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Evolution of Chattel Paper: From Possession to Control

Thomas E. Plank

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[*]Joel A. Katz Distinguished Professor of Law, University of Tennessee College of Law. A.B. 1968, Princeton University; J.D. 1974, University of Maryland. In addition to having taught a course on secured transactions for 20 years, I have benefitted both professionally and financially working on Article 9 security interest issues relating to receivables as a practicing lawyer, including as a partner with Kutak Rock, and then as a consultant for law firms since becoming a full time law professor in 1994, including drafting opinions on the creation, perfection and priority of security interests and on achieving "control" of electronic chattel paper. The views expressed in this article are my personal views informed by my teaching, my research and writing, and my practice experience and are not the views of any law firm for which I serve or have served as a consultant.

Abstract

Since its inception, Article 9 has authorized both non-possessory assignment of chattel paper perfected by the filing of a financing statement and a possessory assignment perfected by possession. As a result, tangible chattel paper is "quasi-negotiable" because certain purchasers for value with possession can have priority over previously perfected secured parties. The 2000 revision of Article 9 authorized security agreements evidenced by an electronic record or records and created electronic chattel paper as a new sub-type of collateral. To extend quasi-negotiability to electronic chattel paper, it also introduced the concept of "control" as an analogue to possession of tangible chattel paper.

The initial definition of control required, in part, the existence of a "single authoritative copy" which is "unique." Given that an electronic record may be perfectly replicated, this definition created challenges for achieving this standard, but the chattel paper finance industry has developed methods for complying with this definition. Nevertheless, the requirement for a single and unique authoritative copy is more stringent than necessary for the purpose of the quasi-negotiability of chattel paper and is more consistent with a possessory analogue for electronic negotiable instruments and documents. The 2010 revision to the definition of control introduced a more flexible standard that requires a system that "reliably establishes" the secured party as the assignee. This new definition will permit the development of methods of control that are less complicated than current methods and more consistent with the limited nature and purpose of the quasi-negotiability of chattel paper. The new definition may even permit the development of a system that eschews the possessory analogue and that resembles the non-possessory assignment of intangible receivables like accounts and payment intangibles.

I. Introduction

The 2000 revision to Article 9 of the Uniform Commercial Code (the "UCC"), which has been enacted in all 50 states and the District of Columbia,[1] modernized the law of secured transactions by authorizing the use of electronic records in lieu of written records. An owner of a property item—the "debtor"[2]—may create a security interest in favor of a secured party[3] in that property item by "authenticating" a security agreement in the form of an electronic record.[4] The debtor and the secured party authorize the filing of electronic financing statements and financing statement amendments without a written signature.[5] Chattel paper, which consists of both a right to payment and a security interest in or a

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[1] *See* U.C.C. § 9-701 (2010). Revised Article 9 took effect on July 1, 2001, except in Connecticut (October 1, 2001), and in Florida, Mississippi, and Alabama (January 1, 2002). *See* Unif. Commercial Code, 3 U.L.A. 14 to 18 (2002). In 2010, the Uniform Law Commission, formerly known as the National Conference of Commissioners on Uniform State Laws, adopted revisions to specific sections of Article 9, and these revisions were enacted in all but six states (and the District of Columbia) effective on July 1, 2013, and were subsequently enacted in California, Alabama, Arizona, and Vermont, effective on or before July 1, 2014. Legislation to enact these revisions has been introduced in the legislatures of New York and Oklahoma. *See* Uniform Law Commission, UCC Article 9 Amendments (2010), *available at* http://www.uniformlaws.org/Act.aspx?title=UCC Article 9 Amendments (2010) (last visited July 29, 2014).

[2] *See* U.C.C. § 9-102(a)(28) (2010) (providing that "debtor" means "(A) a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor; [or] (B) a seller of accounts, chattel paper, payment intangibles, or promissory notes").

[3] *See* U.C.C. § 9-102(a)(73) (providing that "secured party" means "(A) a person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding; [or] (D) a person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold").

[4] *See* U.C.C. § 9-203(b)(3)(A), *quoted infra* note 37; U.C.C. § 9-102(a)(70) (defining "record" to mean "information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form"); U.C.C. § 9-102(a)(7) (defining "authenticate" to mean "(A) to sign; or (B) with present intent to adopt or accept a record, to attach to or logically associate with the record an electronic sound, symbol, or process").

[5] *See* U.C.C. § 9-101 cmt. 4.h ("This Article is 'medium-neutral'; that is, it makes clear that parties may file and otherwise communicate with a filing office by means of records communicated and stored in media other than on paper . . . . To facilitate electronic filing, this Article does not

lease of specific goods, such as automobile and equipment loans and leases,[6] now includes two new sub-types of collateral: Tangible chattel paper evidenced by a writing,[7] and electronic chattel paper "evidenced by a record or records consisting of information stored in an electronic medium."[8] The use of electronic records in lieu of written records significantly reduces the costs of secured transactions for the purchase or leasing of specific goods arising from copying, transmitting and storing written records.

Revised Article 9 also introduced the concept of "control" of electronic chattel paper[9] as an analogue to possession of

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require that the debtor's signature or other authorization appear on a financing statement.").

[6] *See* U.C.C. § 9-102(a)(11):

"Chattel paper" means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this paragraph, "monetary obligation" means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods.

[7] *See* U.C.C. § 9-102(a)(79) (defining "tangible chattel paper" to mean "chattel paper evidenced by a record or records consisting of information that is inscribed on a tangible medium"); U.C.C. § 1-201(b)(43) (2008) (defining "written" to include "printing, typewriting, or any other intentional reduction to tangible form").

[8] *See* U.C.C. § 9-102(a)(31) (2010); U.C.C. § 9-101 cmt. 4.d ("Electronic chattel paper is a record or records consisting of information stored in an electronic medium (i.e., it is not written).").

[9] *See* U.C.C. § 9-105 (2000):

A secured party has control of electronic chattel paper if the record or records comprising the chattel paper are created, stored, and assigned in such a manner that:

(1) a single authoritative copy of the record or records exists which is unique, identifiable and, except as otherwise provided in paragraphs (4), (5), and (6), unalterable;

(2) the authoritative copy identifies the secured party as the assignee of the record or records;

(3) the authoritative copy is communicated to and maintained by the secured party or its designated custodian;

(4) copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the participation of the secured party;

(5) each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

tangible chattel paper.[10] Through this definition, Article 9 attempted to confer on electronic chattel paper the quasi-negotiable status of tangible chattel paper which developed before the drafting of Article 9 began in the late 1940s. As discussed below,[11] the quasi-negotiable status of tangible chattel paper arises from (a) the ability of an originator of the chattel paper to transfer rights in the chattel paper to a "purchaser"[12] without a written assignment and to perfect such transfer without filing a financing statement and, more importantly, (b) the ability of the purchaser that acquires possession to obtain priority, or super-priority, over an earlier purchaser that had perfected its interest without taking possession. Article 9 extended this quasi-negotiability both to secured lenders that take a security interest in chattel paper to secure a debt and to buyers of chattel paper.[13]

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(6) any revision of the authoritative copy is readily identifiable as an authorized or unauthorized revision.

[10] *See* U.C.C. § 9-105 cmt. 2 (2010) (stating that "control of electronic chattel paper is the functional equivalent of possession of 'tangible chattel paper' ").

[11] *See infra* notes 27-31 and 37-40 and accompanying text.

[12] *See* U.C.C. § 1-201(b)(30) (2008) (defining "purchaser" as "a person that takes by purchase"); U.C.C. § 1-201(b)(29) (defining "purchase" to mean "taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property"). A purchaser for value may be a "secured party," whether a secured lender or a buyer of accounts, chattel paper, payment intangibles, or promissory notes, if the debtor has rights in the collateral or the power to transfer rights and the debtor authenticates a security agreement or the purchaser takes possession. *See* U.C.C. § 9-203(b) (requirements for creating an enforceable security interest), *quoted infra* note 37; U.C.C. § 9-102(a)(73) (definition of "secured party"), quoted supra note 3.

[13] *See* U.C.C. § 9-102(1) (1962) (providing that "this Article applies . . . (b) to any sale of accounts . . . or chattel paper").

Article 9 initially incorporated sales of these receivables through misleading defined terms. *See* U.C.C. § 1-201(37) (1962) (providing that a "security interest" includes "any interest of a buyer of accounts or chattel paper"); U.C.C. § 9-105(1)(d) (providing that " '[d]ebtor' . . . includes the seller of accounts . . . or chattel paper"); U.C.C. § 9-105(1)(m) (providing that " '[s]ecured party' means a lender, seller or other person in whose favor there is a security interest, including a person to whom accounts . . . or chattel paper have been sold"); U.C.C. § 9-105(1)(c) (providing that " '[c]ollateral' means the property subject to a security interest, and includes accounts . . . and chattel paper which have been sold").

For interesting historical reasons, the drafters of Article 9 specifically included sales of accounts and chattel paper in Article 9 to subject such sales to the perfection and priority rules that apply to security interests to secure a debt.[14] The 2000 revision of Article 9 continued this coverage and also expanded its coverage to include the sale of payment intangibles and promissory notes.[15]

To confer this quasi-negotiable status on electronic chattel paper, the original definition of control set forth in Section 9-105 of revised Article 9 attempted to replicate the function of possession. This definition required at a minimum that "the record or records comprising the chattel paper [be] created, stored, and assigned in such a manner that (1) a ***single authoritative copy*** of the record or records exists which is

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The use of these misleading defined terms led to significant drafting errors. *See* Plank, Sacred Cows and Workhorses: The Sale of Accounts and Chattel Paper Under Article 9 of the U.C.C. and the Effects of Violating a Fundamental Drafting Principle, 26 Conn. L. Rev. 397, 402–06, 442–493 (1994) (criticizing the use of misleading defined terms to incorporate the sale of accounts and chattel paper under former Article 9 and describing the many drafting errors in the pre-2000 revision Article 9 resulting from such use) [hereinafter, Sale of Accounts and Chattel Paper under Former Article 9].

[14] *See* Plank, Sale of Accounts and Chattel Paper Under Former Article 9, *supra* note 13, at 406-39 (describing the history of the drafting of the original Article 9 and the inclusion of the sales of accounts and chattel paper).

[15] *See* U.C.C. § 9-109(a)(3) (2010) (providing that Article 9 applies to "a sale of accounts, chattel paper, payment intangibles, or promissory notes").

The 2000 revision continued the use of misleading defined terms to incorporate these sales. *See* U.C.C. § 1-201(b)(35) (2008) (providing that "security interest" means "an interest in personal property or fixtures which secures payment or performance of an obligation" and includes "any interest of . . . a buyer of accounts, chattel paper, a payment intangible, or a promissory note"); U.C.C. § 9-102(a)(28) (2010) (defining "debtor" to include a seller of receivables), *quoted supra* note 2; U.C.C. § 9-102(a)(73) (defining "secured party" to include a person to which receivables have been sold), *quoted supra* note 3; U.C.C. § 9-102(a)(12) providing that " '[c]ollateral' means the property subject to a security interest . . . [and includes] (B) accounts, chattel paper, payment intangibles, or promissory notes that have been sold"). *See* Plank, Assignment of Receivables Under Article 9: Structural Incoherence and Wasteful Filing, 68 Ohio St. L.J. 231, 234-47 (2007) (describing the revisions to Article 9 that fixed some of the drafting errors resulting from this methodology and the creation of new drafting errors) [hereinafter, Assignment of Receivables: Structural Incoherence].

unique . . . [and with certain exceptions] ***unalterable***."[16] This requirement presents challenges because of the difference between the characteristics of a writing as an item of property and the characteristics of an electronic record as an item of property.

A single writing or a set of related writings signed by an individual is by its very nature "unique" as is every other tangible item of property. It cannot be altered except by methods that change the tangible characteristics of the writing. An electronic record, which consists of "information . . . which is stored in an electronic or other medium and is retrievable in perceivable form,"[17] can be perfectly replicated many times, and many types of electronic records can easily be altered.[18] Further, the transmission of an electronic record does not actually transfer an object in the same way that transfer of possession of a tangible record transfers the physical thing from the transferor to the transferee. Instead, the transmission of an electronic record creates a new record held by the recipient and, depending on the method of transmission, may not eliminate the record held by the sender.[19]

Despite these challenges, the financial industry has developed systems and procedures that comply with the stringent requirements for "control." In addition, the 2010 revisions of Articled 9, which as of July 1, 2014, have been enacted in all but two of the 50 states of the United States

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[16]*See* U.C.C. § 9-105 (2000), *quoted supra* note 9 (emphasis added).

[17]*See* U.C.C. § 9-102(a)(70) (2010) (defining "record"), *quoted supra* note 4; U.C.C. § 9-102(a)(31) (defining "electronic chattel paper"), quoted supra note 8.

[18]*See generally* Working Group on Transferability of Electronic Financial Assets, a Joint Working Group of the Committee on Cyberspace Law and the Committee on the Uniform Commercial Code of the ABA Section of Business Law and The Open Group Security Forum, Framework for Control over Electronic Chattel Paper—Compliance with UCC § 9-105, 61 Bus. Law. 721, 722 (2006) (Matthias Hallendorff & Mike Jerbic, reporters) (discussing the need to establish a control system in a control environment for electronic chattel paper).

[19]*See generally* The ABA Cyberspace Committee Working Group on Transferable Records, Emulating Documentary Tokens in an Electronic Environment: Practical Models for Control and Priority of Interests in Transferable Records and Electronic Chattel Paper, 59 Bus. Law. 379, 381 (2003), *quoted* in text accompanying note 98 infra.

and the District of Columbia,[20] introduced a more flexible definition for control and relegated the original definition of "control" to a safe harbor. Specifically, revised Section 9-105(a) states: "A secured party has control of electronic chattel paper if a system employed for evidencing the transfer of interests in the chattel paper ***reliably establishes*** the secured party as the person to which the chattel paper was assigned."[21]

This more flexible definition will relax some requirements that the financial industry has developed to establish control under the more stringent original definition. The implementation of the more flexible standard may vary somewhat depending on whether the electronic chattel paper consists of an originally generated electronic record or is an electronic record created by the conversion of a writing by a scanning or imaging process.

The extent to which any system satisfies the legal definition of control should depend on the underlying purpose of possession of tangible chattel paper. The next Part of this article reviews the historical development of chattel paper and the purpose of possession of tangible chattel paper. The purpose of possession of tangible chattel paper is different from, and more limited than, the purpose of possession of negotiable instruments, which have a high degree of

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[20] *See supra* note 1.

[21] *See* U.C.C. § 9-105(a) (2010) [emphasis added]. The original Section 9-105 became subsection (b) with minor changes as follows:

> (b) A system satisfies subsection (a), and a secured party has control of electronic chattel paper, if the record or records comprising the chattel paper are created, stored, and assigned in such a manner that:
>
> (1) a single authoritative copy of the record or records exists which is unique, identifiable, and, except as otherwise provided in paragraphs (4), (5), and (6), unalterable;
>
> (2) the authoritative copy identifies the secured party as the assignee of the record or records;
>
> (3) the authoritative copy is communicated to and maintained by the secured party or its designated custodian;
>
> (4) copies or amendments that add or change an identified assignee of the authoritative copy can be made only with the consent of the secured party;
>
> (5) each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and
>
> (6) any amendment of the authoritative copy is readily identifiable as authorized or unauthorized.

negotiability.[22] The more limited purpose of possession of tangible chattel paper informs the analysis of "control" of electronic chattel paper.

The following Part then analyzes the methods by which purchasers have achieved control under the strict requirements of original Section 9-105 and the safe harbor of revised Section 9-105(b). This Part also shows how the original definition of control for electronic chattel paper and the current safe harbor is more consistent with an electronic analogue for possession of negotiable instruments than for possession of tangible chattel paper. As a result, the original definition of control for electronic chattel paper and the current safe harbor is more restrictive than necessary to accomplish the purposes of "control" of electronic chattel paper. This Part also analyzes how the revised "reliably establishes" standard will permit more flexibility for obtaining control that is consistent with the purpose of providing the electronic analogue of possession of tangible chattel paper. Because of the limited purpose of possession of chattel paper, the "reliably establishes" standard for establishing control eliminates the requirement that there be a "single" and "unique" authoritative copy of the electronic chattel paper. More importantly, the "reliably establishes" standard may permit systems that resemble the assignment of intangibles and not the transfer of possession or some electronic analogue.

II. The Quasi Negotiable Status of Chattel Paper Based on Possession

A. The Purpose of Possession

From the beginning, Article 9 included chattel paper—which until 2001 could only be a writing—as a discrete type of collateral to accommodate two different financing practices that had developed in the first half of the twentieth century. Grant Gilmore described the term "chattel paper" as a "novel term coined by the Code draftsmen to describe a species of property which previously managed to exist without a name."[23] This "species" included the conditional sale contract or bailment lease used as security devices to

[22] *See infra* notes 41-45 and accompanying text.

[23] *See* Grant Gilmore, Security Interests in Personal Property § 12.5 at 378 (1965) (Vol. 1) [hereinafter Gilmore, Security Interests].

finance the purchase of goods.[24] In one type of secured financing, which Grant Gilmore called the automobile financing pattern, the dealer selling an item of goods under a conditional sale contract would transfer the contract to the financer, and the financer would collect the amounts due.[25] In the other type of secured financing, such as financing household goods, the dealer would retain possession of the contract and collect the contract but would assign the contract to a financing company as security for a loan.[26]

To accommodate both financing models, the original version of Article 9 permitted (a) the creation of a security interest in chattel paper either by a written assignment agreement or by delivery of possession[27] and (b) perfection of a security interest either by filing a financing statement[28]—a choice not available to negotiable or non-negotiable instruments[29]—or by taking possession of the chattel paper.[30] Further, to accommodate the possibility that a secured party could have a perfected non-possessory security interest, Section 9-308 of the original Article 9 provided that a purchaser with possession could have priority over a secured party

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[24]*See* Gilmore, Security Interests, *supra* note 23, § 12.5 at 378 (1965) (Vol. 1); *see also* Gilmore, Security Interests, *supra* note 23, § 25.5 at 667 (Vol. II) (stating that the "most familiar illustration of 'chattel paper' is the pre-Code conditional sale contract or bailment-lease"); Gilmore, Security Interests, *supra* note 23, § 3.3 at 68–73 (Vol. I) (discussing conditional sale as a security device); § 3.6 at 75–78 (Vol. I) and Gilmore, Security Interests, *supra* note 23, § 3.1 at 62 n. 4 (Vol. I) (discussing the bailment lease as similar to the conditional sale agreement as a security device).

[25]*See* U.C.C. § 9-308 cmt. 1 (1972); Gilmore, Security Interests, *supra* note 23, § 25.5 at 668–69 (Vol. 2).

[26]*See supra* note 25.

[27]*See* U.C.C. § 9-203(1) (1962).

[28]*See* U.C.C. § 9-304(1). An "instrument" includes both a negotiable instrument under Article 3 and "any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment." *See* U.C.C. § 9-105(1)(i). *See also* U.C.C. § 9-105(1)(i) (1972) (same definition), and U.C.C. § 9-102(a)(47) (2010) (substantially same definition). However, under the 2000 revision of Article 9, a security interest in instruments may be perfected by filing. *See* U.C.C. 9-312(a).

[29]*See* U.C.C. § 9-304(1) (1962).

[30]*See* U.C.C. § 9-305.

perfected other than by possession if certain conditions were met.[31]

The final Official Version of Article 9 of the initial UCC was promulgated in 1962[32] and thereafter enacted in all 50 states and the District of Columbia.[33] The drafters of Article 9 from the very beginning of the drafting process in 1948 included "chattel paper" as a distinct type of collateral.[34] The definition of chattel paper kept changing during the drafting years, and in the first few drafts chattel paper was included in the definition of an instrument.[35] The drafts also quickly

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[31] *See* U.C.C. § 9-308.

[32] The 1962 Official Draft, *reprinted in* 23 Unif. Commercial Code Drafts 381 (Elizabeth S. Kelly ed., 1984) [hereinafter, UCC Drafts].

[33] *See* Unif. Commercial Code, 3 U.L.A. 1 to 3 (2002).

[34] The term "chattel paper" first appeared in Tentative Draft No. 1, Article VII, Secured Commercial Transactions, Part III—Inventory Financing, submitted for consideration at the annual meeting of the America Law Institute on May 20-21, 1948 in joint session with the National Conference of Commissioners on Uniform State Laws. 4 UCC Drafts, *supra* note 32, at 265. Section 2(1)(b) defined an "inventory lien" to include "accounts and chattel paper" and Section 3(c) stated " 'Chattel paper' means [not yet drafted]." 4 UCC Drafts, *supra* note 32, at 271, 272. The notes and comments to the draft stated: " 'Chattel paper' is the term which will probably be used in characterizing the secured credit transactions arising on sale of durable inventory items such as electrical appliances and cars to the ultimate consumer." 4 UCC Drafts, *supra* note 32, at 290. *See also* 25 A.L.I. Proc. Vol. II, at 190 (1948) (remarks of Allison Dunham on the initial draft, Tentative Draft No. 1, 1948): "We use chattel paper to cover both conditional sales and chattel mortgages that are used to finance a consumer in his acquisition of his durable goods."

[35] *See, e.g.,* U.C.C. § 7-104 (May 1949 Draft) (new definition: " 'chattel paper' includes installment obligation arising out of the sale or lease of chattels, the payment of which is secured by rights in the chattels"), 8 UCC Drafts, *supra* note 32, at 82; U.C.C. § 8-106(1)(c), (d) (Sept. 1949 Revisions) (including chattel paper in the definition of instrument and providing that chattel paper "means a writing which evidences a security interest in or lease of goods, and which contains or secures a right to the payment of money, if the writing is one customarily transferred by indorsement or delivery" and that "[w]here an instrument is secured by chattel paper both writings together constitute the chattel paper"), 8 UCC Drafts, *supra* note 32, at 294; U.C.C. § 8-106(3), (4) (Oct. 1949 Revisions) (substantially same definitions of chattel paper, which is also included as an instrument), 8 UCC Drafts, *supra* note 32, at 478–79; U.C.C. § 9-105(1)(c), (g) (Proposed Final Draft, Spring 1950) (chattel paper "means a writing of a type whose transfer customarily requires delivery and which evidences a security interest in or lease of goods"; same language that if

evolved to include the provisions for alternative possessory and non-possessory creation and perfection of security interests in chattel paper and for super-priority for a purchaser of chattel paper for value with possession.[36] Of

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instrument is secured by chattel paper both writings constitute chattel paper; chattel paper no longer included in definition of instrument), 9 UCC Drafts, *supra* note 32, at 413; U.C.C. § 9-105(1)(b) (Sept. 1950 Revisions) (same definitions except for adding "in ordinary course of business" after "whose transfer"), 11 UCC Drafts, *supra* note 32, at 390; U.C.C. § 9-105(1)(b) (Proposed Final Draft No. 2, Spring 1951) (chattel paper "means a security agreement or lease of a type which is in the ordinary course of business transferred by delivery"; minor changes with respect to combination of chattel paper and instrument as chattel paper), 12 UCC Drafts, *supra* note 32, at 268; U.C.C. § 9-105(1)(b) (Final Nov. 1951) (same definition but adding "with appropriate indorsement or assignment" after "delivery"), 13 UCC Drafts, *supra* note 32, at 66; U.C.C. § 9-105(1)(b) (1952 Official Draft) (same), 15 UCC Drafts, *supra* note 32, at 195; U.C.C. § 9-105(1)(b) (1955 Supplement to 1952 Official Draft) (chattel paper "means a writing which evidences either a security interest in or a lease of specific consumer goods or specific equipment"; same language for combination of chattel paper and instrument as chattel paper), 17 UCC Drafts, *supra* note 32, at 380; U.C.C. § 9-105(1)(b) (1956 Recommendations of the Editorial Board for the UCC) (chattel paper "means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods" and providing that when a transaction is evidenced both by a security agreement or lease and an instrument both groups of writings constitute chattel paper), 18 UCC Drafts, *supra* note 32, at 282; U.C.C. § 9-105(1)(b) (1957 Official Edition) (same; showing changes from 1952 text and not from 1955 revision), 20 UCC Drafts, *supra* note 32, at 135. Except for the addition of language excluding the charter of a vessel from the definition, added between 1962 and 1972, the definition remained the same until the 2000 revision of Article 9.

[36] *See, e.g.,* U.C.C. Art. VII, § 326 (Tentative Draft No. 2, Aug. 6, 1948) (creation, perfection by possession or upon assignment, and priority for good faith holder), 5 UCC Drafts, *supra* note 32, at 148; U.C.C. § 7-319 (May 1949 Draft) (creation, perfection by possession or upon assignment, and priority for good faith holder), 8 UCC Drafts, *supra* note 32, at 125–26.

These drafts had been organized by types of collateral, with each part addressing security interests in different types of collateral (e.g., part 2-pledge, part 3-inventory and accounts receivable, part 4-equipment financing). After the May 1949 draft, the drafters reorganized the Article in September 1949 so that different parts addressed different substantive issues (e.g., part 2-creation, part 3-title creditors and purchasers, part 4-perfection and priority). The October 1949 draft further refined the organization structure to the structure of Article 9 in effect until the 2000 revision.

In addition, the provisions for chattel paper became more developed. *See, e.g.* U.C.C. § 8-203(2) (Sept. 1949 Revisions) (assignment effective

course, the current version of Article 9 continues these

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upon delivery or written agreement), U.C.C. § 8-402(1)(d) (Alternative A-automatic perfection, Alternative B-perfection by filing), U.C.C. § 8-404(2) (perfection by possession through definition of instrument), 8 UCC Drafts, *supra* note 32, at 310, 333, 339; U.C.C. § 8-204(1), (2) (Oct. 1949 Revisions) (attachment upon written assignment or possession), U.C.C. § 8-303 (perfection by filing), U.C.C. § 8-305 (perfection by possession through the definition of instrument), U.C.C. § 8-308 (super-priority based on good faith possession by assignee for value and either in ordinary course of business or without knowledge of earlier security interest), 8 UCC Drafts, *supra* note 32, at 491, 504, 507–08, 513; U.C.C. § 9-204 (Proposed Final Draft, Spring 1950) (a writing or possession for attachment), U.C.C. § 9-302(1) (perfection by possession or filing), U.C.C. § 9-304 (automatic 10 day perfection for chattel paper), U.C.C. § 9-305(1) (perfection by possession of chattel paper), U.C.C. § 9-308(1)(b) (super-priority over perfected assignee based on good faith possession for value, in ordinary course of his business and without knowledge of earlier interest), 9 UCC Drafts, *supra* note 32, at 418, 425, 426–27, 429; U.C.C. § 9-204(1), (2) (Sept. 1950 Revisions) (a writing or possession for attachment), U.C.C. § 9-302 (perfection by filing), U.C.C. § 9-304 (automatic 21 day perfection for chattel paper), U.C.C. § 9-305(1) (perfection by possession), U.C.C. § 9-308(1)(b), (2) (super-priority over perfected inventory lender in chattel paper as proceeds based on good faith possession for value, in ordinary course of his business and without knowledge of earlier interest, but knowledge of security interest in inventory not such knowledge if no notation on chattel paper), 11 UCC Drafts, *supra* note 32, at 397, 405, 407–08, 410; U.C.C. § 9-203(1)(a), (b) (Proposed Final Draft No. 2, Spring 1951) (a writing or possession for attachment), U.C.C. § 9-302 (perfection by filing), U.C.C. § 9-304(1) (eliminating automatic 21 day perfection for chattel paper), U.C.C. § 9-305(1) (perfection by possession), U.C.C. § 9-308 (purchaser for value and in ordinary course of his business who takes possession takes free of prior perfected security interest if chattel paper is proceeds or if purchaser is without actual knowledge that chattel paper has been assigned), 12 UCC Drafts, *supra* note 32, at 274, 281–82, 284–86, 288; U.C.C. § 9-203(1)(a), (b) (Final Nov. 1951) and (1952 Official Draft) (same for attachment), U.C.C. § 9-302(1) (perfection by filing), U.C.C. § 9-305(1) (perfection by possession), U.C.C. § 9-308 (super-priority over secured party perfected by filing for purchaser for ***new*** value and in ordinary course of his business who takes possession without actual knowledge that specific chattel paper is subject to a security interest) [emphasis added], 13 UCC Drafts, *supra* note 32, at 72, 79–80, 83, 86, and 15 UCC Drafts, *supra* note 32, at 214, 233, 244, 257; U.C.C. § 9-305 (1956 Recommendations of the Editorial Board for the UCC) and (1957 Official Edition) (revision of provision on perfection by possession), U.C.C. § 9-308 (complete rewrite to give purchaser for new value who takes possession in ordinary course of his business has priority over security interest perfected by filing if without knowledge that specific chattel paper is subject to security interest [which priority also applied to non-negotiable instrument] or if prior security interest is claimed merely as proceeds even if purchaser has knowledge of prior security interest), 18 UCC Drafts, *supra* note 32,

provisions: Either an authenticated security agreement or a transfer of possession will support creation of the security interest.[37] A secured party may perfect its security interest in tangible chattel paper by filing[38] or possession.[39] A purchaser for value that takes possession may have super-priority over a secured party previously perfected by filing.[40]

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at 303–04, 308–09, and 20 UCC Drafts, *supra* note 32, at 179, 188. The latest versions of these sections became part of the 1962 official text. In the 1972 revision of Article 9, Section 9-203 on attachment was revised without substantive change as it related to chattel paper and Section 308 on super-priority was completely rewritten without substantive change except to extend protection for chattel paper also to all instruments, including instruments that were proceeds. *See* U.C.C. §§ 9-203, 9-308 (1972).

[37] *See* U.C.C. § 9-203(b) (2010) [emphasis added]:

> [With exceptions not relevant here] a security interest is enforceable against the debtor and third parties with respect to the collateral only if:
>
> (1) value has been given;
>
> (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and
>
> (3) one of the following conditions is met: (A) the debtor has authenticated a security agreement that provides a description of the collateral . . . [or] (B) the collateral is . . . in the ***possession*** of the secured party under Section 9-313 pursuant to the debtor's security agreement [or] (D) the collateral is deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights, and the secured party has ***control*** under Section 9-104, 9-105, 9-106, or 9-107 pursuant to the debtor's security agreement.

Clauses (B) and (D) require that possession or control must be pursuant at least to an oral agreement.

[38] *See* U.C.C. § 9-312(a) (providing that a "security interest in chattel paper, negotiable documents, instruments, or investment property may be perfected by filing").

[39] *See* U.C.C. § 9-313(a) (providing that "a secured party may perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral").

[40] *See* U.C.C. § 9-330 [emphasis added]:

> (a) A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed merely as proceeds of inventory subject to a security interest if:
>
> (1) in good faith and in the ordinary course of the purchaser's business, the purchaser gives new value and ***takes possession*** of the chattel paper or ***obtains control*** of the chattel paper ***under Section 9-105***; and
>
> (2) the chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.
>
> (b) A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed other than merely as proceeds of inventory subject to a security interest if the purchaser gives new value and **takes possession** of the chattel paper or ***obtains control*** of the chattel paper

These provisions recognized and codified the limited negotiability of chattel paper. In contrast, negotiable instruments have a robust form of negotiability, surpassed perhaps only by the negotiability of money. This robust form of negotiability includes the following elements:

(1) a person in possession may transfer the right to enforce the right to payment by transferring possession of the writing;[41]

(2) a person with the rights of a holder in due course takes the instrument free of any claims to the instrument;[42]

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under Section 9-105 in good faith, in the ordinary course of the purchaser's business, and without knowledge that the purchase violates the rights of the secured party.

The knowledge requirement for super-priority for chattel paper claims merely as proceeds, that is, the absence of a notation on the chattel paper, is less stringent than for other transactions, which requires that purchaser be "without knowledge that the purchase violates the rights" of the prior assignee.

[41] *See* U.C.C. § 3-201(a) (1990) (stating that " 'Negotiation' means a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder."); U.C.C. § 3-301 (defining a "person entitled to enforce" as "(i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession" with the right to enforce a lost or stolen instrument); U.C.C. §§ 3-412, 3-413, 3-414(b), 3-415(a) (obligations of makers, acceptors, drawers, and indorsers owed to person entitled to enforce instrument). The Uniform Law Commission approved revisions to Article 3 in 2002, but as of July 1, 2014, those revisions have been adopted in only 12 states. *See* Uniform Law Commission, UCC Article 3, Negotiable Instruments and Article 4, Bank Deposits (2002), *available at* http://www.uniformlaws.org/Act.aspx?title=UCC Article 3, Negotiable Instruments and Article 4, Bank Deposits (2002) (last visited July 29, 2014). The 1990 revision of Article 3 remains in effect in most of the states (but not New York, which still uses the 1962 version of Article 3 with some modifications), and for this reason, this Article cites the 1990 revision of Article 3.

The 2000 revision to Article 9 expanded the coverage to include the sale of promissory notes. *See supra* note 15 and accompanying text. An owner of a note can sell the note by signing a sale agreement, *see* U.C.C. § 9-203(b)(3)(A) (2010), *quoted supra* note 37, and a sale of a promissory note is perfected automatically, U.C.C. § 9-309(4). Accordingly, an owner can transfer a perfected ownership interest in a promissory note without transferring possession. Nevertheless, transferring the right to enforce the note under Article 3 requires transferring possession.

[42] *See* U.C.C. § 3-306 (1990):

A person taking an instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right

(3) the right of a holder in due course is not subject to any defenses (other than certain "real" defenses) or claims in recoupment against a party other than the holder;[43]

(4) a holder takes free of any claim in recoupment that arises out of a transaction other than the transaction that gave rise to the instrument;[44] and

(5) payment by the obligor to a person that is not the holder of the instrument or a nonholder in possession with the rights of a holder (except in the case of a lost note) does not discharge the obligation against a holder in due course.[45]

A transfer of possession of tangible chattel paper does not confer most of the benefits of this negotiability. An assignee receives only the first two of these benefits. As noted above, transfer of possession is sufficient to create and perfect the transferee's interest.[46] More importantly, transfer of possession can give the assignee super-priority over a prior

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in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A person having rights of a holder in due course takes free of the claim to the instrument.

[43]*See* U.C.C. § 3-305:

(a) Except as stated in subsection (b), the right to enforce the obligation of a party to pay an instrument is subject to the following (1) [certain "real" defenses, such as infancy], (2) a defense of the obligor stated in another section of this Article or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract; and (3) a claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument.

(b) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a)(1), but is not subject to defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in subsection (a)(3) against a person other than the holder.

[44]*See* U.C.C. § 3-305(a)(3), *quoted supra* note 43.

[45]*See* U.C.C. § 3-602(a) (providing that "an instrument is paid to the extent payment is made (i) by or on behalf of a party obliged to pay the instrument, and (ii) to a person entitled to enforce the instrument"); U.C.C. § 3-301 (defining a "person entitled to enforce"), *quoted supra* note 41; U.C.C. § 3-601(a) (providing that the "obligation of a party to pay the instrument is discharged . . . by an act or agreement with the party which would discharge an obligation to pay money under a simple contract"); U.C.C. § 3-601(b) (stating that "[d]ischarge of the obligation of a party is not effective against a person acquiring rights of a holder in due course of the instrument without notice of the discharge").

[46]*See* U.C.C. § 9-203(b)(3)(B) (2010) (creation), *quoted supra* note 37; U.C.C. § 9-313(a) (perfection by possession), *q*uoted supra note 39.

perfected assignee.[47] These benefits protect the assignee against the claims of the assignor or those who have a claim to the chattel paper through the assignor in ways that assignees of ordinary rights to payment, such accounts or payment intangibles, do not.

For example, a security interest in accounts and payment intangibles requires an authenticated security agreement.[48] Filing a financing statement is necessary to perfect a security interest in accounts (including as noted above[49] a buyer's interest in accounts) and a security interest in payment intangibles to secure a debt.[50] Generally, the first assignee to file a financing statement will have priority.[51] No assignee

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[47] *See* U.C.C. § 9-330(a), (b), *quoted supra* note 40.

[48] *See* U.C.C. § 9-203(b)(3)(A), *quoted supra* note 37 (requiring an authenticated security agreement describing the collateral).

[49] *See* U.C.C. § 1-102(b)(35) (2008), *quoted supra* note 15 (defining "security interest" to include the interest of a buyer of accounts, chattel paper, a payment intangible, or a promissory note).

[50] *See* U.C.C. § 9-310(a) (2010) (requiring filing to perfect security interests other than those excepted by subsection (b)). Possession is not a permissible method of perfection because accounts and payment intangibles are intangible. *See* U.C.C. § 9-313(a). A sale of payment intangibles, however, is perfected upon attachment. U.C.C. § 9-309(3).

[51] *See* U.C.C. § 9-322(a):

> Except as otherwise provided in this section, priority among conflicting security interests and agricultural liens in the same collateral is determined according to the following rules:
>
> (1) Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest or agricultural lien is first perfected, if there is no period thereafter when there is neither filing nor perfection.
>
> (2) A perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien.
>
> (3) The first security interest or agricultural lien to attach or become effective has priority if conflicting security interests and agricultural liens are unperfected.

I use the word "generally" because, except in the case of a sale of payment intangibles, filing is necessary to perfect a security interest in accounts or payment intangibles. U.C.C. § 9-310(a). Accordingly, the first to file or perfect rule of section 9-322(a)(1) and the perfected over unperfected rule of 9-322(a)(1), *see supra*, is really a first to file rule. Because a sale of payment intangibles, however, is perfected upon attachment, U.C.C. § 9-309(3), there is a debate about whether a buyer of payment intangibles may obtain priority based on a filing made before its interest is perfected. *See* Harris and Mooney, Jr., Using First Principles of UCC Article 9 to

that is the second to file may obtain super-priority over a perfected assignee that had filed first.

None of the quasi-negotiable provisions for chattel paper, however, give the assignee of chattel paper any advantages over other assignees of ordinary rights to payment against the obligors on the chattel paper that holders of negotiable instruments can obtain. Like assignees of accounts, payment intangibles and other general intangibles, the assignee of chattel paper takes subject to all defenses and claims in recoupment of the obligor (called the "account debtor") that arise from the transaction that gave rise to the chattel paper.[52] The assignee also takes subject to any other defense or claim of the obligor against the assignor which accrues before the obligor receives notification of the assignment.[53] Payment by the obligor to the assignor will discharge the payment obligation unless the obligor receives notification of the assignment to the assignee.[54]

Almost from the beginning of the drafting, the drafters incorporated these limitations to the negotiability of tangible chattel paper. Although Homer Kripke argued in 1950 that as a matter of public policy a third party providing credit pursuant to chattel paper should have holder in due course

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Solve Statutory Puzzles in Receivables Financing, 46 Gonz. L. Rev. 297, 311–18 (2011) (arguing why filing should provide priority for a buyer of payment intangibles); Plank, Article 9 of the UCC: Reconciling Fundamental Property Principles and Plain Language, 68 Bus. Law. 439, 497–99 (2013) (agreeing with Professors Harris and Mooney on this point).

[52] *See* U.C.C. § 9-404(a) (2010) (providing that "the rights of an assignee are subject to: (1) all terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction that gave rise to the contract; and (2) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee"). The "account debtor" is the "person obligated on an account, chattel paper, or general intangible." *See* U.C.C. § 9-102(a)(3).

[53] *See* U.C.C. § 9-404, *discussed supra* note 52.

[54] *See* U.C.C. § 9-406(a) (providing that "an account debtor on an account, chattel paper, or a payment intangible may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.").

status,[55] the drafters subjected the holders of the chattel paper to the defenses and claims of the obligors,[56] including discharge of the obligor's payment obligation by payment to an assignor before receipt of notification of assignment.[57] The definition of chattel paper further provided that, even if the monetary obligation was evidenced by a note that was a negotiable instrument, the combination of the note and the security agreement securing the note constituted chattel paper.[58]

Therefore, possession of tangible chattel paper does not improve the assignee's rights against the obligor, whereas possession of a negotiable instrument not only can give the holder extra protections against the prior holder but also can give the holder extra protections against the obligor on the instrument. These expanded protections derive from the par-

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[55]*See* Kripke, Chattel Paper as a Negotiable Specialty Under the Uniform Commercial Code, 59 Yale L.J. 1209, 1222 (1950).

[56]*See* U.C.C. Art. VII, § 318(2) (Tentative Draft No. 2, Aug. 6, 1948) (accounts only, by virtue of definition of "account debtor" in § 303(5) as obligor on an account), 5 UCC Drafts, *supra* note 32, at 135, 142–43; U.C.C. § 7-315(2) (May 1949 Draft) (through expanded definition of "account debtor" in § 7-303(4) to include obligor on chattel paper), 8 UCC Drafts, *supra* note 32, at 110, 122; U.C.C. § 8-306(2) (Sept. 1949 Revisions) (same through definition of "account debtor" in § 8-104(1)(a)), 8 UCC Drafts, *supra* note 32, at 289, 327; U.C.C. § 8-315(2) (Oct. 1949 Revisions) (same, through definition of "account debtor" in § 8-104(b)), 8 UCC Drafts, *supra* note 32, at 474, 527; U.C.C. § 9-317(1) (Proposed Final Draft, Spring 1950) (same with minor changes, through definition of "account debtor" in § 9-105(1)(a)), 9 UCC Drafts, *supra* note 32, at 413, 434; U.C.C. § 9-319(1) (Sept. 1950 Revisions) (same), 11 UCC Drafts, *supra* note 32, at 390, 417; U.C.C. § 9-318(1) (Proposed Final Draft No. 2, Spring 1951) (same with minor changes), 12 UCC Drafts, *supra* note 32, at 295. This provision thereafter remained the same until the 2000 revision of Article 9. *See* U.C.C. § 9-318(1) (1952 Official Draft), 15 UCC Drafts, *supra* note 32, at 273; U.C.C. § 9-318(1) (1957 Official Edition), 20 UCC Drafts, supra note 32, at 205 and U.C.C. § 9-318(1) (1962) and (1972).

[57]*See* U.C.C. § 9-317(2) (Proposed Final Draft, Spring 1950), 9 UCC Drafts, *supra* note 32, at 434; U.C.C. § 9-319(2) (Sept. 1950 Revisions) (same with minor changes), 11 UCC Drafts, *supra* note 32, at 417–18; U.C.C. § 9-318(3) (Proposed Final Draft No. 2, Spring 1951) (same with minor changes), 12 UCC Drafts, *supra* note 32, at 296. This provision thereafter remained the same until the 2000 revision of Article 9. *See* U.C.C. § 9-318(3) (1952 Official Draft), 15 UCC Drafts, *supra* note 32, at 273-74; U.C.C. § 9-318(3) (1957 Official Edition), 20 UCC Drafts, *supra* note 32, at 205 and U.C.C. § 9-318(3) (1962) and (1972).

[58]*See* UCC sections cited *supra* note 35.

ticular rules governing negotiable instruments that give to the concept of "possession" a different meaning than the concept of possession of tangible chattel paper.

B. Illustration of Distinct Roles of Possession

Two circumstances illustrate the differences in the purpose and importance of possession. One circumstance is the effect of payment to discharge an obligation, and the other is the effect of multiple duplicate originals that bear an original "wet ink" signature. To explore these circumstances, assume two similar transactions, T1 and T2. In T1, a customer O1 buys an item of property from S1 for $100 or borrows $100 from S1, and O1 issues to S1 a negotiable promissory note in the amount of $100. In T2, a customer O2 buys a specific good for $100 in exchange for tangible chattel paper, that is, the customer signs a written agreement promising to pay to the seller S2 the $100 and granting a security interest in the good to secure the promise to pay. Assume further that at some point, each of S1 and S2 transfer possession of the note and the chattel paper to a purchaser for value, respectively, P1 and P2 (or more than one purchaser for value), and that neither obligor O1 or O2 is notified of this transfer.

1. Payment of the Obligation

In T1, O1 pays S1 the $100 to discharge O1's obligation under the promissory note. In this case, O1 should demand possession of the note, or O1 should ensure that the note is physically marked to show payment.[59] In this case, possession of the note or a marking of the note is critical to protect O1. So long as S1 retains possession of the note that is not marked "paid," S1 can transfer the note to a bona fide purchaser P1 for value without notice of any payment who qualifies as a holder in due course. If P1 then demands payment from O1, O1 must pay a second time. O1's payment to S1 does not discharge O1's obligation to pay the note to P1.[60] O1 can avoid this result only by regaining possession of the note, which would prevent a subsequent transfer, or by

[59] *See* U.C.C § 3-501(b)(2) (1990):

> Upon demand of the person to whom presentment is made, the person making presentment must (i) exhibit the instrument, (ii) give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of authority to do so, and (iii) sign a receipt on the instrument for any payment made or surrender the instrument if full payment is made.

[60] *See supra* note 45 and accompanying text.

ensuring that the note carries a notation that it has been paid, which notation would ensure that no subsequent holder can acquire it without notice of the payment.

In T2, however, if on the due date O2 pays the $100 owed under the chattel paper to S2 before O2 receives notification of the transfer of the chattel paper to P2, O2's payment will discharge the $100 obligation.[61] Whether S2 or P2 has possession of the tangible chattel paper is irrelevant to O2's liability on the chattel paper. O2's liability depends upon notification of assignment.

2. Multiple Originals

In T1, O1 would not normally sign more than one original note and, for reasons that will become apparent, should not sign more than one original note. In T2, it has been fairly common practice for O2 to sign multiple identical copies of the tangible chattel paper.[62]

Assume that both O1 and O2 sign duplicate original documents. In T1, by signing two notes promising to pay $100, O1 will have in fact incurred two obligations for $100. Now, if S1 retains the two notes and demands payment of both notes, O1 will have a defense to payment of the second note—lack of consideration.[63] However, if S1 has transferred one originally signed copy of the note to P1-A who becomes a holder in due course and the other originally signed copy of the note to another purchaser P1-B who becomes a holder in due course, and both P1-A and P1-B demand payment, O1 must pay both.[64] O1's defense of lack of consideration for the obligation under the second note (whether held by P1-A or P1-B) will not be effective against either P1-A or P1-B.[65]

In T2, however, signing two original copies of the chattel paper will not create two obligations by O2. By such signing, O2 will have incurred only one obligation for $100. If S2 has

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[61] *See supra* note 54 and accompanying text.

[62] *See, e.g.,* sources cited *infra* in notes 68, 69 & 77 and accompanying text.

[63] *See* U.C.C. § 3-303(b) (1990) (providing that the "drawer or maker of an instrument has a defense if the instrument is issued without consideration"); U.C.C. § 3-305(a)(2) (providing that "the right to enforce the obligation of a party to pay an instrument is subject . . . a defense of the obligor stated in another section of this Article").

[64] *See supra* note 43 and accompanying text.

[65] *See* sources cited *supra* note 63.

transferred one originally signed writing to P2-A and the other originally signed writing to another purchaser P2-B, O2 is entitled to pay S2 until O2 receives notification of any assignment. If O2 receives notification from either P2-A or P2-B, O2 can pay the $100 owed under the chattel paper to the person from whom it first receives notification of assignment. Such payment would discharge O2's obligation under the chattel paper. The other assignee will have taken subject to O2's defense of payment of the obligation. Further, O2 will have a defense of lack of consideration for more than one obligation under the writing which will be effective against either P2-A or P2-B.

C. What is Possession?

The foregoing examples illustrate the differences in the meaning of possession for negotiable instruments and chattel paper. If multiple originally signed copies of a written note exist, whoever has possession of each written note bearing an original signature has possession of the note. If multiple originally signed copies of tangible chattel paper exist, and one person has possession of all originally signed written chattel paper, that one person would have "possession" of "***the***" chattel paper. But, if multiple originally signed copies of tangible chattel paper exist, and different persons have possession of an originally signed written chattel paper, does any person have "possession" of "***the***" chattel paper for purposes of perfection or super-priority?

The quasi-negotiability of tangible chattel paper suggests that, if more than one person has possession of an originally signed tangible chattel paper, no person has possession of "***the***" chattel paper. As between the debtor and a secured party, the transfer of possession of the chattel paper is sufficient to create and perfect a security interest if possession by the secured party imparts notice to the world that the debtor no longer has the ability to assign its interest to another. If both the debtor and the secured party each have possession of an originally signed chattel paper, however, possession by the secured party of one original does not serve this notice function. The secured party's possession does not deprive the debtor of its ability, derived from its possession of an original written chattel paper, to mislead its creditors and subsequent purchasers about the extent of its interests

in the chattel paper.[66] If in the T2 example above, S2 transferred possession of one originally signed chattel paper to P2-A, but retained the other originally signed chattel paper, S2 appears to own the chattel paper unencumbered and also retains the power to transfer that original chattel paper to another purchaser. The situation combines the classic "ostensible ownership" problem and the potential fraud problem that has plagued personal property security law for centuries, only for tangible chattel paper instead of sheep.[67]

Treating the possession of each original by the debtor and the secured party as "possession" would defeat the purpose of permitting perfection by possession. The court in *Funding Systems Asset Management Corp. v. Chemical Business Credit Corp. (In re Funding Systems Asset Management Corp.)*[68] agreed. In this case, the originator of tangible chattel paper, as a matter of routine, caused the lessee/obligor to sign three originals of a master lease, a lease schedule that contained the specific terms of the tangible chattel paper, and in some cases an assignment agreement. These originals were distributed in a variety of ways. This case involved 12 such leases pledged to a secured lender. The secured lender had failed to perfect its security interest by filing a financing statement because it filed the financing statement in the wrong filing office. Nevertheless, the secured lender had possession of each of the 12 originally executed lease schedules. For nine of the leases, however, the debtor also had possession of the originally executed schedules. For the other three

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[66] *See* Gilmore, Security Interests, *supra* note 23, § 14.1 at 438 (Vol. 1).

[67] *See* Gilmore, Security Interests, *supra* note 23, § 2.1 at 64 n.1 (Vol. 1) (summarizing Twyne's Case, 76 Eng. Rep. 809 (Star Chamber 1601), in which the debtor Pierce had deeded sheep to his creditor Twyne in satisfaction of a debt but retained possession of and control over the sheep; the transfer was deemed to be fraudulent because Pierce's continued possession and trading of the sheep deceived his creditors); Mooney, Jr., The Mystery and Myth of "Ostensible Ownership" and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases, 39 Ala. L. Rev. 683, 725–43 (1988) (examining the doctrine of "ostensible ownership" and noting that courts and commentators have failed to distinguish a concern about ostensible ownership from a concern about fraud on the part of debtors and some secured creditors).

[68] In re Funding Systems Asset Management Corp., 111 B.R. 500, 11 U.C.C. Rep. Serv. 2d 205 (Bankr. W.D. Pa. 1990).

leases, the debtor had possession of only a copy of the schedules.

The court held that the lender was perfected by possession in the three leases for which the debtor had only a copy but was not perfected in the nine leases in which the debtor had a duplicate original.[69] The court reasoned that the lender had absolute dominion and control over the three leases because its possession of the original schedules and the debtor's possession of only a copy deprived the debtor of the ability to mislead others that it was free to pledge the three leases. On the other hand, the lender failed to exercise absolute dominion and control over all available originals for the nine leases for which the debtor had possession of origi-

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[69]The Colorado Court of Appeals in Denver Tec Bank v. F.D.I.C., 843 P.2d 129, 19 U.C.C. Rep. Serv. 2d 595 (Colo. App. 1992) cited *Funding Systems Asset Management Corp.* in a priority dispute between two banks that claimed a security interest in the same leases perfected by filing, although the court reached the wrong result in awarding priority to the first bank to file a financing statement because that bank's debtor had failed to acquire a perfected security interest in the leases. In this case, Municipal Investor Service, Inc. ("MIS") had acquired all of the originally signed copies of two equipment leases from the initial lessor. MIS then assigned its interests in the leases to its vice president, John Terborg, and delivered one set of originally signed copies of the two equipment leases to Terborg. Terborg granted a security interest in the leases to Cherry Creek National Bank ("CCNB"), for which the Federal Deposit Insurance Corp. ("FDIC") was later appointed as receiver, which security interest CCNB perfected by filing. MIS later granted a security interest to the predecessor of Denver Tec Bank, which was also perfected by a later filed financing statement.

The parties did not dispute the trial court's determination that, because MIS retained one set of the originally signed equipment leases, a security interest in the leases could not be perfected by possession and could only be perfected by filing. *Denver Tec Bank v. F.D.I.C.,* 843 P.2d at 132. The court then held that the FDIC as successor to CCNB, which was the first filer, had priority over Denver Tec Bank. The court did address the fact that Terborg was a different debtor than MIS, but rejected the plaintiff's assertion that FDIC has no security interest because Terborg did not file a financing statement: "The UCC does not require an owner of collateral to perfect his or her ownership interest by filing such a document." *Denver Tec Bank v. F.D.I.C.,* 843 P.2d at 133. This statement is wrong because Article 9 from the beginning had required buyers of chattel paper to perfect their interests by filing or possession. *See supra* notes 13–15 and accompanying text. Because Terborg's security interest, which was an ownership interest, was not perfected, Denver Ten Bank's security interest had priority over Terborg's security interest. Therefore the FDIC's interest, derived from Terborg's subordinate interest, was likewise subordinate to Denver Ten Bank.

nal lease schedules because the debtor's possession of the original schedules would allow the debtor to mislead others that it was free to pledge the nine leases.[70]

Funding Systems addressed one aspect of the quasi-negotiability of tangible chattel paper—perfection by possession. The more important aspect is super-priority. As between conflicting security interests, transfer of possession confers super-priority to the possessor over other security interests. However, if more than one person has possession of originally signed copies of chattel paper, neither person will be entitled to priority based on possession.

This result follows from the language of Section 9-330(a) and (b). Under these two subsections (one dealing with chattel paper that is proceeds of inventory subject to a security interest and the other dealing with all other chattel paper), a bona fide purchaser for value that takes "possession" of "***the***" chattel paper may have priority over a prior perfected non-possessory security interest. This rule works, however, only if one person has possession of all originals. If in the T2 example above S2 transferred possession of one originally signed chattel paper to P2-A in a way that would otherwise give P2-A priority under Section 9-330, but retained the other originally signed chattel paper, S2 retains the power to transfer that original chattel paper to P2-B in a way that would convince P2-B that P2-B would have priority. If S2

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[70] 111 B. R. at 516–19. This case can be contrasted with *Glosser v. Colonial Pacific Leasing Co.* (*In re Equitable Financial Management, Inc.,* 164 B.R. 53, 22 U.C.C. Rep. Serv. 2d 1152 (Bankr. W.D. Pa. 1994)), in which the bankruptcy trustee attempted to avoid a secured lender's security interest in two equipment leases (which constitute chattel paper) on the grounds that the secured lender had not perfected its interest. Specifically, the trustee argue that, although the secured lender had possession of all of the originally executed documents constituting the lease agreement, the secured lender was not perfected by possession because the debtor also had possession of originally signed lease documents. The court rejected the trustee's avoidance action because the debtor had possession of only preliminary and incomplete documents, and possession of equipment schedules that were part of the lease that were only copies not containing the original signature of the lessee as obligor. The court stated: "The equipment schedules debtor possessed were only photocopies of the originals CPL [the secured lender] possessed. As such, they have no more binding legal effect than would a photocopy of, say, a ten dollar bill. No reasonably prudent purchaser of chattel paper would have accepted the photocopied equipment schedules as original equipment schedules constituting a portion of the lease agreements." *In re Equitable Financial Management, Inc.,* 164 B.R. at 57.

transferred possession of one originally signed chattel paper to P2-B in a way that would otherwise give P2-B priority under Section 9-330, P2-B should not acquire priority notwithstanding its possession of the original.

If possession of an original, but not all originals, is not "possession" for perfection under 9-313 and is also not possession under 9-330, Section 9-330 would not apply and the normal priority rules would apply. Between the competing purchasers, P2-A and P2-B, the purchaser that was the first to file (if both had filed financing statements or if only one had filed a financing statement and the other was unperfected) or the first to attach (if neither had filed financing statements) would prevail.[71]

On the other hand, even if possession of each original by each purchaser were "possession" within the meaning of 9-330(a) and (b), then each of P2-A and P2-B could have priority over the other, which is to say that neither would priority over the other. Accordingly, the other priority rules would apply, unless a court were to hold that, if both qualified for priority under Section 9-330, each was entitled to a pro-rata share of the chattel paper. Hence, to accomplish the purpose of super-priority, the purchaser must have all copies of the originally signed tangible chattel paper.

D. The Limited Purpose of Super-Priority

The analysis of the requirements for possession (and therefore of the requirements for control as an analogue to possession in the following Part) requires an understanding of the limited reason for providing super-priority to a purchaser of chattel paper. The super-priority for such purchasers is essential for the efficient operation of the current "indirect" origination business model for chattel paper. For example, the vast majority of automobile loan originations follow the indirect origination model.[72] Finance companies purchase automobile loans from automobile dealers that originate the loans on the forms of the finance companies and in compliance with the underwriting and

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[71] *See* U.C.C. § 9-322(a) (2010), *quoted supra* note 51.

[72] Standard & Poor's Rating Services, ABS: General Methodology and Assumptions for Rating U.S. Auto Loan Securitizations, ¶ 13 (Jan. 11, 2011, republished Jan. 5, 2012) ("Most auto financings are indirect auto loans, which means that the auto dealer helped to secure financing for the buyer.").

other criteria determined by the finance companies. Each dealer is thus the initial originator, but the purchasing finance company is also known in the industry as an originator.

In the indirect origination model, the dealers originate chattel paper in exchange for the sale of a specific good, such as an automobile. Such dealers typically acquire the goods that they sell—the inventory—with financing provided by inventory financers that take a security interest in the inventory perfected by the filing of a financing statement.[73] The chattel paper is therefore proceeds of the inventory,[74] and the inventory financer will have a perfected security interest in the chattel paper whose priority will date from the date of the filing of the financing statement.[75] Without a super-priority rule, a subsequent purchaser of chattel paper would typically be subordinate to the inventory financer. Accordingly, without a super-priority rule, dealers would be limited to one of two more expensive choices. Either the dealers would have to obtain financing of their chattel paper from their inventory financers, or the dealers and other financing companies would need to negotiate amendments to the inventory security agreements to subordinate or release the inventory security interest in the chattel paper sold or pledged to other finance companies.[76]

Once a purchaser obtains super-priority by taking posses-

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[73]*See* Steven L. Harris & Charles W. Mooney, Jr., Security Interests in Personal Property: Cases, Problems and Materials 97-127 (5th ed. 2011) (presenting a prototype of inventory and consumer automobile secured financing).

[74]*See* U.C.C. § 9-102(a)(64) (2010) (defining "proceeds" to include "whatever is acquired upon the sale . . . or other disposition of collateral").

[75]*See* U.C.C. § 9-315(a)(2) (providing that a security interest attaches to identifiable proceeds); § 9-315(c), (d)(1) (providing that perfection of a security interest in proceeds continues if the security interest in the original collateral was perfected by the filing of a financing statement and a security interest in the proceeds may be perfected by a filing); U.C.C. § 9-322(a)(1), (2) (priority for the first to file or perfect or for perfected over unperfected), *quoted su*pra note 51.

[76]*See* U.C.C. § 9-315(a)(1), which provides that a security interest continues in collateral notwithstanding sale or other disposition unless the disposition was authorized free of such security interest. Release provisions for chattel paper could be comparable to the provisions in some inventory security agreements that permit the sale of inventory to buyers in ordinary course. Such buyers already take free of the inventory lender's

sion, the super-priority rule loses a great deal of its economic significance. Subsequent transfers of the chattel paper can be effected by an authenticated security agreement and perfected by the filing of a financing statement, and they are typically done this way. The market practice for selling chattel paper differs from that for mortgage loans. Mortgage loans are evidenced by promissory notes, and, unlike most chattel paper (which typically have a three-five year maturity), are long term assets (typically 15 or 30 years). Mortgage loans are often traded more than once in the market place, and the transfer of such mortgage loans is frequently accompanied by a transfer of possession of the mortgage note. In the case of chattel paper, however, finance companies that are indirect originators of chattel paper that acquire possession of tangible chattel paper from the initial originators often do not transfer possession. The costs are too great and the risk of a fraudulent or inadvertent subsequent transfer of possession to a different purchaser, though real, is considered small.

In sum, the quasi-negotiability of tangible chattel paper, the type of possession necessary to achieve this quasi-negotiability, and the necessity for super-priority based on possession are different from and more limited than the negotiability of negotiable promissory notes, the type of possession necessary for negotiability, and the necessity in the market place for super-priority. The negotiability of negotiable instruments depends upon the existence of a single, unique writing containing an original signature of the obligor. On the other hand, the quasi-negotiability of tangible chattel paper does not depend upon the existence of a single, unique writing containing an original signature of the obligor. Tangible chattel paper may consist of multiple copies of a writing each containing an original signature of the obligor. The quasi-negotiability of tangible chattel paper therefore depends upon two alternatives. Either one person has possession of all copies containing the original signature of the obligor or, as suggested by comment 4 to Section 9-330, if all of the copies with original signatures designate one of the originals as the "original" for purposes of possession, one

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security interest, *see* U.C.C. § 9-320(a), but it is common for the security agreement also to release the security interest in favor of such buyers.

person has possession of that designated original.[77] The interpretation of the definition of "control" for electronic chattel paper should take into account this different meaning of quasi-negotiability and the type of possession necessary to achieve quasi-negotiability and also the more limited necessity of super-priority of chattel paper.

III. The Quasi Negotiable Status of Chattel Paper Based on Control

A. The Purpose of Control

Historically, negotiability and quasi-negotiability of negotiable instruments, chattel paper and securities depended upon possession of the writing evidencing the negotiable instruments, chattel paper and securities. In response to the demands of the market, however, the law began in the last half of the 20th century to recognize non-possessory methods of maintaining the negotiability of investment property consisting of uncertificated securities and security entitlements. These methods rely on a system of registration of the owners of the uncertificated securities on the books of the issuer[78] and the book entry system recognized by the 1994 revision of Article 8 in which securities intermediaries

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[77] *See* U.C.C. § 9-330 cmt. 4, second para.:

> Two common practices have raised particular concerns with respect to the possession requirement [underlined words added in 2010]. First, in some cases the parties create more than one copy or counterpart of chattel paper evidencing a single secured obligation or lease. This practice raises questions as to which counterpart is the "original" and whether it is necessary for a purchaser to take possession of all counterparts in order to "take possession" of the chattel paper . . .. The problem raised by the first practice is easily solved. The parties may in the terms of their agreement and by designation on the chattel paper identify only one counterpart as the original chattel paper for purposes of taking possession of the chattel paper.

[78] *See generally* U.C.C. Art. 8, prefatory note, pt. I (1994), Unif. Commercial Code, 2C U.L.A. 431-38 (2005) (describing the evolution of the securities holding systems); *see also* U.C.C. § 8-102(a)(18) (1994) (defining an "uncertificated security" to mean "a security that is not represented by a certificate"); U.C.C. § 8-102(a)(15) (part of the definition of a "security" is that it be an obligation or interest "the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer"); U.C.C. § 8-102(a)(12) (defining "instruction" to mean "a notification communicated to the issuer of an uncertificated security which directs that the transfer of the security be registered or that the security be redeemed"); U.C.C. § 8-207(a) (providing that before presentment of an instruction requesting registration of transfer of an uncertificated security, the issuer "may treat the registered owner as the person exclusively

register the holders of security entitlements in securities or other financial assets held by the securities intermediaries.[79]

Unlike the system used for intangible investment property, the definition of "control" in the first iteration of Section 9-105[80] in the 2000 revision of Article 9 and its continuation as a safe harbor in current Section 9-105(b)[81] attempts to maintain the quasi-negotiability of electronic chattel paper by constructing a definition of "control" as an analogue to possession. Therefore, the initial definition rationally included a requirement for a single and unique authoritative copy of the electronic chattel paper as an analogue of the single and unique nature of every tangible item of property.[82] The goal was to provide a purchaser of electronic chattel paper the same benefits that a purchaser of tangible chattel paper could obtain by taking possession.

When the initial originator of electronic chattel paper assigns the chattel paper, whether by sale or a grant of a secu-

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entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner"); U.C.C. § 8-301(b) (providing that "delivery" of an uncertificated security requires registration of the purchaser or its agent as the registered owner).

[79] *See* U.C.C. Art. 8, prefatory note, pt. I, *supra* note 78; U.C.C. § 8-102(a)(7) (1994) (defining an "entitlement holder" as the "person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary"); U.C.C. § 8-102(a)(14) (defining a "securities intermediary" as a "(i) a clearing corporation; or (ii) a person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity"); U.C.C. § 8-102(a)(17) (defining "security entitlement" to mean "the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5 [of Article 8]"); U.C.C. § 8-501(b) (providing that a person acquires a security entitlement when a securities intermediary credits a financial asset to a securities account maintained by the securities intermediary); *see also* Schroeder, Is Article 8 Finally Ready This Time? The Radical Reform of Secured Lending on Wall Street, 1994 Colum. Bus. L. Rev. 291, 298-99 (1994) (expressing concerns about what she calls the "supernegotiability" of securities and security entitlements under the 1994 revision of Article 8).

[80] *See* U.C.C. § 9-105(1) (2000), *quoted supra* note 9.

[81] *See* U.C.C. § 9-105(b)(1) (2010), *quoted supra* note 21.

[82] For a discussion of the history of the drafting of the initial Section 9-105 and the difficulties that the drafters faced in developing standards that were neither too restrictive nor too lax, *see* Winn, Electronic Chattel Paper: Invitation Accepted, 46 Gonz. L. Rev. 407, 415-20 (2010) [hereinafter, Winn, Electronic Chattel Paper 2010].

rity interest to secure a debt, to a finance company, the finance company seeks to obtain "control" to perfect the assignment without the filing of a financing statement.[83] More importantly, as described above, the finance company seeks to obtain super-priority over any other secured party that has a security interest in the chattel paper perfected by a previously filed financing statement.[84]

A failure by finance companies to obtain control is not a significant problem for perfecting their interest. Finance companies can perfect their interest by filing a financing statement. To be sure, to file financing statements against hundreds or thousands of initial originators will increase costs, but the costs are small relative to the dollar volume of chattel paper that finance companies acquire from the initial originators. On the other hand, obtaining super-priority in electronic chattel paper by control against inventory secured parties is very important for the same reasons why finance companies obtain super-priority in tangible chattel paper by possession.[85]

As in the case of finance companies that obtain possession of tangible chattel paper from the initial originators to achieve super-priority over inventory financers, however, once a finance company acquires control of the electronic chattel paper, there is no great need for that finance company to transfer control. For example, when rating securities backed by receivables evidenced by chattel paper, such as automobile loans, Standard and Poor's Rating Services requires that the finance companies that sell more than a certain percentage of electronic chattel paper into the securitization demonstrate that they have obtained control of the chattel paper. Standard and Poor's will perform due diligence on the control procedures and will require a legal opinion on "control" from a law firm.[86] Standard and Poor's does not, however, require the subsequent transfer of control

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[83] *See* U.C.C § 9-314(a) (2010) (providing that a "security interest in investment property, deposit accounts, letter-of-credit rights, or electronic chattel paper may be perfected by control of the collateral under Section 9-104, 9-105, 9-106, or 9-107").

[84] *See* U.C.C. § 9-330(a), (b), *quoted supra* note 40.

[85] *See supra* note 76 and accompanying text.

[86] *See* Standard & Poor's Rating Services, Legal Criteria for U.S. Structured Finance Transactions 66-67 (2006).

to the issuers of the rated securities, and instead relies on perfection of such transfer by filing.[87] Also, for finance companies that originate automobile loans directly to the purchaser of the automobile loan, super-priority based on possession or control is not necessary.[88]

Further, a person with possession of tangible chattel paper does have the capacity to transfer such possession to subsequent purchasers. Because of the differences between the essential characteristics of tangible and electronic chattel paper as property items, however, control is more ephemeral. As discussed below, a person that has dominion over an electronic record evidencing electronic chattel paper may have no capacity or only a diminished capacity to transfer "control" to a subsequent purchaser. The limited necessity for control and the limited ability to transfer control may permit the development of a system of control for finance companies purchasing electronic chattel paper from initial originators that eschews the current possessory analogue of "control."

An originator and its customer may create electronic chattel paper initially in electronic form. In the indirect origination industry, the finance company that acquires the chattel paper from the dealer will need control. Alternatively, the originator and its customer may create chattel paper in tangible form and then at some point the chattel paper is converted to electronic chattel paper. For converted chattel paper, then, a finance company that acquires the chattel may need to ensure both possession and control. Satisfying the more general "reliably establishes" standard of revised Section 9-105(a) for control, however, may be easier for converted electronic chattel paper.

B. Initially Created Electronic Chattel Paper

For chattel paper initially created in the form of an

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[87] *See* Standard & Poor's Rating Services, Legal Criteria for U.S. Structured Finance Transactions 66-67 (2006).

[88] *See* Standard & Poor's Rating Services, Legal Criteria for U.S. Structured Finance Transactions 66–67 (2006):

> For direct originations of electronic chattel paper, Standard & Poor's does not look for perfection by control for transfers by the originator to subsequent transferees. As with tangible chattel paper, Standard & Poor's relies on covenants by the originator not to transfer control to a third party (other than an SPE or securitization trustee), which would enable the third party to have priority over the rated noteholders.

electronic record or records, current industry methods that have satisfied this strict definition are essentially book entry systems comparable to that for securities and security entitlements with one important distinction. Under a common and developing current industry method,[89] the initial originator of the electronic chattel paper and the potential assignee-secured party contract with a third party custodian that actually creates and holds the electronic record as the authoritative copy in an electronic vault subject to a control system that regulates access to the authoritative copy. This third party custodian establishes procedures to ensure compliance with all of the requirements of the original Section 9-105 and the current safe harbor of Section 9-105(b) for any interactions with the authoritative copy in the electronic vault.[90] The custodian then maintains the electronic chattel paper on behalf of the initial secured party or the assignee of the secured party.

There is no requirement for a third party custodian. As an alternative, the finance company that will acquire the electronic chattel paper could establish and operate the electronic contracting and vaulting system. This procedure would establish control in the finance company as against the dealer-originator. This procedure, however, may present challenges for the subsequent assignment of control to future purchasers. The use of a custodian would more easily permit the subsequent assignment of the electronic chattel paper and the transfer of control to future purchasers. On the other hand, as discussed above, there is less need to provide for the subsequent transfer of control. Instead, finance companies will use third party custodians when reliance on such

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[89] *See* Working Group on Transferability of Electronic Financial Assets, *supra* note 18 (providing a detailed discussion of a control system and control environment that would satisfy the requirements of the definition of the original definition and the current safe harbor definition of "control"); ABA Cyberspace Committee Working Group on Transferable Records, *supra* note 19, at 385–86 (containing a brief description of the electronic vaulting method "that takes advantage of a self-contained, secured environment and leverages the fact that with an electronic record it is control over access, and not physical location, that is of chief importance to the owner of the record").

[90] *See* U.C.C. § 9-330(a), (b) (2010), *quoted supra* note 40.

specialists is more efficient than developing in-house control systems.[91]

1. Safe Harbor: Single and Unique Authoritative Copy.

As noted above,[92] the characteristics of an electronic record present challenges to satisfying the requirement in original Section 9-105 and in current Section 9-105(b) that a "single authoritative copy of the record or records exists which is unique."[93] Each electronic record can be perfectly replicated. Further, an electronic record may exist in the form of multiple bits of data that are stored in different parts of a hard drive or other equipment, in different hard drives, or even in different systems but that, by virtue of the computer system processes, are retrievable in perceivable form as one record or one set of records. In any one computer system there may be more than one copy of the record or set of records, including temporary or permanent back-up copies.

Comment 2 to original and revised Section 9-105 states that control of electronic chattel paper is the "functional equivalent" of possession of tangible chattel paper.[94] The key word in this comment is "functional." A requirement for a physically "unique" electronic record comparable to the physical uniqueness of tangible chattel paper would render "control" of electronic chattel paper unworkable if not impossible. Nevertheless, the requirement for a single and unique authoritative copy is satisfied by a computer system

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[91]For example, RouteOne LLC is one company that provides vaulting services for finance companies and dealers. According to its website, it was formed more than 10 years ago by Ally Financial, Ford Motor Credit, TD Auto Finance, and Toyota Financial Services. RouteOne, About Us, http://www.routeone.com/about-us (last visited July 29, 2014).

[92]*See* notes 18 & 19 *supra* and accompanying text. *See also* Winn, Electronic Chattel Paper Under Revised Article 9: Updating the Concept of Embodied Rights for Electronic Commerce, 74 Chi.-Kent L. Rev. 1055, 1061 (1999) [hereinafter, Winn, Electronic Chattel Paper 1999] (nothing that an electronic record cannot be unique in the same sense that a signed original chattel paper is unique); ABA Cyberspace Committee Working Group on Transferable Records, *supra* note 19, at 381 (noting that electronic records are often held in dynamic files or on a networked array of storage devices).

[93]*See* U.C.C. § 9-105(1) (2000), *quoted supra* note 9, and U.C.C. § 9-105(b)(1) (2010), *quoted s*upra note 21.

[94]*See* U.C.C. § 9-105 cmt. 2 (2000), and U.C.C. § 9-105 cmt. 2 (2010), *quoted supra* note 10.

and procedures that identify one record or set of records that is retrievable as the "authoritative" copy and that identify any other otherwise identical records, including back-up records, that are retrievable in perceivable form as a non-authoritative copy.[95] Similarly, the computer procedures and protocols should require that any printed copies be labelled as non-authoritative copies. These procedures also satisfy the requirements of clause (5) that each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy.[96]

The use of computer systems and procedures that identify one record or set of records that is retrievable as the "authoritative" is supported by several commentators who have addressed the requirement for a single and unique authoritative copy. For example, Professor Jane Winn has succinctly described the issue of "uniqueness":

> The issue is, therefore, not whether the electronic chattel paper record is absolutely unique in the sense that chattel paper represented by a piece of paper is a unique collection of atoms in the material world, because no electronic record used in an electronic business information system can be unique in that sense. Rather, the electronic chattel paper record must

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[95] *See* Working Group on Transferability of Electronic Financial Assets, *supra* note 18, § 3.1.2, ques. 4 at 731 (noting that the actions that may be taken by an authorized participant include identifying the authoritative copy but also noting that affirmative action may not be needed and that the "identification of the single authoritative copy as such follows from its attributes and existence with a Control System"); Working Group on Transferability of Electronic Financial Assets, *supra* note 18, § 3.1.2, ques. 6 at 731–32 (describing how non-authoritative copies are readily identifiable); Working Group on Transferability of Electronic Financial Assets, *supra* note 18, § 3.1.4, ques. 8 at 732 (describing the monitoring of authoritative and non-authoritative copies); Working Group on Transferability of Electronic Financial Assets, *supra* note 18, § 3.2.1, ques. 1 at 734 (describing identification of the authoritative copy); Working Group on Transferability of Electronic Financial Assets, *supra* note 18, § 3.3, ques. 1 at 736 (describing identification of non-authoritative copies); Working Group on Transferability of Electronic Financial Assets, *supra* note 18, § 3.4.1, at 737–38 (discussing uniqueness of authoritative copy); ABA Cyberspace Committee Working Group on Transferable Records, *supra* note 19, at 386 (discussing uniqueness and distinguishing non-authoritative copies).

[96] *See* U.C.C. § 9-105(5) (2000), *quoted supra* note 9, and U.C.C. § 9-105(b)(5) (2010), *quoted supra* note 21.

> exist within a computer system which is designed to distinguish one special copy of the record as uniquely significant.[97]

The ABA Cyberspace Committee Working Group on Transferable Records also addressed the issue of uniqueness as follows:

> The first requirement of the [original Section 9-105], for an "authoritative copy," reflects a reality of the electronic environment noted earlier-there is no such thing as an "original" document that can be transferred from person to person. The transmittal of an electronic document results in the creation of a new copy, not the physical transposition of the existing copy. A copy, to qualify as the authoritative copy, must meet three criteria-it must be unique, identifiable, and (except as otherwise provided) unalterable.
>
> "Unique" is not otherwise defined, and it therefore should be understood in its simple dictionary sense; that is, the authoritative copy must have a characteristic that distinguishes it from other copies. That characteristic may be provided by technology, or by process or agreement. For example, an authoritative copy stored within a controlled-access system may be provided with a unique control number, or be held in a specified server or other location that makes it distinguishable from other copies . . ..
>
> The authoritative copy does not have to be static over time. The copy that qualifies as the "authoritative copy" at one time, during or after the transaction, need not be the same copy that qualifies as the authoritative copy at another time. All that is required is that, at any given moment, there be a single authoritative copy.[98]

Companies that offer custodian services for initially created electronic chattel paper have developed the detailed and complicated computer systems and procedures that are necessary to satisfy the requirement of a single and unique authoritative copy. With the new "reliably establishes" standard for control, however, some of these procedures may no longer be strictly necessary.

2. Safe Harbor: Other requirements

Aside from the requirement for a single and unique authoritative copy discussed below, the requirements for control under the original Section 9-105 and the current safe harbor of Section 9-105(b) are not difficult to satisfy. The

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[97] Winn, Electronic Chattel Paper (1999), *supra* note 92, at 1061.

[98] *See* The ABA Cyberspace Committee Working Group on Transferable Records, *supra* note 19, at 384–85.

control system provisions of the custodian can establish compliance[99] with the following clauses of the definition of control in original Section 9-105[100] and in current Section 9-105(b):[101]

(1) "a single authoritative copy of the record or records exists which is . . . identifiable, and, except as otherwise provided in paragraphs (4), (5), and (6), unalterable": To exist, any receivable must be identifiable. Establishing procedures for the identification of the authoritative copy are not difficult. The computer systems and procedures for establishing control can ensure such identification and ensure that there are no improper alterations.[102]

(2) "the authoritative copy identifies the secured party as the assignee of the record or records": Again, any system for the assignment of receivables must be able to identify the assignee, and the control system can ensure such identification. There is no need that the actual electronic contract originally created by the obligor and the initial originator be revised to show such assignee. Because an authoritative copy can be a "record or records," the authoritative copy can consist of both the record that contains the original electronic contract and a separate record that serves as an ownership log, as in a book entry system, that is logically tied by the computer system processes to the contract

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[99] *See* Working Group on Transferability of Electronic Financial Assets, *supra* note 18, § 3.4.2 at 738–39 (discussing the "identifiable" requirement); Working Group on Transferability of Electronic Financial Assets, *supra* note 18, § 3.4.3 at 739–42 (discussing the "unalterable" requirement and the permissible amendments and revisions); Working Group on Transferability of Electronic Financial Assets, *supra* note 18, § 3.5 at 742–44 (discussing assignment and transfer); ABA Cyberspace Committee Working Group on Transferable Records, *supra* note 19, at 385–86 (a more summary description of the requirements of the definition).

[100] *See* U.C.C. § 9-105 (2000), *quoted supra* note 9.

[101] *See* U.C.C. § 9-105(b) (2010), *quoted supra* note 21.

[102] *See* The ABA Cyberspace Committee Working Group on Transferable Records, *supra* note 19, at 384:

> As a practical matter, if a record is unique, then almost by definition it is identifiable, so that the second criteria for an authoritative copy appears redundant. The most sensible interpretation of the "identifiability" rule is that the document management system being used, or the agreement of the parties, must explicitly define the authoritative copy in terms of its unique characteristic. In other words, an agreement or system rule presumably must specify or describe the unique feature that identifies the authoritative copy, and how that unique feature can be accessed or confirmed.

through a unique identification number for each electronic contract.[103]

(3) "the authoritative copy is communicated to and maintained by the secured party or its designated custodian": Maintenance of the authoritative copy by the secured party or its custodian is a feature of the control system. The only quibble could be the statutory requirement that the authoritative copy be "communicated" to the secured party or the custodian. The custodian (or the intended assignee secured party) of the electronic chattel paper maintains the electronic record in its electronic vault. For this reason, the authoritative copy is never "communicated"[104] in one sense to the custodian (or intended assignee secured party).

Nevertheless, the creation of the contract does require that the obligor and the initial originator communicate information to the custodian (or the intended assignee secured party) to create the electronic chattel paper. If a custodian maintains the chattel paper, the initial originator and the intended assignee also communicate information between themselves and through the custodian to effect the assignment of the electronic chattel paper from the initial originator to the assignee secured party through the custodian's system. This communication of the information by the initial originator to the custodian (or the intended assignee secured party) that provides for the creation and assignment of the authoritative copy should satisfy the requirements for such "communication" of the authoritative copy to the secured party or its custodian.

A contrary interpretation would require the transmission of electronic chattel paper from one entity—the initial originator or a custodian for the originator—to a separate entity—the assignee secured party or the custodian for the assignee secured party. As noted above,[105] such transmission actually creates a new electronic record for the recipient and by itself could leave the transmitter in possession of an

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[103] *See* The ABA Cyberspace Committee Working Group on Transferable Records, *supra* note 19, at 386.

[104] *See* U.C.C. § 9-102(a)(18)(B) (2010) (providing that the word "communicate" ***includes*** "to transmit a record by any means agreed upon by the persons sending and receiving the record") [emphasis added]. The use of the word "includes" permits a broader definition of "communicate" that serves the purpose of maintain control of electronic chattel paper.

[105] *See supra* note 19 and accompanying text.

identical electronic record. Such a transmission requirement would needlessly increase costs, would present the risk of diminished security for the "control" of a single authoritative copy of the electronic record under the safe harbor requirements,[106] and would serve no useful purpose.

(4) "copies or amendments [revisions] that add or change an identified assignee of the authoritative copy can be made only with the consent [participation] of the secured party": Again, a control system will contain the necessary procedures and protocols to ensure that the secured party must approve changes in the identified assignee.

(5) "each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy": This requirement is part of the requirement for a single and unique authoritative copy discussed in detail above.

(6) "any amendment [revision] of the authoritative copy is readily identifiable as authorized or unauthorized": Again, a control system will contain the necessary procedures and protocols to ensure authorized revisions or amendments.

C. The "Reliably Establishes" Standard: No Single or Unique Requirement

The requirements for a single and unique authoritative copy and the differentiation between authoritative and nonauthoritative copies in the safe harbor are more appropriate for a robust level of negotiability, like that for a negotiable instrument.[107] The requirement for a single and unique authoritative copy of an electronic promissory note would be useful to protect the maker of the note. If a person could be deemed to have control over two identical authoritative copies of a negotiable promissory note and qualified as a holder in due course, theoretically, the maker of the note could be required to pay two notes.[108]

Interestingly, the Uniform Electronic Transactions Act ("UETA"), promulgated in 1999 after the drafters of revised Article 9 had added the definition of "control" to the then

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[106]For a discussion about how under the "reliably establishes" standard, transmission of and retention by the initial originator of the electronic chattel paper may not destroy the ability to transfer control, see *infra* notes 115–116 and accompanying text.

[107]*See supra* notes 41–45 and accompanying text.

[108]*See supra* notes 63–65 and accompanying text.

current draft of Article 9 in 1998,[109] included the more stringent definition of "control" of "transferrable records," with the requirement for a single and unique authoritative copy, as a safe harbor to the "reliably establishes" standard that now appears in the 2010 revision of Section 9-105(a).[110] A transferrable record under UETA is a record that, but for a writing, would qualify as a negotiable instrument under UCC Article 3 or a negotiable document of title under UCC Article 7.[111] Similarly, in 2000, the federal Electronic Signatures in Global and National Commerce Act ("eSign"), enacted a similar control provision containing the general standard and the restrictive safe harbor for a "transferrable record" under eSign, which is defined as an electronic record that would be a negotiable note under Article 3 and that relates to a loan secured by a mortgage.[112]

For the purposes of the quasi-negotiability of chattel paper, however, the existence of a single and unique authoritative copy is not critical to establish control. To establish perfection and super-priority against the initial originator, it would be sufficient if the assignee secured party or a custodian have the only authoritative electronic copy or copies of the electronic chattel paper. For example, a custodian could maintain the electronic chattel paper in its vault on behalf of an originating automobile dealer until the dealer assigns the chattel paper to a finance company through the custodian's system. In either case, it makes no difference if the assignee secured party or custodian has one copy or 100 copies of the electronic record so long as (a) all copies are "authoritative," that is, there are no variations among the copies, and (b) in the case of the custodian, the custodian identifies only one person for which it is maintaining control.

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[109] *See* Winn, Electronic Chattel Paper 2010, supra note 82, at 416, 418, 421–22.

[110] *See* U.E.T.A § 16(b) (1999) (general "reliably establishes" standard), § 16(c) (safe harbor requiring, among other items, a single and unique authoritative copy). UETA has been adopted by 47 states and the District of Columbia with numerous non-uniform amendments. *See* Uniform Law Commission, *Electronic Transaction Act), available at* http://www.uniformlaws.org/Act.aspx?title=Electronic Transactions Act (last visited July 29, 2014).

[111] *See* U.E.T.A § 16(a)(1) (1999).

[112] 15 U.S.C.A. § 7021(a)(1) (definition of transferrable record), § 7021(b) (general definition of control), § 7021(c) (safe harbor definition of control).

The first paragraph of Comment 4 to current Section 9-330 seems to confirm this interpretation of control of electronic chattel paper in light of its purpose of solving for ostensible ownership and the possibility of debtor-secured party fraud. In addressing chattel paper that comprises one or more tangible records and one or more electronic records, the comment states:

> [A] purchaser may satisfy the possession-or-control requirement by taking possession of the tangible records under Section 9-313 and having control of the electronic records under Section 9-105. In determining which of several related records constitutes chattel paper and thus is relevant to possession or control, the form of the records is irrelevant. Rather, the touchstone is whether possession or control of the record would afford the public notice contemplated by the possession and control requirements.[113]

For these reasons, a standard of control under Section 9-105(a) that a system "reliably establish" the secured party as the person to which the chattel paper was assigned should not require the maintenance of a single authoritative copy that is unique and distinguishable from other copies held in the system. Instead, the "singleness" and the "uniqueness" of the electronic chattel paper should refer to the fact that only one person has dominion over the electronic chattel paper.

One counter to this suggestion appears in the revised comment 3 to Section 9-105. It states:

> As under UETA, a system must be shown to reliably establish that the secured party is the assignee of the chattel paper. Reliability is a high standard and encompasses the general principles of uniqueness, identifiability, and unalterability found in subsection (b) without setting forth specific guidelines as to how these principles must be achieved.[114]

This comment, however, refers to uniqueness without reference to a "single authoritative copy" or the necessity that non-authoritative copies be distinguishable from the authoritative copy. If a custodian holds multiple copies of electronic chattel paper for the benefit of a secured party, but no other person has any electronic copies or a written copy that purports to be an original, the chattel paper held by the custodian represents a single and unique monetary obligation of the obligor, regardless of how many copies exist. So

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[113] *See* U.C.C. § 9-330 cmt. 4, first para. (2010).

[114] *See* U.C.C. § 9-105 cmt. 3.

long as no other person has a copy of the electronic chattel paper, dominion by the assignee or its custodian over the electronic chattel paper regardless of the number of copies should satisfy the "principles" of uniqueness required by the safe harbor.

D. The Future: A System of Control Not Based on the Possession Analogy

Custodians have developed systems that do comply with the stricter requirements of the safe harbor. Because of the importance for purchasers of electronic chattel paper of obtaining super-priority over the secured creditors of dealers, finance companies may insist that these systems continue to meet the more stringent safe harbor. On the other hand, the constant pressures on businesses in a competitive market to reduce costs may induce custodians and assignee secured parties to search for less expensive methods of establishing control.

For example, if an initial originator, like a dealer, initially created electronic chattel paper directly and assigned it to a finance company and retained an electronic copy of the chattel paper, could the automobile financer nevertheless have control? Under an analysis that is analogous to that used for tangible chattel paper, which seems to be embedded in the comments to Section 9-330 discussed above,[115] the argument would be that the assignee should not have control because the dealer could market its electronic chattel paper to subsequent purchasers who do not have notice of the prior assignment. In this case, however, the analogy with tangible chattel paper breaks down.

For tangible chattel paper, the existence of the original wet ink signed tangible chattel paper in the hands of a dealer may indicate that the dealer owns the tangible chattel paper and that the dealer can assign it to a subsequent purchaser for value in ordinary course without notice. But for the possible existence of multiple originals held by different persons, transfer of possession is enough to perfect the transfer. But electronic chattel paper is different. It is not tangible, and it cannot exist without a separate computer system.

The existence of the electronic record purporting to be chattel paper in the initial originator's computer system

[115] *See supra* note 113 and accompanying text.

does not by itself establish the existence of the chattel paper that the initial originator owns or purports to own in the way that a tangible document does. There is no "ostensible ownership" of electronic chattel paper. It is essentially intangible like any account carried on the books of the owner of the account. Accordingly, any potential purchaser of electronic chattel paper that was not involved in the creation of the chattel paper—which involvement is an integral part of the indirect origination model—would need to do more due diligence to establish the existence of the chattel paper. The type of due diligence would resemble the type of due diligence that purchasers of accounts undertake to establish the existence of the account, including the tracking of cash flows relating to the receivables such as payments by the obligor.[116]

Moreover, a transfer of possession of tangible chattel paper actually transfers a physical thing. A transmission of the electronic chattel paper does not. Such a transmission creates a new electronic record, and depending on the manner of transmission the sender may retain an identical copy. Hence, by itself a transmission of the electronic chattel paper is not enough to transfer control, especially under the safe harbor requirement of a single and unique authoritative copy. Potential purchasers should know the limitations of an electronic record. Except in the case of an assignment immediately upon creation, the existence of the electronic record does provide notice of the difficulty of obtaining control. These limitations may permit the use of a more flexible system for the transfer of control, especially to an assignee that participates in the initial creation of the electronic chattel paper in the indirect origination model.

Accordingly, it may be possible for an initial originator of electronic chattel paper to establish a system by which it reliably establishes an assignee as the person to which the chattel paper has been assigned even though the originator retains an electronic copy. Further, such a system may resemble a system of assignment of other intangible receivables, perhaps enhanced in some way, more than a system that resembles the assignment of tangible chattel paper and written promissory notes. Such a system is at this point

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[116] *See* Plank, Assignment of Receivables: Structural Incoherence, supra note 15, at 267.

merely a possibility. Needless to say, developing such a system would require a great deal more thought.

E. Converted Electronic Chattel Paper

If a person in possession of tangible chattel paper converts it into an electronic record, the electronic record becomes electronic chattel paper.[117] The drafters of Article 9 contemplated the use of electronic chattel paper that had been converted from tangible chattel paper.[118] The provisions for control for purposes of attachment under Section 9-203(b)(3)(D), perfection under Section 9-314(a) and most importantly super-priority under Section 9-330(a) and (b) would apply. Typically the conversion from tangible to electronic chattel paper is accomplished through a scanning and imaging process that produces an image of the tangible chattel paper.

1. Safe Harbor

Compliance with the definition of control under the original Section 9-105 and the safe harbor of current Section 9-105(b) would still depend on the existences of a single and unique authoritative copy. Again, because the electronic record may be replicated perfectly, satisfying this requirement requires a system that effectively designates one record or set of records as the authoritative copy and that effectively designates all other copies, including back-up copies, as non-authoritative copies. Financers and their custodians have developed systems that meet these requirements comparable to the systems developed for originally created electronic chattel paper discussed above. These systems can ensure that only the assignee secured party or its custodian has one copy of the electronic chattel paper designated as the authoritative copy and that all other copies are designated or marked as non-authoritative copies.[119] These systems can

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[117] *See* U.C.C. § 9-102(a)(70) (2010) (defining "record"), *quoted supra* note 4; U.C.C. § 9-102(a)(31) (defining "electronic chattel paper"), quoted *supra* note 8.

[118] *See* U.C.C. § 9-105 cmt. 3 (2000) and U.C.C. § 9-105 cmt. 4 (2010), *quoted infra* text accompanying note 123.

[119] *See supra* notes 92–98 and accompanying text.

also satisfy the other requirements of the safe harbor discussed above.[120]

Converted chattel paper, however, does present an additional issue. To what extent does the existence of the tangible chattel paper affect the control of the electronic chattel paper? The purpose of converting from tangible to electronic chattel paper is to reduce the cost of storage and retrieval of the chattel paper. Hence, the tangible chattel paper that has been converted to electronic form—really, copied to electronic form—is typically destroyed after some period of time. Nevertheless, because of the desirability of ensuring that the imaging process has accurately and successfully replicated the tangible chattel paper, the system should allow for some delay in the destruction so that any errors in the conversion process may be detected and corrected.

One could interpret the language of clause (1) of original Section 9-501 and revised Section 9-105(b) that a secured party has "control" of electronic chattel paper if, *inter alia*, "the ***record or records comprising the chattel paper*** are created, stored, and assigned in such a manner that (1) a single authoritative copy of the ***record or records*** exists [emphasis added]."[121] If the reference to "record or records" encompasses only the electronic records, the existence of a single and unique authoritative copy of the electronic chattel paper is sufficient to create control, regardless of the continued existence of the original tangible chattel paper. Of course, to fulfill the purpose of providing for possession or control of chattel paper, the secured party (directly or through one or more custodians) must have both possession of the tangible chattel paper and control of the electronic chattel paper.[122]

Notwithstanding this interpretation, it would be prudent simply to designate the tangible chattel paper as a non-authoritative copy. The term "chattel paper" in the phrase

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[120] *See supra* note 99–107 and accompanying text

[121] *See* U.C.C. § 9-105(1) (2000), *quoted supra* note 9; U.C.C. § 9-105(b)(1) (2010), *quoted supra* note 21. Similarly, the reference in original Section 9-105(5) and revised Section 9-105(b)(5) to distinguishing authoritative and non-authoritative copies can reasonably be interpreted in each case to refer only to copies that consist of electronic records.

[122] *See* U.C.C. § 9-330 cmt. 4, first para. (2010), *quoted supra* in text accompanying note 113 (added in 2010 revision).

"the record or records comprising the chattel paper" could be read to refer not only to the electronic record or records comprising electronic chattel paper but also to any existing tangible records comprising the tangible chattel paper from which the electronic chattel paper was created. If so, control of the electronic chattel paper would require the existence of a single authoritative copy of all the records, both electronic and tangible.

Comment 3 to original and comment 4 current Section 9-105 supports this interpretation:

> One requirement for establishing control under paragraph (b) is that a particular copy be an "authoritative copy." Although other copies may exist, they must be distinguished from the authoritative copy. This may be achieved, for example, through the methods of authentication that are used or by business practices involving the marking of any additional copies. When tangible chattel paper is converted to electronic chattel paper, in order to establish that a copy of the electronic chattel paper is the authoritative copy it may be necessary to show that the tangible chattel paper no longer exists or has been permanently marked to indicate that it is not the authoritative copy.[123]

A system that sufficiently designates the tangible chattel paper as the non-authoritative should satisfy this interpretation of this control provision. The comment does refer to the alternative of permanently marking the tangible chattel paper, but such marking is likely not cost effective. Nor should the method of identifying such tangible records as the non-authoritative copy be so limited. So long as the tangible contracts are held by the assignee secured party (directly or through one or more of its custodians),[124] business procedures adopted by the assignee secured party or custodian designating such tangible contracts as non-authoritative copies and preventing the removal of such tangible records (unless appropriately marked) pending destruction should be sufficient.

2. The "Reliably Establishes" Standard

The analysis that under the "reliably establishes" standard the "single and unique" requirement no longer applies for electronic chattel paper applies equally to converted

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[123] *See* U.C.C. § 9-105 cmt. 3 (2000); U.C.C. § 9-105 cmt. 4 (2010).

[124] *See* U.C.C. § 9-330 cmt. 4, first para. (2010), *quoted supra* in text accompanying note 113 (added in 2010 revision).

electronic chattel paper produced by a scanning and imaging process. A person can have control of the converted electronic chattel paper if it has all of the authoritative copies, regardless of number.

Further, to the extent that the image is unalterable without detection to the same extent that a writing is unalterable, compliance with the requirements of the general "reliably establishes" standard of current 9-105(a) may be easier. If the electronic image of the tangible chattel paper shows an assignment from the initial originator to the finance company as assignee secured party, the conversion process would constitute a system employed for evidencing the transfer of interests in the chattel paper that "reliably establishes the secured party as the person to which the chattel paper was assigned."[125]

Such an electronic record would satisfy the basic requirement for establishing the quasi-negotiability of chattel paper. Regardless of who has a copy of the electronic record—including the original assignor—no subsequent purchaser can be without notice of the assignment to the assignee claiming control.[126] The existence of multiple copies of this type of electronic record would not multiply the obligation of the obligor on the chattel paper, and the obligor would be obligated to pay only the original secured party on the chattel paper or, after receiving notice of assignment to an assignee, to pay the assignee.

If the initial originator retained a copy of the electronic record, the originator may have the ability to alter the image in the record to delete the assignment to the assignee secured party and then attempt to resell the chattel paper to another purchaser. Such alteration would be the result of an intentionally fraudulent action by the initial originator. It

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[125] *See* U.C.C. § 9-105(a) (defining "control").

[126] For a purchaser to have super-priority in chattel paper claimed merely as proceeds, the chattel paper must not indicate that is has been assigned. For a purchaser to have super-priority in chattel paper claimed other than merely as proceeds, the purchaser must be without knowledge that the purchase violates the rights of another person. *See* U.C.C. § 9-330(a), quoted *supra* note 40. The assignment language in the electronic chattel paper would provide such knowledge. *See* U.C.C. § 9-330(f) (providing that "if chattel paper or an instrument indicates that it has been assigned to an identified secured party other than the purchaser, a purchaser of the chattel paper or instrument has knowledge that the purchase violates the rights of the secured party").

would not occur by accident or inadvertence. The ease with which such alteration could be done without detection by a subsequent purchaser may affect the determination that the conversion process reliably establishes the assignment to the secured party. On the other hand, after delivering possession of an originally signed tangible chattel paper to a purchaser, the initial originator could easily produce a fraudulent duplicate copy bearing what appears to be an original signature of the obligor of tangible chattel paper and sell that to a different purchaser. That possibility would not destroy the first purchaser's possession of the tangible chattel paper.

Also, regardless of how many copies of the chattel paper exist, the obligor has only one payment obligation. The obligor will only pay the original assignor until the obligor receives notification of an assignment. Whether fraudulent or inadvertent, a double assignment of chattel paper, which normally requires monthly payments, soon becomes apparent. This fact acts as a practical constraint on double assignments.

Hence the possibility of fraudulent alteration of the electronic chattel paper in the form of a scanned image should not destroy the first purchaser's control of the electronic chattel paper. As comment 3 to current Section 9-105 states, "the standards applied to determine whether a party is in control of electronic chattel paper should not be more stringent than the standards now applied to determine whether a party is in possession of tangible chattel paper."[127]

Finally, even if the converted electronic chattel paper consists of a generally unalterable image, it is nevertheless an intangible item of property. To be sure, a generally unalterable image may appear to resemble a tangible property item. Nevertheless, any purchaser other than the initial intended assignee secured party in the indirect origination model of origination would need to do the necessary due diligence to verify the existence of the obligation represented by the image. As with initially created electronic chattel paper and regardless of the extent of the alterability of the converted electronic chattel paper, it may be possible for an initial originator of electronic chattel paper to create a system by which it reliably establishes an assignee as the

[127] *See* U.C.C. § 9-105 cmt. 3 (2000); U.C.C. § 9-105 cmt. 4 (2010).

person to which the chattel paper has been assigned that resembles a system of assignment of other intangible receivables more than a system that relies on a possessory paradigm.

IV. Conclusion

The tangible nature of the initial form of chattel paper and the business practices of those involved in the creation of chattel paper of necessity required the implementation of a form of quasi-negotiability of chattel paper. The initial drafters of Article 9 determined that providing super-priority to a purchaser of chattel paper that is proceeds of inventory over a secured inventory financer was the best rule for the various parties. It was only natural for the initial drafters of Article 9 to follow the then existing practices to rely on the transfer of possession of the chattel paper as a means for achieving this super-priority.

With the evolution from paper to electronic records, it was reasonable to attempt to adopt a system of control of electronic chattel paper that followed a possessory paradigm. On the other hand, it was not the only way to achieve super-priority. Article 9 has long contained a super-priority rule for purchase money security interests that does not require any transfer of a tangible item to the secured party with the super-priority.[128]

A super-priority rule comparable to the purchaser money security interest super-priority geared to the indirect origination model for chattel paper may have been sufficient. Aside from the necessity for achieving super-priority over an inventory lender that in many cases will have been the first to file a financing statement, there is in the market place no great demand for or need for the quasi negotiability of chattel paper.

The industry has adapted to the rules for control that follow the quasi-possessory paradigm. The question remains whether the "reliably establishes" standard for control of electronic chattel paper will permit a system of assignment

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[128] *See* U.C.C. § 9-324 (2010) (super-priority of purchase money security interest in goods). Article 9 also contains a super-priority rule for buyers in ordinary course of inventory subject to a security interest, but this rule does require transfer of possession of the good to the buyer. *See* U.C.C. § 9-320(a) (buyer in ordinary course takes free of security interest); U.C.C. § 1-201(b)(9) (2008) (definition of buyer in ordinary course).

that eschews reliance on the analogy to possession of a tangible item of property and looks to other systems that do reliably establish the assignment of intangible property items.

In this regard, given the limited reasons for quasi-negotiability of chattel paper in contrast to the reasons for negotiability of negotiable promissory notes and documents of title, the fact that the language of the different statutes governing control—Section 9-105 of Article 9, Section 16 of UETA,[129] and Section 7021 of eSign[130]—is is almost identical should not prevent the development of systems that respond to the different needs of the transactions with these different types of property items. For example, the conferring of holder in due course status on a holder of a "transferrable record" that is to be the equivalent of a holder of a negotiable instrument or negotiable document, with additional benefits as against the obligor, may require a stricter form of control. But whatever the requirements for control of transferrable records, the requirements for control of electronic chattel paper should be sufficient for, but no stricter than, what is necessary to confer the limited quasi-negotiable status to chattel paper for the limited purposes of such status.

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[129] *See supra* note 111 and accompanying text.

[130] *See supra* note 112 and accompanying text.