

# Legislative Analysis

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## UNIFORM COMMERCIAL CODE UPDATES

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**House Bill 5081 (Substitute H-1)**  
**Sponsor: Rep. Matt Huuki**

**House Bill 5082 (Substitute H-1)**  
**Sponsor: Rep. Kevin Cotter**

**House Bill 5083 (Substitute H-1)**  
**Sponsor: Rep. Ellen Cogen Lipton**  
**Committee: Banking and Financial Services**

**Complete to 1-24-12**

### **A SUMMARY OF HOUSE BILLS 5081-5083 AS REPORTED FROM COMMITTEE:**

Each of the bills described in this summary would amend the Uniform Commercial Code (MCL 440.1101-440.1211). The UCC is a comprehensive code that deals with most elements of commercial law, including sales, negotiable instruments, bank deposits and collections, and investment securities. It has been described as a set of suggested laws relating to commercial transactions. The UCC is a model code, drafted by private organizations, and must be adopted by a state legislature for it to have legal effect in that state. It has been enacted, with some variations, in every state, as well as in the District of Columbia and the Virgin Islands.

From time to time, recommendations are made for amendments to the Code, and legislation implementing those recommendations is then introduced in state legislatures. The recommendations are produced by the Uniform Law Commission (ULC), also known as the National Conference of Commissioners on Uniform State Laws (NCCUSL).

The Uniform Commercial Code is divided into "articles" by subject matter. As of 2011, the types of transactions included within the Code are: Sales (Amended Article 2); Leases (Amended Article 2A); Negotiable Instruments, previously known as Commercial Paper (Revised Article 3); Bank Deposits and Collections (Amended Article 4); Funds Transfers (Article 4A); Letters of Credit (Revised Article 5); Bulk Sales, previously known as Bulk Transfers (Revised Article 6, now repealed); Documents of Title (Revised Article 7); Investment Securities (Revised Article 8); and Secured Transactions (Revised Article 9). Article 1 of the Code contains a set of general provisions equally applicable to all subsequent articles.

These bills implement changes to the UCC that have been recommended in recent years, primarily to Articles 1, 7, and 9.

House Bill 5081 primarily amends Article 1 of the UCC, the general provisions article. It also contains complementary amendments and technical amendments to Articles 2, 2A, 3, 4A, 5, and 8.

House Bill 5082 primarily amends Article 7 (Documents of Title). It also contains amendments to Articles 1, 2, 2A, and 4. The thrust of these amendments are the recognition of electronic documents of title, including electronic records and signatures. Generally speaking, electronic documents of title are treated equally with tangible documents of title.

House Bill 5083 amends Article 9 (Secured Transactions) and repeals Article 11. (Article 11 contains effective date provisions from prior amending legislation, as well as provisions regarding the transition to those amendments.) The Article 9 amendments deal with the filing of financing statements, among other things. (This article was updated comprehensively in 2000. Explanations of that legislation can be found at: <http://www.legislature.mi.gov/documents/1999-2000/billanalysis/House/pdf/1999-HLA-5228-C.pdf>)

House Bills 5081-5083 are all tie-barred to one another, meaning none will take effect unless all do. The effective date of the bills is July 1, 2013.

**This document provides, in what follows, the NCCUSL's own summaries of these recommended changes.** These descriptions were obtained from the organization's website at: <http://uniformlaws.org/Acts.aspx>.

### **House Bill 5081: UCC Article 1, General Provisions (2001)**

Article 1 of the Uniform Commercial Code (UCC) provides definitions and general provisions which, in the absence of conflicting provisions, apply as default rules covering transactions and matters otherwise covered under a different article of the UCC. As other parts of the UCC have been revised and amended to accommodate changing business practices and development in the law, these modifications need to be reflected in an updated Article 1. Thus, Article 1 contains many changes of a technical, non-substantive nature, such as reordering and renumbering sections, and adding gender neutral terminology. In addition, over the years it has been in place, certain provisions of Article 1 have been identified as confusing or imprecise. Several changes reflect an effort to add greater clarity in light of this experience. Finally, developments in the law have led to the conclusion that certain changes of a substantive nature needed to be made.

The first substantive change is intended to clarify the scope of Article 1. Section [1102] [MCL 440.1102] now expressly states that the substantive rules of Article 1 apply only to transactions within the scope of other articles of the UCC. Second, the statute of frauds requirement that sometimes has been interpreted to govern transactions outside the UCC has been deleted. Statute of frauds issues have been resolved article by article in the UCC, and a statute of frauds provision in Article 1 has become redundant and not applicable in the UCC. Third, amended [Section 1103] clarifies the application of

supplemental principles of law by establishing UCC rules as primary when there is a conflict. Fourth, the definition of "good faith" found in [1201] is revised to mean "honesty in fact and the observance of reasonable commercial standards of fair dealing." This change conforms to the definition of good faith that applies in all of the recently revised UCC articles except Revised Article 5. Fifth, evidence of "course of performance" may be used to interpret a contract along with course of dealing and usage of trade.

The 2001 Revision of Uniform Commercial Code Article 1 rounds out a complete refurbishment of the Uniform Commercial Code that began in 1985. New articles have been added. All the major articles have been either revised or amended. Article 6 on "Bulk Transfers" may be repealed, by recommendation, shortening the UCC by one article. The Article 1 Revision merely responds to all of the work and effort on the UCC since 1985.

### **House Bill 5082: UCC Article 7, Documents of Title (2003)**

The original **Article 7 of the Uniform Commercial Code**, "Warehouse Receipts, Bills of Lading and Other Documents of Title," combined two earlier uniform acts, the Uniform Warehouse Receipts Act (1906) and the Uniform Bills of Lading Act (1909), with some principles from the Uniform Sales Act (which became Article 2-Sales of the UCC). Article 7 had not been revisited after the 1951 promulgation of the original Uniform Commercial Code until 2003, a period of 52 years. The longevity of the principles of warehouse receipts and bills of lading suggests very successful law and law-making as it pertains to the commercial storage and shipment of goods. The basic principles do not change in the 2003 revision. But there are reasons to readdress this area of the commercial law in 2003, which shall be discussed a little later. First, it is necessary to establish some of the basics.

#### **Introduction to Documents of Title**

The storage and shipment of tangible goods for commercial purposes has been going on for centuries. The physical side of the business is carried on by entities that provide warehouses (warehousemen) and entities that carry the goods from place of origin to destination (common carriers). These are tangible, visible businesses. What is not tangible and visible is the transfer of rights in the goods while they are stored and/or shipped. The common law provided the rules of bailment. The terminology of bailor and bailee is still incorporated in the Uniform Act. As the law developed, the transfer of rights came to depend upon the transfer of specific documents of title. The transfer of the documents from one person to another became the transfer of the rights. The title documents were warehouseman's receipts on the storage/warehouse side, and the bill of lading on the carrier side. The original uniform acts and the 2003 revision all incorporate these basics.

One of the important principles carried forward into the 2003 revision is that of negotiability. Free transfer of interests is an important policy norm throughout the UCC. In Article 7, documents of title may be negotiable. Whether a document is negotiable or non-negotiable depends upon how it identifies the transferee and how it is transferred. A negotiable document may be one of two kinds of paper documents, bearer paper or order

paper. A document made out to bearer may be transferred from one person to another by simple delivery of possession. The delivery transfers the rights to the goods (therefore the title) to the transferee. Order paper is made out to a specific person. After initial delivery to the person named on the document, it may be negotiated to another person by the indorsement of the named person and delivery of possession to that other person. The rights to the goods (and therefore the title) pass with the negotiation to the transferee.

Documents of title may also be made non-negotiable. This is primarily done by a statement on the face of the instrument. Non-negotiable documents of title may also be assigned or transferred. The difference between negotiable and non-negotiable documents is the rights that they may transfer. A non-negotiable document of title transfers only the actual interests of the transferor. A negotiable document of title may transfer more than the actual interests of the transferor. If negotiated, for example, it transfers free of any claims against the issuer of the document. A non-negotiable document is not free of such claims.

Negotiation as a concept exists to make commerce in goods possible. Goods would not be transferred if the purchaser always has to look behind the transaction to see who may come after the goods after the transfer is complete. Negotiation erases the peril. The principle enunciated in Article 7 is consistent with other parts of the UCC governing notes, drafts, checks and investment securities.

### **Electronic Documents of Title**

Article 7 governs other important aspects of the transfer of rights in goods when stored or shipped, such as the liens of warehousemen and carriers and their enforcement and allocation of risk of loss of the goods either in storage or transit, but the issue of negotiation has been its single most important aspect, up to the revisions in 2003. Something very important has happened to change the way we look at the principle of negotiation. That something is computers, electronic communications and the ability to create electronic documents of title. Computers have been accused and applauded for their impact on commerce and business. Their impact on storage and shipment of goods is profound. Federal law has actually recognized electronic documents for some time, but electronic documents of title cannot be substituted one to one with tangible documents of title. Their characteristics in electronic form are not the same as their characteristics in tangible form.

The tangible form is a written document on paper with signatures of issuers and subsequent transferors. The individual document is a unique token of the rights and interests it represents. Even if there is a copy, there is always the original. This is not so with electronic documents. Originals and copies are indistinguishable from each other in electronic form. Signatures in the sense of an individual's scribing them uniquely on a piece of paper cannot be equally duplicated in an electronic document. Transferors and transferees, who are remote from each other when tangible documents are transferred, are not remote from each other in electronic media. Electronic communications can occur between any two persons anywhere in the world. Yet, it is difficult for each participant in an electronic communication to verify or authenticate the identity of the other party. To have the effective electronic documents that commerce demands, new concepts have to

be introduced into the law. The concept of negotiation as we have known it in American law cannot apply in electronic media. The great addition to Article 7, therefore, is the new rules for electronic documents of title.

These rules must deal with distinct issues: recognition of electronic documents of title; statute of fraud extensions; establishment of the unique original in electronic form (sometimes thought of as authentication); and interchangeability between electronic and tangible documents of title. In addition, the rules for electronic documents of title must fit as seamlessly as possible into the existing system governing tangible documents of title. The law should avoid skewing the choice between tangible and electronic documents of title in the favor of either form. Only the actual marketplace should determine users' choices. Revised Article 7 deals with these issues and meets the test of seamless insertion into the existing law.

### **Recognition of Electronic Documents of Title**

Recognition of electronic documents of title begins in the definition of "Document of Title:" "An electronic document of title is evidence by a record consisting of information stored in an electronic medium." Other definitions have been modified to accord with this root definition. For example, "Holder" is defined to include: "a person in control of a negotiable electronic document of title." Electronic documents of title become the equal to tangible documents of title.

### **Statute of Frauds Requirements**

Revised Article 7 extends statute of fraud requirements to include electronic records and signatures. Any writing requirement that relates to enforceability of a document is a statute of frauds requirement. Article 7 treats electronic records and signatures as the equivalent of paper documents and written, manual signatures. This initially occurs in new definitions of "record" and "sign." A record is "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form." The term "sign" is defined to "execute or adopt a tangible symbol" and "to attach or logically associate with the record an electronic sound, symbol or process." Within Revised Article 7, wherever the term "writing" or an equivalent may have been used before revision, the term "record" is uniformly used. When a document is required to be signed anywhere in Revised Article 7, electronic signing meets the test.

In addition, Revised Article 7 provides language stating expressly that it modifies, limits and supersedes the federal Electronic Signatures in Global and National Commerce Act. This express language, permitted in the federal act, avoids any issue of federal preemption. The federal statute allows specific tailoring for the purposes of incorporating electronic records and signatures into state law.

### **Establishing the Unique Token**

It is not possible to transfer an electronic document of title in the same manner as a tangible document of title, particularly in terms of negotiating it. It cannot be guaranteed that a transfer directly from one person to the next by delivery and/or signature will transfer the authentic original document of title. An electronic alternative to the tangible

system is necessary. To accomplish the equivalent system for electronic documents of title, Article 7 adapts the concept of "control" to the purpose. It is not a brand-new concept. It initially was developed in Article 8 of the Uniform Commercial Code for investment securities in the indirect holding system. The 1999 revisions to Article 9 adapted the concept further for secured transactions. Further adaptation of the concept occurred in Section 16 of the Uniform Electronic Transactions Act for promissory notes. This latter adaptation is most important for Revised Article 7, because the issues of negotiation for promissory notes are very similar to those for documents of title.

A person has control of a document of title for Article 7 purposes "if a system employed for evidencing the transfer of interests in the electronic document reliably establishes that person as the person to which the electronic document was issued or transferred." Such a system exists when it establishes a "single authoritative copy ...which is unique, identifiable and ... unalterable." The authoritative copy must identify the person in control or the next person to whom the document has transferred. The person in control determines to whom the document is next transferred. Further, the standard requires that copies that are not authoritative, including copies of the authoritative copy, must be readily identifiable as not being the authoritative copy.

There is more than one way to meet this set of standards, unlike negotiation of a paper document, which occurs in one way only. One way to establish the single authoritative document is to have a single custodian of the electronic record, who enters all transfers of the document and identifies the person in control on its records, records that for all who want to know is the source of the single authoritative copy. In such a system, the person in control notifies the custodian of any transfer or authorized change in the document, who then notates its records appropriately and notifies the person in control and other relevant parties of the action. A transfer would obviously shift control from transferor to transferee. The transferee would become the new person in control.

Encryption technology may provide other methods for meeting these standards. Some kind of hybrid system of encryption and custodian may arise. UCC Article 7 prescribes no system per se and more than one system may develop over time. It is not possible to predict what technology may finally bring to electronic transfer systems. Revised Article 7 allows the technology to develop without need to amend it later when a new kind of technology comes along.

### **Interchangeability**

UCC Article 7 provides for an electronic system of transfer for electronic documents of title and for the traditional paper system of documents of title which includes negotiable documents of title. There are dual tracks. Control is the operative term with electronic documents and negotiation is the operative term for tangible documents of title. With respect to the transfer of rights in a particular group of goods, can electronic documents be converted to tangible documents and vice versa? UCC Article 7 provides for such conversions. An electronic document may be converted when the person in control surrenders control to the issuer, which then issues a tangible document of title containing a statement that it substitutes for the electronic document. The same kind of process will convert a tangible document to an electronic one. The person entitled to enforce a



tangible document surrenders possession to the issuer. The electronic document must also state that it is a substitute for the tangible document. Without the ability to convert from tangible to electronic documents, this system would not work.

### **Other Benefits to Revision**

The revisions to UCC Article 7, beyond making way for electronic documents of title, primarily update or clarify existing rules of law. There are references to tariffs and regulations in original UCC Article 7 that no longer exist with deregulation. These have been eliminated in the revision. There is nothing as significant as the rules for electronic documents of title. But these rules alone make it imperative for the states to enact the revision to UCC Article 7 as soon as practicable. Documents of title are fundamental to the transfer of goods in interstate commerce. The new rules are wholly commerce friendly and every state needs them as soon as possible.

### **House Bill 5083: UCC Article 9 Amendments (2010)**

Article 9 provides the rules governing any transaction (other than a finance lease) that couples a debt with a creditor's interest in a debtor's personal property. If the debtor defaults, the creditor may repossess and sell the property (generally called collateral) to satisfy the debt. The creditor's interest is called a "security interest." Article 9 also covers certain kinds of sales that look like a grant of a security interest.

Article 9 was substantially revised in 1998, and the 1998 revisions are in effect in all states and the District of Columbia. The 2010 amendments to Article 9 modify the existing statute to respond to filing issues and address other matters that have arisen in practice following over a decade of experience with the revised Article 9.

Of most importance, the 2010 amendments provide greater guidance as to the name of a debtor to be provided on a financing statement. For business entities and other registered organizations, the amendments clarify that the proper name for perfection purposes is the name filed with the state and provided on the organization's charter or other constitutive documents, to the extent there is a conflict with the name on an entity database. More importantly, the 2010 Amendments provide significantly greater clarity as to the name of an individual debtor to be provided on a financing statement.

Since the adoption of the 1998 revision of Article 9, there have been at least a dozen court decisions dealing with the question of what name needs to be provided on a financing statement for an individual debtor. Several states have adopted non-uniform amendments to Article 9 to address this issue. The 2010 Amendments to Article 9 give greater guidance by providing states with two alternatives.

- Alternative A, known as the "only-if" rule, requires a filer to provide on the financing statement the name on the debtor's driver's license, if the license has not on its face expired. If the debtor does not have a driver's license, the filer must use either the individual name of the debtor (i.e., whatever the debtor's name is under current law) or the debtor's surname and first personal name. A state considering adopting Alternative A should in particular consider whether the state's driver's

license database is compatible with its Uniform Commercial Code database as to characters, field length and the like.

- Alternative B, known as the "safe harbor" rule, leaves intact the requirement that the financing statement use the debtor's "individual name," but provides that the name on the driver's license will also be sufficient as well as the debtor's surname and first personal name.

If a state issues from the same office a non-driver's identification card, and it is not possible for the same individual to hold both a driver's license and a non-driver's identification card, the name provided on the non-driver's identification card may be used with the same effect as a driver's license name under either alternative.

A number of related changes were also made – for example the 2010 amendments make it clear that a change in the name used on a debtor's driver's license or the expiration of the driver's license may qualify as a name change for purposes of [9507(c)]. With respect to trusts, if collateral is held by a statutory trust or in Massachusetts type business trust, the trust is a registered organization and the trust's name is the debtor name. For common law trusts that are not Massachusetts type business trusts, the financing statement must provide the name of the trust as identified in the trust's organic records if it has name indicated there, or otherwise the name of the settlor or testator and sufficient additional information to distinguish a particular trust from others held by that same settlor or testator.

The Amendments also deal with perfection issues arising on after-acquired property when a debtor (individual or organization) moves to a new jurisdiction. Article 9 currently provides that perfection by filing continues for four months after the jurisdiction in which the debtor is located changes. However, this temporary period of perfection applies only with respect to collateral owned by the debtor at the time of the change. Even if the security interest attaches to after-acquired collateral, there is currently no perfection with respect to such new collateral unless and until the secured party perfects pursuant to the law of the new jurisdiction. The amendments change this by giving the filer perfection for four months in collateral acquired post-move. A similar change is made with respect to a new debtor that is a successor by merger. The new rule provides for temporary perfection in collateral owned by the successor before the merger or collateral acquired by the successor within four months after the merger.

Existing Section [9518] authorizes the debtor to file a correction statement: a claim that a financing statement filed against it was in fact unauthorized. While this filing has no legal effect on the underlying claim, it does put in the public record the debtor's claim that the financing statement was wrongfully filed. The amendments change Section [9518] in two ways. First, the filing is no longer called a "correction statement," but is instead referred to as an "information statement." Second, the amendments authorize the secured party of record to also file an information statement if the secured party believes that an amendment to its financing statement was not authorized. The change addresses concerns of secured parties that an amendment to a different financing statement may be inadvertently filed on the secured party's financing statement because the amendment contains an error when referring to the file number of the financing statement to be



amended. The comments also make clear that the secured party has no duty to file an information statement, even if it knows of the unauthorized filing. A number of additional technical amendments are also included in this package. For example, some extraneous information currently provided on financing statements will no longer be required. A safe harbor for the transfer of chattel paper in conformance with the Uniform Electronic Transactions Act is included in the amendments. [. . .] Clarification is given with respect to certificates of title for title goods where the certificates of title are, in whole or in part, in electronic form, and greater guidance is given with respect to the notice requirements applicable to electronic dispositions of collateral (specifically, time and "electronic location" of online auctions) when a security interest is enforced by sale or other disposition of the collateral.

**FISCAL IMPACT:**

House Bills 5081, 5082 & 5083 are not likely to have a significant direct fiscal impact on state or local budgets. The Uniform Commercial Code, as an effort to harmonize common law pertaining to interstate commercial transactions, largely affects the activities of private persons and entities.

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.