 to the securities intermediary to transfer a financial asset to the account of the entitlement holder at another financial intermediary or to cause the financial asset to be transferred to the entitlement holder in the direct holding system (e.g., by delivery of a securities certificate registered in the name of the former entitlement holder).) Subsection (f) is included to make clear the general point stated in subsection subsections (c) and (d) that the test of control is whether the purchaser has obtained the requisite power, not whether the debtor has retained other powers. There is no implication that retention by the debtor of powers other than those mentioned in subsection (f) is inconsistent with the purchaser having

control. Nor is there a requirement that the purchaser's powers be unconditional, provided that further consent of the entitlement holder is not a condition.

Example 10. Debtor grants to Alpha Bank and to Beta Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. By agreement among the parties, Alpha's security interest is senior and Beta's is junior. Able agrees to act on the entitlement orders of either Alpha or Beta. Alpha and Beta each has control under subsection (d)(2). Moreover, Beta has control notwithstanding a term of Able's agreement to the effect that Able's obligation to act on Beta's entitlement orders is conditioned on the Alpha's consent. The crucial distinction is that Able's agreement to act on Beta's entitlement orders is not conditioned on Debtor's further consent.

Example 11. Debtor grants to Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Able agrees to act

on the entitlement orders of Alpha, but Alpha's right to give entitlement orders to the securities intermediary is conditioned on the Debtor's default. Alternatively, Alpha's right to give entitlement orders is conditioned upon Alpha's statement to Able that Debtor is in default. Because Able's agreement to act on *Beta's Alpha's*\* entitlement orders is not conditioned on Debtor's further consent, Alpha has control of the securities entitlement under either alternative.

In many situations, it will be better practice for both the securities intermediary and the purchaser to insist that any conditions relating in any way to the entitlement holder be effective only as between the purchaser and the entitlement holder. That practice would avoid the risk that the securities intermediary could be caught between conflicting assertions of the entitlement holder and the purchaser as to whether the conditions in fact have been met. Nonetheless, the existence of unfulfilled conditions effective against the intermediary would not preclude the purchaser from having control.

## § 8-110. Applicability; Choice of Law.

\* \* \*

(e) The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:

- (1) If an agreement between the securities intermediary and its entitlement holder ~~specifies that it is governed by the law of a particular jurisdiction governing the securities account expressly provides that a particular jurisdiction is the securities intermediary's jurisdiction for purposes of this part, this article, or this [Act], that jurisdiction is the securities intermediary's jurisdiction.~~
- (2) If paragraph (1) does not apply and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.
- (2)(3) If neither paragraph (1) nor paragraph (2) applies and an agreement between the securities intermediary and its entitlement holder ~~does not specify the governing law as provided in paragraph (1), but governing the securities account expressly specifies provides that the securities~~

\* Amendments in italics approved by the Permanent Editorial Board for Uniform Commercial

Code January 15, 2000.

account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

~~(3)(4)~~ If an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in paragraph (1) or (2), none of the preceding paragraphs applies, the securities intermediary's jurisdiction is the jurisdiction in which ~~is located~~ the office identified in an account statement as the office serving the entitlement holder's account is located.

~~(4)(5)~~ If an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in paragraph (1) or (2) and an account statement does not identify an office serving the entitlement holder's account as provided in paragraph (3), none of the preceding paragraphs applies, the securities intermediary's jurisdiction is the jurisdiction in which ~~is located~~ the chief executive office of the securities intermediary is located.

(f) A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets, or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or by the location of facilities for data processing or other record keeping concerning the account.

#### Official Comment

\* \* \*

3. Subsection (b) provides that the law of the securities intermediary's jurisdiction governs the issues concerning the indirect holding system that are dealt with in Article 8. Paragraphs (1) and (2) cover the matters dealt with in the Article 8 rules defining the concept of security entitlement and specifying the duties of securities intermediaries. Paragraph (3) provides that the law of the security intermediary's jurisdiction determines whether the intermediary owes any duties to an adverse claimant. Paragraph (4) provides that the law of the security intermediary's jurisdiction determines whether adverse claims can be asserted against entitlement holders and others.

Subsection (e) determines what is a "securities intermediary's jurisdiction." The policy of subsection (b) is to ensure that a securities intermediary and all of its entitlement holders can look to a single, readily-identifiable body of law to determine their rights and duties. Accordingly, subsection (e) sets out a sequential series of tests to facilitate identification of that body of law. Paragraph (1) of subsection (e) permits specification of the governing law securities intermediary's

jurisdiction by agreement. In the absence of such a specification, the law chosen by the parties to govern the securities account determines the securities intermediary's jurisdiction. See paragraph (2). Because the policy of this section is to enable parties to determine, in advance and with certainty, what law will apply to transactions governed by this Article, the validation of the parties' selection of governing law by agreement is not conditioned upon a determination that the jurisdiction whose law is chosen bear a "reasonable relation" to the transaction. See Section 4A-507; compare Section 1-105(1). That is also true with respect to the similar provisions in subsection (d) of this section and in Section 9-103(6) 9-305. The remaining paragraphs in subsection (e) contain additional default rules for determining the securities intermediary's jurisdiction.

\* \* \*

5. The following examples illustrate how a court in a jurisdiction which has enacted this section would determine the governing law:

Example 1. John Doe, a resident of Kansas, maintains a securities account with

Able & Co. Able is incorporated in Delaware. Its chief executive offices are located in Illinois. The office where Doe transacts business with Able is located in Missouri. The agreement between Doe and Able specifies that ~~it is governed by Illinois law~~ is the securities intermediary's (Able's) jurisdiction. Through the account, Doe holds securities of a Colorado corporation, which Able holds through Clearing Corporation. The rules of Clearing Corporation provide that the rights and duties of Clearing Corporation and its participants are governed by New York law. Subsection (a) specifies that a controversy concerning the

rights and duties as between the issuer and Clearing Corporation is governed by Colorado law. Subsections (b) and (e) specify that a controversy concerning the rights and duties as between the Clearing Corporation and Able is governed by New York law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

\* \* \*

7. The choice of law provisions concerning security interests in securities and security entitlements are set out in Section ~~9-103(6)~~ 9-305.

### § 8-301. Delivery.

(a) Delivery of a certificated security to a purchaser occurs when:

- (1) the purchaser acquires possession of the security certificate;
- (2) another person, other than a securities intermediary, either acquires possession of the security certificate on behalf of the purchaser or, having previously acquired possession of the certificate, acknowledges that it holds for the purchaser; or
- (3) a securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, only if the certificate is in registered form and ~~has been~~ is (i) registered in the name of the purchaser, (ii) payable to the order of the purchaser, or (iii) specially indorsed to the purchaser by an effective indorsement and has not been indorsed to the securities intermediary or in blank.

\* \* \*

#### Official Comment

\* \* \*

2. Subsection (a) defines delivery with respect to certificated securities. Paragraph (1) deals with simple cases where purchasers themselves acquire physical possession of certificates. Paragraphs (2) and (3) of subsection (a) specify the circumstances in which delivery to a purchaser can occur although the certificate is in the possession of a person other than the purchaser. Paragraph (2) contains the general rule that a purchaser can take delivery through another person, so long as the other person is actually acting on behalf of the purchaser or acknowledges that it is holding on behalf of

the purchaser. Paragraph (2) does not apply to acquisition of possession by a securities intermediary, because a person who holds securities through a securities account acquires a security entitlement, rather than having a direct interest. See Section 8-501. Subsection (a)(3) specifies the limited circumstances in which delivery of security certificates to a securities intermediary is treated as a delivery to the customer. Note that delivery is a method of perfecting a security interest in a certificated security. See Section 9-313(a), (e).

\* \* \*

**§ 8-302. Rights of Purchaser.**

(a) Except as otherwise provided in subsections (b) and (c), a purchaser upon delivery of a certificated or uncertificated security to a purchaser, the purchaser acquires all rights in the security that the transferor had or had power to transfer.

(b) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

(c) A purchaser of a certificated security who as a previous holder had notice of an adverse claim does not improve its position by taking from a protected purchaser.

**Official Comment**

1. Subsection (a) provides that if a purchaser of a certificated or uncertificated security is delivered (Section 8-301) to a purchaser in a transfer, the purchaser acquires all rights that the transferor had or had power to transfer. This statement of the familiar "shelter" principle is qualified by the exceptions that a purchaser of a limited interest acquires only that interest, subsection (b), and that a person who does not qualify as a protected purchaser cannot improve its position by taking from a subsequent protected purchaser, subsection (c).

2. Although this section provides that a purchaser acquires a property interest in a certificated or uncertificated security upon "delivery," it does not state that a person can acquire an interest in a security only by delivery purchase. Article 8 also is not a comprehensive codification of all of the law governing the creation or transfer of interests in securities by purchase.\* For example, the grant of a security interest is a transfer of a property interest, but the formal steps necessary to effectuate such a transfer are

governed by Article 9, not by Article 8. Under the Article 9 rules, a security interest in a certificated or uncertificated security can be created by execution of a security agreement under Section 9-203 and can be perfected by filing. A transfer of an Article 9 security interest can be implemented by an Article 8 delivery, but need not be.

Similarly, Article 8 does not determine whether a property interest in certificated or uncertificated security is acquired under other law, such as the law of gifts, trusts, or equitable remedies. Nor does Article 8 deal with transfers by operation of law. For example, transfers from decedent to administrator, from ward to guardian, and from bankrupt to trustee in bankruptcy are governed by other law as to both the time they occur and the substance of the transfer. The Article 8 rules do, however, determine whether the issuer is obligated to recognize the rights that a third party, such as a transferee, may acquire under other law. See Sections 8-207, 8-401, and 8-404.

**§ 8-502. Assertion of Adverse Claim Against Entitlement Holder.**

\* \* \*

**Official Comment**

\* \* \*

3. The following examples illustrate the operation of Section 8-502.

\* \* \*

Example 4. Debtor holds XYZ Co. shares in a securities account with Able & Co. As collateral for a loan from Bank, Debtor grants Bank a security interest in the security entitlement to the XYZ Co. shares.

\* Amendments in italics approved by the Permanent Editorial Board for Uniform Commercial

Code January 15, 2000.

Bank perfects by a method which leaves Debtor with the ability to dispose of the shares. See Section ~~9-115~~ 9-312. In violation of the security agreement, Debtor sells the XYZ Co. shares and absconds with the proceeds. Assume—implausibly—that Bank is able to trace the XYZ Co. shares and show that the “same shares” ended up in Buyer’s securities account with Baker & Co. Section 8-502 precludes any action by Bank against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

\* \* \*

Example 6. Debtor grants Alpha Co. a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha also has an account with Able. Debtor instructs Able to transfer the shares to Alpha, and Able does so by crediting the shares to Alpha’s account. Alpha has control of the 1000 shares under Section 8-106(d). (The facts to this

point are identical to those in Section 8-106, Comment 4, Example 1, except that Alpha Co. was Alpha Bank.) Alpha next grants Beta Co. a security interest in the 1000 shares included in Alpha’s security entitlement. See Section 9-207(c)(3). Alpha instructs Able to transfer the shares to Gamma Co., Beta’s custodian. Able does so, and Gamma credits the 1000 shares to Beta’s account. Beta now has control under Section 8-106(d). By virtue of Debtor’s explicit permission or by virtue of the permission inherent in Debtor’s creation of a security interest in favor of Alpha and Alpha’s resulting power to grant a security interest under Section 9-207, Debtor has no adverse claim to assert against Beta, assuming implausibly that Debtor could “trace” an interest to the Gamma account. Moreover, even if Debtor did hold an adverse claim, if Beta did not have notice of Debtor’s claim, Section 8-502 will preclude any action by Debtor against Beta, whether framed in constructive trust or other theory.

\* \* \*

### § 8-510. Rights of Purchaser of Security Entitlement From Entitlement Holder.

(a) An In a case not covered by the priority rules in Article 9 or the rules stated in subsection (c), an action based on an adverse claim to a financial asset or security entitlement, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who purchases a security entitlement, or an interest therein, from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim, and obtains control.

(b) If an adverse claim could not have been asserted against an entitlement holder under Section 8-502, the adverse claim cannot be asserted against a person who purchases a security entitlement, or an interest therein, from the entitlement holder.

(c) In a case not covered by the priority rules in Article 9, a purchaser for value of a security entitlement, or an interest therein, who obtains control has priority over a purchaser of a security entitlement, or an interest therein, who does not obtain control. Purchasers Except as otherwise provided in subsection (d), purchasers who have control rank equally, except that a according to priority in time of:

- (1) the purchaser’s becoming the person for whom the securities account, in which the security entitlement is carried, is maintained, if the purchaser obtained control under Section 8-106(d)(1);



- (2) the securities intermediary's agreement to comply with the purchaser's entitlement orders with respect to security entitlements carried or to be carried in the securities account in which the security entitlement is carried, if the purchaser obtained control under Section 8-106(d)(2); or
- (3) if the purchaser obtained control through another person under Section 8-106(d)(3), the time on which priority would be based under this subsection if the other person were the secured party.

(d) A securities intermediary as purchaser has priority over a conflicting purchaser who has control unless otherwise agreed by the securities intermediary.

#### Official Comment

\* \* \*

4. Subsection (c) specifies a priority rule for cases where an entitlement holder transfers conflicting interests in the same security entitlement to different purchasers. It follows the same principle as the Article 9 priority rule for investment property, that is, control trumps non-control. Indeed, the most significant category of conflicting "purchasers" may be secured parties. Priority questions for security interests, however, are governed by the rules in Article 9. Subsection (c) applies only to cases not covered by the Article 9 rules. It is intended primarily for disputes over conflicting claims arising out of repurchase agreement transactions that are not covered by the other rules set out in Articles 8 and 9.

The following example illustrates subsection (c):

Example 4. Dealer holds securities through an account at Alpha Bank. Alpha Bank in turn holds through a clearing corporation account. Dealer transfers securities to RP1 in a "hold in custody" repo transaction. Dealer then transfers the same securities to RP2 in another repo transaction. The repo to RP2 is implemented by transferring the securities from Dealer's regular account at Alpha Bank to a special account maintained by Alpha Bank for Dealer and RP2. The agreement among Dealer, RP2, and Alpha Bank provides that Dealer can make substitutions for the securities but RP2 can direct Alpha Bank to sell any securities held in the special account. Dealer becomes insolvent. RP1 claims a prior interest in the securities transferred to RP2.

In this example Dealer remained the entitlement holder but agreed that RP2 could initiate entitlement orders to Dealer's security intermediary, Alpha Bank. If RP2 had become the entitlement holder, the adverse claim rule of Section 8-502 would apply. Even if RP2 does not become the entitlement holder, the arrangement among Dealer, Alpha Bank, and RP2 does suffice to give RP2 control. Thus, under Section 8-510(c), RP2 has priority over RP1, because RP2 is a purchaser who obtained control, and RP1 is a purchaser who did not obtain control. The same result could be reached under Section 8-510(a) which provides that RP1's earlier in time interest cannot be asserted as an adverse claim against RP2. The same result would follow under the Article 9 priority rules if the interests of RP1 and RP2 are characterized as "security interests," see Section ~~9-115(5)(a)~~ 9-328(1). The main point of the rules of Section 8-510(c) is to ensure that there will be clear rules to cover the conflicting claims of RP1 and RP2 without characterizing their interests as Article 9 security interests.

The priority rules in Article 9 for conflicting security interests also include a default temporal priority rule of pro-rata treatment for cases where multiple secured parties have obtained control but omitted to specify their respective rights by agreement. See Section ~~9-115(5)(b)~~ 9-328(2) and Comment ~~6 5~~ to Section ~~9-115~~ 9-328. Because the purchaser priority rule in Section 8-510(c) is intended to track the Article 9 priority rules, it too has a pro-rata temporal priority rule for cases where multiple non-secured party purchasers have obtained control but omit-

ted to specify their respective rights by agreement. The rule is patterned on Section 9-328(2).

5. If a securities intermediary itself is a purchaser, subsection (d) provides that it has priority over the interest of another purchaser who has control. Article 9 contains a similar rule. See Section 9-328(3).

## APPENDIX II

### MODEL PROVISIONS FOR PRODUCTION-MONEY PRIORITY

*Legislative Note: States that enact these model provisions should add the following definitions to Section 9-102(a) following the definition of "proceeds" and preceding the definition of "promissory note", renumbering paragraphs in 9-102(a) accordingly:*

( ) "Production-money crops" means crops that secure a production-money obligation incurred with respect to the production of those crops.

( ) "Production-money obligation" means an obligation of an obligor incurred for new value given to enable the debtor to produce crops if the value is in fact used for the production of the crops.

( ) "Production of crops" includes tilling and otherwise preparing land for growing, planting, cultivating, fertilizing, irrigating, harvesting, and gathering crops, and protecting them from damage or disease.

#### **[MODEL SECTION [9-103A]. "PRODUCTION-MONEY CROPS"; "PRODUCTION-MONEY OBLIGATION"; PRODUCTION-MONEY SECURITY INTEREST; BURDEN OF ESTABLISHING.**

(a) A security interest in crops is a production-money security interest to the extent that the crops are production-money crops.

(b) If the extent to which a security interest is a production-money security interest depends on the application of a payment to a particular obligation, the payment must be applied:

- (1) in accordance with any reasonable method of application to which the parties agree;
- (2) in the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or
- (3) in the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order:
  - (A) to obligations that are not secured; and
  - (B) if more than one obligation is secured, to obligations secured by production-money security interests in the order in which those obligations were incurred.

(c) A production-money security interest does not lose its status as such, even if:

- (1) the production-money crops also secure an obligation that is not a production-money obligation;

- (2) collateral that is not production-money crops also secures the production-money obligation; or
- (3) the production-money obligation has been renewed, refinanced, or restructured.

(d) A secured party claiming a production-money security interest has the burden of establishing the extent to which the security interest is a production-money security interest.

*Legislative Note: This section is optional. States that enact this section should place it between Sections 9-103 and 9-104 and number it accordingly, e.g., as Section 9-103A or 9-103.1.*

#### Official Comment

1. **Source.** New.
2. **Production-Money Priority; "Production-Money Security Interest."** This section is patterned closely on Section 9-103, which defines "purchase-money security interest." Subsection (b) makes clear that a security interest can obtain production-money status only to the extent that it secures value that actually can be traced to the direct production of crops. To the extent that a security interest secures indirect costs of production, such as general living expenses, the security interest is not entitled to production-money treatment.

#### [MODEL SECTION [9-324A]. PRIORITY OF PRODUCTION-MONEY SECURITY INTERESTS AND AGRICULTURAL LIENS.

(a) Except as otherwise provided in subsections (c), (d), and (e), if the requirements of subsection (b) are satisfied, a perfected production-money security interest in production-money crops has priority over a conflicting security interest in the same crops and, except as otherwise provided in Section 9-327, also has priority in their identifiable proceeds.

(b) A production-money security interest has priority under subsection (a) if:

- (1) the production-money security interest is perfected by filing when the production-money secured party first gives new value to enable the debtor to produce the crops;
- (2) the production-money secured party sends an authenticated notification to the holder of the conflicting security interest not less than 10 or more than 30 days before the production-money secured party first gives new value to enable the debtor to produce the crops if the holder had filed a financing statement covering the crops before the date of the filing made by the production-money secured party; and
- (3) the notification states that the production-money secured party has or expects to acquire a production-money security interest in the debtor's crops and provides a description of the crops.

(c) Except as otherwise provided in subsection (d) or (e), if more than one security interest qualifies for priority in the same collateral under subsection (a), the security interests rank according to priority in time of filing under Section 9-322(a).

(d) To the extent that a person holding a perfected security interest in production-money crops that are the subject of a production-money security inter-