2024 UCC UPDATE
Legislative Research Commission

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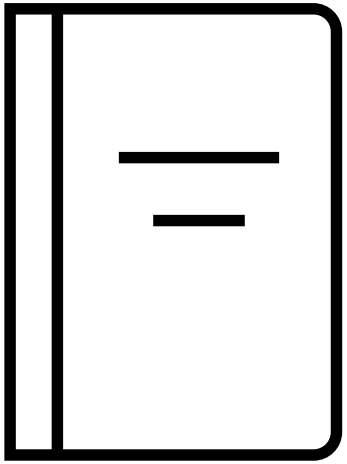

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WHAT IS THE UCC?

Nation's Primary Body of Commercial Law

State Law

Covers the Sale and Lease of Goods, Negotiable Instruments, Bank Deposits and Collections, Wire Transfers, Letters of Credit, Warehouse Receipts, Investment Securities, Secured Transactions, and Controllable Electronic Records (digital assets)

PURPOSE OF THE UCC

The purpose of the UCC is to facilitate commerce by providing certainty in the outcome of commercial transactions.

HOW DOES THE UCC WORK?

Through uniformity of the law amongst the states

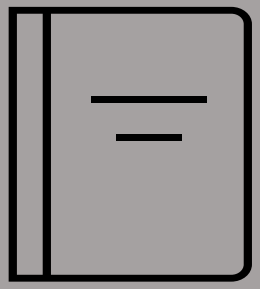
States can maintain uniformity while tailoring the law for the individual state

Equine Collateral

Loss allocation rules that generally protect the party least able to protect itself

HISTORY OF THE UCC

- Kentucky was one of the first two states to adopt the UCC in 1958, effective January 1, 1960
- The UCC has always chased technological and commercial changes
- Additional Articles covered leases and wire transfers
- Revisions addressed computerization of UCC records



DRAFTING OF THE 2022 AMENDMENTS

- Study Committee appointed in 2019
- Drafting began in 2020
- Presented to the ULC in 2021 for discussion
- Adopted as a Uniform Act in 2022

2022 AMENDMENTS ARE THE FIRST REVISION OF THE ENTIRE UCC AND ADD ARTICLE 12

- Purpose: To Accommodate Emerging Technologies
  - Drafted for durability and to accommodate technologies not yet developed

ENACTMENTS

- 21 states have enacted the Amendments
- 2 states are close to enacting the Amendments (IL and RI)
- Pending in 6 additional states
- Conspiracy theories have delayed what ordinarily would be enactment by all states

THE 2022 AMENDMENTS DO <u>NOT</u> FACILITATE A CENTRAL BANK DIGITAL CURRENCY

- Section 113, SB 155:
  - **"Nothing in this Act shall be construed to support, endorse, create, or implement a national digital currency."**
  - **Article 8-511 does NOT enable the large banks and brokerage companies to steal your investment securities.**

2022 Amendments to the UCC to Accommodate Emerging Technologies in Kentucky

Kentucky Senate Bill 155
Sponsored by Sen. Whitney Westerfield

Effective January 1, 2025

Kentucky was the 15th state to enact the Amendments

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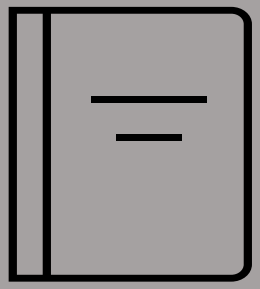
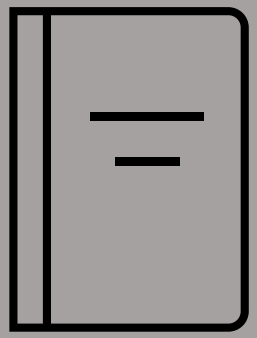


2022 AMENDMENTS TO THE UNIFORM COMMERCIAL CODE

- Create a new UCC Article 12 on Controllable Electronic Records
- Updates Article 9 to accommodate perfection of security interests in digital assets
- New rules for mixed transactions involving both goods and services
- Updated rules for electronic negotiable instruments
- Updated terminology to account for electronic signature and documents

UCC Article 12
Controllable Electronic Records

- Ongoing effort to adapt the UCC to emerging technologies
- Drafted with a broad application in mind
    - Virtual currency and distributed ledger technology
- Main function: Clarify the rights of a purchaser of a controllable electronic record.[1.]
- UCC § 12-102(a)(1): "Controllable electronic record" means a record stored in an electronic medium that can be subjected to control under Section 12-105. The term does not include a controllable account, a controllable payment intangible, a deposit account, an electronic copy of a record evidencing chattel paper, an electronic document of title, electronic money, investment property, or a transferable record.



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1 Uniform Commercial Code & Emerging .Technologies, Uniform Law Commission, January 28-29, 2022 Committee Meeting Report at 89.

UCC Article 12
Controllable Electronic Records

- There is a difference between records and the rights attached to those records.
- A controllable record could or could not be inherently valuable.
- Generally, Article 12 applies to the records, not the rights. Look to other law, including Article 9, for provisions governing rights.
    - Exception: "controllable accounts" and "controllable payment intangibles"

UCC Article 12
Controllable Electronic Records

- UCC § 12-105 provides the definition of "Control"
- (a) A person has control of a controllable record if the electronic record, a record attached to or logically associated with the electronic record, or a system in which the electronic record is recorded:
  - (1) gives the person:
    - (A) the power to avail itself of substantially all the benefit from the electronic record
    - (B) exclusive power, subject to subsection (b) [control through another person], to:
    - (i) prevent others from availing themselves of substantially all the benefit from the electronic record; and
    - (ii) transfer control of the electronic record to another person or cause another person to obtain control of another controllable electronic record as a result of the transfer of the electronic record; and
  - (2) enables the person readily to identify itself in any way, including by name, identifying number, cryptographic key, office, or account number, as having the powers specified in paragraph (1).

Section 12-104
Rights in Controllable Account, Controllable Electronic Record, and Controllable Payment Intangible

- UCC § 12-104(d) "Shelter" provision under which a purchaser "acquires all rights in the controllable electronic record that the transferor had or had power to transfer…"
  - Commentary suggests this provision should be read broadly to account for situations where the transfer of a controllable electronic record results in a new type or form of a controllable electronic record
- UCC § 12-104(e) provides that a qualifying purchaser "acquires its rights in the controllable electronic record free of a claim of a property right in the controllable electronic record."
  - Take-free rule similar to the good-faith purchaser provisions found in Articles 2, 3, 7, and 9

Section 12-104
Rights in Controllable Account, Controllable Electronic Record, and Controllable Payment Intangible

- UCC § 12-104(f) outlines exceptions to subsection (e)'s take-free rule
  - This provision limits the application of the rule to controllable electronic records, controllable accounts, and controllable payment intangibles.
- UCC § 12-104(g): The No-Action Rule
  - This provisions protects purchasers in those situations where the acquired record is not the "same" as the record that was transferred.

Corresponding Changes to Article 9 with the Addition of Article 12

- Two New Types of collateral
- UCC § 9-102(27A) "Controllable account" means an account evidenced by a controllable electronic record that provides that the account debtor undertakes to pay the person that under Section 12-105 has control of the controllable electronic record.

- UCC § 9-102(27B) "Controllable payment intangible" means a payment intangible evidenced by a controllable electronic record that provides that the account debtor undertakes to pay the person that under Section 12-105 has control of the controllable electronic record.

Changes to Article 9 with the Addition of Article 12

- Definition of “general intangible” is expanded to include controllable electronic records
- Definition of “payment intangible” now includes a controllable payment intangible

Changes to Article 9 with the Addition of Article 12

- Perfection of a security interest in a controllable account or controllable payment intangible:
  - 1. filing a financing statement; or
  - 2. obtaining control of the controllable electronic record that evidences the account or payment intangible.
  - UCC § 9-312(a); UCC § 9-314(a); UCC § 9-107(A)(b)
  - Perfection by control will have priority over a conflicting security interest that is perfected by a different method. UCC § 9-326A

Changes to Article 9 with the Addition of Article 12

- UCC § 9-105
  - Control of Electronic Copy of Record Evidencing Chattel Paper
- New sections provide extensive rules for electronic chattel paper
- UCC § 9-105A
  - Control of Money in Electronic Form
  - Distinguished from "Tangible money" which means money in tangible form

Changes to the UCC

- Removing many references to “written”
- Removing all references to “authenticated”

New Definitions in Article 1

- "Electronic" means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities. UCC § 1-201(b)(16A)
- Newly added provision to the definition of "Money" excludes from said definition "an electronic record that is a medium of exchange recorded and transferable in a system that existed and operated for the medium of exchange before the medium of exchange was authorized or adopted by the government. UCC § 1-201(b)(24)

New Definitions in Article 1

- "Sign" means, with present intent to authenticate or adopt a record:

  (A) execute or adopt a tangible symbol; or

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

  UCC § 1-201(b)(37)

Revisions to Articles 2 and 2A

- "Hybrid Transaction" means a single transaction involving a sale of goods and:

  (a) the provision of services;

  (b) the lease of other goods; or

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

  UCC § 2-106(5)

Revisions to Article 3

- A new subsection is added to KRS § 355.3-604 to accommodate mobile deposits and check truncations.

- "The obligation of a party to pay the instrument is not discharged by the destruction of a check in connection with a process in which information is extracted from the check and an image of the check is made and, subsequently, the information and image are transmitted for payment."

Revisions to Article 3

- A “negotiable instrument” may now include a term that specifies a choice of law and choice of forum.

Revisions to Articles 3 and 4

- Plaintiff on a presentment warranty can recover “reasonable attorneys’ fees”

Revisions to Article 4A

- Additions to the definition of "Security Procedure" in UCC § 4A-201
  - "may impose an obligation on the receiving bank or the customer"
  - Requiring a payment order to be sent from a known email address, IP address, or telephone number are NOT alone a security procedure

Revisions to Article 5

- If a letter of credit agreement does not contain a choice of law clause, then the law of the jurisdiction in which the person is located applies.
- A person is located in the state where the person's undertaking was issued.

- Revisions to Article 7
- The rules relating to electronic warehouse receipts are improved and the concept of "control" is included.

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- The rules relating to electronic warehouse receipts are improved and the concept of “control” is included.

Revisions to Article 8

- Controllable Accounts, electronic records, and payment intangibles are added to the definition section and used in the Article.

Additional Revisions to Article 9

- Provisions regarding "chattel paper" are expanded to include certain leases.
- Part 4 is amended to match Kentucky organizational law that allows restrictions on the grant of a security interest in a general partnership, limited partnership, or LLC.
- The "magic form" notices of disposition under UCC § 9-613 and § 9-614 are improved and recognize electronic communication.

Transition

- The Amendments will be effective January 1, 2025.
- Secured parties will have an "adjustment date" of July 1, 2025.

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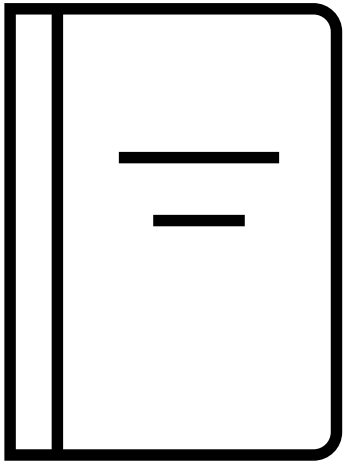

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