I'm an Article 9 Lawyer, So Why Do I Need to Know Articles 1-8 Of The UCC?

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When they think of “the Uniform Commercial Code”, many young practitioners think only of Article 9 on Secured Transactions. Which is not unreasonable; Article 9’s forms are labeled “UCC”, not “UCC 9.” The UCC, of course, contains many more articles, and even if one is dealing only with secured transactions, concepts from all the other articles interact with Article 9. Thus, it is important even for an Article 9 practitioner to understand the ways in which all the articles work with one another.

While most lawyers are probably aware and at least moderately conversant with Article 1, which contains definitions applicable to the entire UCC, and Article 2 on sales, they may have had less exposure to some of the other articles.

In our seminar, a diverse panel of experts on the UCC will explore how Articles 1, 2, 2A, 3, 4, 5, 7 and 8 work with Article 9, and how “Article 9 expertise” is inadequate without an understanding of the entire UCC. (We omitted Articles 4A, on funds transfers, because the panel was already large; Article 6 has been repealed in nearly every state).

While it is impossible in a 90 minute presentation to cover every way in which Article 9 practitioners might refer back to the other articles, the panel will cover many of the highlights of the relationship among the articles of the UCC.

**Article 1 (General Provisions)** contains definitions that are used throughout the UCC, as well as basic concepts, like choice of law and good faith, that are critical to practice in Article 9. When looking for the meaning of a word in Article 9 that is not defined in Section 9-102(a) or elsewhere in Article 9, it’s always best to look at Article 1. Article 1 also containst the “traffic cop” provision that determines whether a transaction falls under Article 2A or Article 9.

**Article 2 (Sales)** directly invokes Article 9 when a seller attempts to retain title, and concepts of sale on approval or return that are closely related to secured transactions. Article 2 sellers are often unaware that their documents create a security interest, and that failure to perfect that security interest will leave them with far fewer rights in goods they have sold than they believed.

**Article 2A (Leases)** (with an assist, as noted above, from Article 1) contrasts the concepts of “true lease” and a lease that is a disguised secured transaction. The determination of which basket a transaction will fall in is a matter of substance and not of label. Indeed, it’s often the case that it is worth documenting a transsaction both ways, just to make sure that the desired outcome is achieved. Any practitioner dealing with something denominated a lease should consider it from both an Article 2A and an Article 9 perspective. The UCC-1 form contains a check box that allows the secured party to give notice that the transaction is intended to fall within the “lessor/lessee” relationship, rather than debtor and secured party, although the statute contains no penalty for checking it when it is proven to be incorrect.
Article 3 (Negotiable Instruments) includes a whole category of Article 9 collateral, but also the holder in due course rule, which requires that an instrument be negotiable under Article 3, can indirectly determine who has title to goods paid for with the instrument.

Article 4 (Bank Deposits and Collections) looks to Article 9 when determining whether someone claiming to have given “value” for holder in due course status can use its status as a secured party to prove it.

Article 5 (Letters of Credit) also governs a whole category of Article 9 collateral, one which is often a “supporting obligation” as well.

Article 7 (Documents of Title) governs some but not all of the Article 9 collateral category of “documents”. It also contains concepts relating to rights of warehouses that can contrast with the rights of secured parties.

Article 8 (Investments Securities) and Article 9 may interact the most of any two UCC articles; the concept of “control” in Article 9 first was adopted in Article 8 and spread. When dealing with investment property, a practitioner will realize that flipping back and forth and back again between the two articles can be dizzying, but is necessary to ensure that a security interest in investment property can be created and perfected.
Introduction to Article 8 of the Uniform Commercial Code and Security Interests in Certain Investment Property

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SCOPE OF ARTICLE 8

Article 8 of the Uniform Commercial Code ("UCC") governs issues including:

- classification of obligations and interests as securities or financial assets
- holding systems for securities or financial assets (direct v.s. indirect)
- acquisitions and transfers of securities or financial assets or interests therein

Note: all cites are to the New York Uniform Commercial Code.
What property is governed by Article 8?

- Security see UCC §§ 8-102(a)(15) and 8-103
- Security Entitlement see UCC §8-102(a)(17)
- Financial Asset (includes securities) see UCC §8-102(a)(9)
- Securities Account see UCC §8-501(a)

All of the above constitute “investment property” under Article 9 (more about that later)
What is a security?

“Security," except as otherwise provided in Section 8-103, means an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer:

(i) which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;

(ii) which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and

(iii) which:

(A) is, or is of a type, dealt in or traded on securities exchanges or securities markets; or

(B) is a medium for investment and by its terms expressly provides that it is a security governed by this Article.

UCC § 8-102(a)(15)
What is a security? cont’d

Rules for determining whether certain obligations and interests are securities or financial assets. (UCC §8-103)

(a) A share or similar equity interest issued by a corporation, business trust, joint stock company, or similar entity is a security.

(b) An “investment company security” is a security. . . . Investment company security does not include an insurance policy or endowment policy or annuity contract issued by an insurance company.

(c) An interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, its terms expressly provide that it is a security governed by [Article 8], or it is an investment company security. However, an interest in a partnership or limited liability company is a financial asset if it is held in a securities account.

(d) A writing that is a security certificate is governed by this Article and not by Article 3, even though it also meets the requirements of that Article. However, a negotiable instrument governed by Article 3 is a financial asset if it is held in a securities account.

(e) An option or similar obligation issued by a clearing corporation to its participants is not a security, but is a financial asset.

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

(g) A document of title is not a financial asset unless Section 8-102(a)(9)(iii) applies.
What is a security? cont’d

Clarifying the definition of “security”

● One component – which appears in § 8-102(a)(13)(ii) and (15)(i) – is that transfer “may be registered upon books maintained for that purpose by or on behalf of the issuer”

● New York Court of Appeals in Highland Capital case: promissory notes were securities for purpose of old § 1-206(1) statute of frauds even though no registry was maintained

● Official Comment 13 to § 8-102 disapproves of the case in 2010; see also PEB Commentary No. 18 (July 2014)

● Non-uniform NY UCC § 8-103(h): obligation, share, etc. “does not satisfy section 8-102(a)(13)(ii) or 8-102(a)(15)(i) merely because the issuer or a person acting on its behalf: (1) maintains records of the owner thereof for a purpose other than registration of transfer; or (2) could, but does not, maintain books for the purpose of registration of transfer.”
What is a financial asset?

"Financial asset," except as otherwise provided in Section 8-103, means:

(i) a security;

(ii) an obligation of a person or a share, participation, or other interest in a person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on financial markets, or which is recognized in any area in which it is issued or dealt in as a medium for investment; or

(iii) any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this Article.

As context requires, the term means either the interest itself or the means by which a person’s claim to it is evidenced, including a certificated or uncertificated security, a security certificate, or a security entitlement.

see UCC §8-102(a)(9)
SOME BASICS
VISUAL AID FOR HOLDING SYSTEM – FINANCIAL ASSETS
(certificated and uncertificated)

DIRECT HOLDING SYSTEM
(for securities)

ISSUER

FRB

Co.

DTC

Bank

Broker

Co.

Co.

Co.

INDIRECT HOLDING SYSTEM
(for all financial assets)
SOME BASICS cont’d - Security Interests in Certain Investment Property

Starting out . . . “creation”

In order for a security interest to “attach” (be created) under the Uniform Commercial Code:

- Generally, an authenticated security agreement with an adequate description of the relevant collateral is required.
  
  See UCC §§ 9-203(b)(3)(A) and 9-108

- The person creating the security interest must have rights in the collateral or the power to transfer rights.
  
  See UCC §9-203(b)(2)

- Value (UCC §1-204) must have been given (not necessarily to the person creating the security interest).
  
  See UCC §§9-203(b)(3)(B), (C) and (D)
SOME BASICS cont’d - Security Interests in Certain Investment Property

Perfection

Method depends on type of investment property collateral and type of transaction (visual aids to follow)

- certificated securities and uncertificated securities can be “delivered” (UCC §§ 9-313(a), 8-301, 8-106(c)(1))

- any type of investment property can be “controlled” (UCC §§ 9-314, 9-106, 8-106)

- any type of investment property can be “filed against” (UCC § 9-312)

- a security interest in investment property created by a broker or securities intermediary and a “pmsi” in a financial asset are automatically perfected (UCC §§9-309(10), 9-206(c))
Priority/Freedom from adverse claims hierarchy for investment property

- Perfected beats unperfected
- Perfected generally beats judgment lien creditors including the bankruptcy trustee
- Perfection by control beats perfection without control
- Intermediary’s control beats others control
- Perfection by acquiring possession beats perfection by filing
- Security interests created by a broker or securities intermediary perfected without control rank equally
- Perfection by filing first beats perfection by filing later
- Control plus value given without notice of adverse claims → takes free
PATHS TO PERFECTION BY CONTROL
Control Via Delivery – Certificated Securities

Pledgor → Certificate
Delivery obtained pursuant to §8-301; control pursuant to §8-106(a) or (b)

Pledgee
§8-301(a)(1)

or

§8-301(a)(2)

or

§8-301(a)(3)

Perfection determined pursuant to §9-314. Priority and freedom from adverse claims determined pursuant to §8-303 and §9-328.
PATHS TO PERFECTION BY CONTROL
Control Via Delivery – Uncertificated Securities

“Reregistration”

Issuer

Registered owner before

Pledgor

Delivery via §8-301; control via §8-106(c)(1)

Registered owner after

Pledgee

§8-301(b)(1)

or

3d P non SI

§8-301(b)(2)

Perfection determined pursuant to §9-314. Priority and freedom from adverse claims determined pursuant to §9-328, §9-331, and §8-303.
PATHS TO PERFECTION BY CONTROL
Control Via Delivery – Uncertificated Securities

Issuer

[Registered Owner]/Pledgor

Pledgee

Control obtained pursuant to §8-106(c)(2)

Perfection determined pursuant to §9-314.
Priority determined pursuant to §9-328.
PATHS TO PERFECTION BY CONTROL
Control via Being the Securities Intermediary – Security Entitlements

“Being There”

- Securities Intermediary §8-106(e)
- Pledge
- Security entitlement (§8-501)

[Entitlement Holder]/Pledgor

Perfection determined pursuant to §9-314.
Priority determined pursuant to §9-328.
PATHS TO PERFECTION BY CONTROL
Control via Becoming the “Entitlement Holder” – Security Entitlements

Colloquially referred to as “deliver out”

Securities Intermediary A
Security entitlement (§8-501) extinguished

[Entitlement Holder] Pledgor

Securities Intermediary B
Security entitlement (§8-501) created

Pledgee
§8-106(d)(1)
or

3d P
§8-106(d)(3)

Perfection determined pursuant to §9-314.
Priority determined pursuant to §9-328.
PATHS TO PERFECTION BY CONTROL

Control via Securities Account Control Agreement – Security Entitlements

Typically referred to as “tri-party control agreement”

- Security entitlement (§ 8-501)
- Pledgor
- Entitlement Holder
- Securities Intermediary
- Pledgee

Perfection determined pursuant to §9-314.
Priority determined pursuant to §9-328.
CURRENT ISSUES IN SECURITIES ACCOUNT CONTROL AGREEMENTS

- Pledgor access
  - a pledgor’s right to continue dealing with investment property collateral does not vitiate the secured party’s control UCC §8-106(f)

- Credit risk and regulatory capital concerns are drivers for limiting pledgor access
FUN WITH CHOICE OF LAW
Article 1 Rule (Applies to the Security Agreement Itself)

UCC §1-301

(a) Except as otherwise provided in this section, when a transaction bears a reasonable
relation to this state and also to another state or nation, the parties may agree that the law
either of this state or of such other state or nation shall govern their rights and duties.

(b) In the absence of an agreement effective under subsection (a), and except as provided in
subsection (c), [the Uniform Commercial Code] applies to transactions bearing an appropriate
relation to this state.

(c) If one of the following provisions of [the Uniform Commercial Code] specifies the
applicable law, that provision governs and a contrary agreement is effective only to the extent
permitted by the law so specified: . . . (7) Section 8-110; (8) Sections 9-301 through 9-307.
FUN WITH CHOICE OF LAW
Article 8 and 9 Rules

UCC §8-110

(a) The local law of the issuer’s jurisdiction, as specified in subsection (d), governs:

(1) the validity of a security;
(2) the rights and duties of the issuer with respect to registration of transfer;
(3) the effectiveness of registration of transfer by the issuer;
(4) whether the issuer owes any duties to an adverse claimant to a security; and
(5) whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security
FUN WITH CHOICE OF LAW
Article 8 and 9 Rules

UCC §8-110

(b) The local law of the securities intermediary’s jurisdiction, as specified in subsection (e) governs:

(1) acquisition of a security entitlement from the securities intermediary;

(2) the rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;

(3) whether the securities intermediary owes any duties to an adverse claimant to a security entitlement; and

(4) whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder.
FUN WITH CHOICE OF LAW
Article 8 and 9 Rules

UCC §9-305

(a) [Governing law: general rules.]
Except as otherwise provided in subsection (c), the following rules apply:
(1) While a security certificate is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in the certificated security represented thereby.
(2) The local law of the issuer’s jurisdiction as specified in Section 8-110(d) governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in an uncertificated security.
(3) The local law of the securities intermediary’s jurisdiction as specified in Section 8-110(e) governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a security entitlement or securities account.

(c) [When perfection governed by law of jurisdiction where debtor located.] The local law of the jurisdiction in which the debtor is located governs:
(1) perfection of a security interest in investment property by filing;
(2) automatic perfection of a security interest in investment property created by a broker or securities intermediary.
(d) “Issuer’s jurisdiction” means the jurisdiction under which the issuer of the security is organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organized under the law of this State may specify the law of another jurisdiction as the law governing the matters specified in subsection (a)(2) through (5).
FUN WITH CHOICE OF LAW
Article 8 and 9 Rules

UCC §8-110
(e) The following rules determine a “securities intermediary’s jurisdiction” for purposes of this section:

1. If an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that a particular jurisdiction is the securities intermediary’s jurisdiction for purpose of this part, this article, or this act, that jurisdiction is the securities intermediary’s jurisdiction.

2. If paragraph (1) does not apply and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary’s jurisdiction.

3. If neither paragraph (1) nor paragraph (2) apply and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary’s jurisdiction.

4. If none of the preceding paragraphs apply, the securities intermediary’s jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the entitlement holder’s account is located.

5. If none of the preceding paragraphs apply, the securities intermediary’s jurisdiction is the jurisdiction in which the chief executive office of the securities intermediary is located.
FUN WITH CHOICE OF LAW
Article 8 Rules cont’d

UCC §8-110

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

Background and History

- Promulgated in 2006 by the Hague Conference on Private International Law and became effective in the U.S. on April 1, 2017

- Treaties and conventions prevail over state law, *Ware v. Hylton*, 3 U.S. (3 Dall.) 15 199 (1796), thus supersedes UCC choice of law rules


THE HAGUE SECURITIES CONVENTION

Overview

- The Hague Securities Convention provides ONLY CHOICE OF LAW RULES, not substantive law.

- The Hague Securities Convention applies only to securities credited to a securities account held with an intermediary.

Note: The Hague Securities Convention’s definition of “securities credited to a securities account” is both narrower (expressly excludes cash) and potentially broader (includes credit derivatives) than security entitlements under the UCC.
THE HAGUE SECURITIES CONVENTION
International Aspect

- Convention by its terms “applies in all cases involving a choice of law between the laws of different States” (Article 3)

- Examples: When any of the following are located in a different nation the choice-of-law rules of the Convention are likely to be implicated:
  - The account holder
  - An issuer of any of the securities
  - Any party to a transfer of securities
  - Any intermediary
  - Location of security certificates
  - Any adverse claimant

[Note these include factors ignored by UCC §8-110]
THE HAGUE SECURITIES CONVENTION

Scope

- Article 2(1) of the Hague Convention lays out the issues as to which its choice-of-law rules determine applicable law.

These issues include:

- The legal nature and effects against the intermediary and third parties of the rights resulting from a credit of securities to a securities account.
  
  - Article 2(2) makes clear that the Convention determines the law applicable to dispositions even if the rights resulting from a credit of securities to a securities account are determined by that law to be contractual in nature.

- The legal nature and effects against the intermediary and third parties of a disposition of securities held with an intermediary.

- The requirements, if any, for perfection of a disposition of securities held with an intermediary.
Whether a person’s interest in securities held with an intermediary extinguishes or has priority over another person’s interest

The duties, if any, of an intermediary to a person other than the account holder who asserts in competition with the account holder or another person an interest in securities held with that intermediary

The requirements, if any, for the realization of an interest in securities held with an intermediary (e.g., the exercise of the power to sell or appropriate collateral upon default)

Whether a disposition of securities held with an intermediary extends to entitlements to dividends, income, or other distributions, or to redemption, sale, or other proceeds
These issues largely (but not completely) coincide with the issues set forth in UCC §§ 8-110(b) and 9-305(a)(3) that are governed by the “local law of the securities intermediary’s jurisdiction” as defined in UCC §8-110(e).

Two particular differences to note:

- The Hague choice of law rule covers remedies, but the UCC in §1-301 would apply the transacting parties’ choice of law to govern the agreement to the remedies component of their agreement.

- The UCC does not include a choice of law rule for determining whether a transfer is a sale or creates a security interest, but the Explanatory Report to the Convention makes clear that the “legal nature and effects” of a disposition includes such characterization. [¶ 2-18]
THE HAGUE SECURITIES CONVENTION

Scope cont’d – Exclusions from Scope

- Convention does *not* determine the law applicable to
  - “the rights and duties arising from the credit of securities to a securities account to the extent that such rights and duties are *purely* contractual or otherwise *purely* personal” (Art. 2(3)(a))
    - “the contractual or other personal rights and duties of parties to a disposition of securities held with an intermediary” (Art. 2(3)(b))
    - The rights and duties of an issuer, registrar, or transfer agent (Art. 2(3)(c))
THE HAGUE SECURITIES CONVENTION
Article 4(1) Primary Rule

“The law applicable to all the issues specified in Article 2(1) (Scope) is the law in force in the State expressly agreed in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law.”

See Explanatory Report, ¶ 4-15 for discussion of meaning of ‘in force’ and its equivalence with the ‘law of’
THE HAGUE SECURITIES CONVENTION
Article 4(1) Primary Rule cont’d

Very similar to choosing the “securities intermediary’s jurisdiction” under UCC §8-110(e)(1) and (2)

- (e)(1): specific selection of securities intermediary’s jurisdiction can differ from general governing law clause
- (e)(2): general governing law clause itself chooses the jurisdiction

Note distinction between Convention’s use of “in the account agreement” and the use of “in an agreement. . .governing the securities account” in UCC §8-110
THE HAGUE SECURITIES CONVENTION
Primary Rule – Part 2 – Qualifying Office Test

The law designated in accordance with the primary rule applies only if the relevant intermediary has, at the time of the agreement, an office in that State, which –

   a) alone or together with other offices of the relevant intermediary or with other persons acting for the relevant intermediary in that or another State –

      i) effects or monitors entries to securities accounts

      ii) administers payments or corporate actions relating to securities held with the intermediary; or

      iii) is otherwise engaged in a business or other regular activity of maintaining securities accounts; or

   b) is identified by an account number, bank code, or other specific means of identification as maintaining securities accounts in that State
THE HAGUE SECURITIES CONVENTION
Primary Rule – Part 2 – Qualifying Office Test cont’d

Office is defined – Art. 1(1)(j)

Qualifying Office Test – as applied in a Multi-unit State (e.g., the U.S.)

- If the law of a territorial unit has been selected in the account agreement, references to “State” in the first sentence of Article 4(1) are to that territorial unit (Article 12(1)(a)) but the references to “that State” in the second sentence are to the Multi-unit State itself (Article 12(1)(b))

  - The intermediary need only have an office in the country (“State”), not the particular unit (“state”) whose law is chosen

    - e.g., if a securities intermediary has its sole office in Atlanta and the account agreement chooses the law of New York, the test is satisfied

The Uniform Commercial Code has no counterpart.
THE HAGUE SECURITIES CONVENTION

Fallback Rules

Article 5 of the Convention provides a series of “fallback rules” that will come into play if the applicable law is not determined by the “primary rule”

- Detailed explication for determining the office through which the intermediary entered into the account agreement
- Last set of fallback rules refer to an intermediary’s jurisdiction of organization or place (or principal place) of business

Largely similar to UCC §8-110(e)(3), (4), and (5)

Note that you do not reach the fallback rules just because you can’t find the account agreement.
THE HAGUE SECURITIES CONVENTION
Additional Considerations

- Choice of law governing perfection by filing.
  - UCC’s debtor location rules generally only apply if the Hague Securities Convention would point to the U.S. and the debtor is “located” in the U.S. under the UCC. See HSC § 12(2)(b).

- Applicability of the Hague Securities Convention to the law governing the creation of a security interest with respect to third parties.
  - Enforceability against the debtor remains governed by the UCC’s general choice of law rules (UCC §1-301)
  - Enforceability vis a vis the intermediary and third parties governed by the Hague Securities Convention if applicable

Bottom Line- Analyze under the UCC and the Hague.

Be careful out there!
ARTICLE 3 & 4

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ARTICLE 3’S INTERSECTION
WITH ARTICLE 9
SCOPE OF ARTICLE 3

• “This Article applies to **negotiable instruments**. It does *not* apply to money, to payment orders governed by Article 4A, or to securities governed by Article 8.” § 3-102(a).

• A negotiable instruments means a **promise** or **order** to pay. § 3-104(a).

• A “promise” is **note** (*i.e.*, a promissory note) and an “order” is a **check** (*i.e.*, regular check, cashier’s check, certified check, teller’s check, traveler’s check).
The Derivative Title Doctrine

Whose rights to the bike are superior – Al’s or Bob’s?

Al’s!
The Derivative Title Doctrine

• “A purchaser of goods acquires all title which his transferor had or had power to transfer....” §2.403(a).
  – What does this mean?
    • A transferee of goods gets title only as good as his transferor had.

• What title to the bike did Thief have?
  – None

• So what title does Bob receive?
  – None

• Note: As to stolen goods, it does not matter that Bob is a BFP. The transferee gets title only as good as his transferor’s, and that title is void.
The Negotiability Concept

Whose rights to the money are superior – Al’s or Bob’s?

Bob’s!
The Money Rule

– Bob has received stolen money in exchange for the bike he sold.
– The “money rule” provides that one who takes stolen money in good faith and for valuable consideration obtains good title and prevails over the victim of the theft.
  • *So, in the case of money stolen, the true owner cannot recover it, after it has been paid away fairly and honestly upon a valuable and bona-fide consideration*
– Therefore, Bob has obtained ownership rights to the money from Thief.
The Negotiability Concept

• A commodity is negotiable if and to the extent that a transferee can obtain title superior to that of his transferor.
  – Money is governed by the negotiability doctrine.
  – Goods are governed by the derivative title doctrine.

• A primary function of commercial law is to allocate risks. As to the risk of theft:
  – The “true owner” of money bears the risk of its being stolen, since a BFP can obtain good title to it.
  – The buyer of goods bears the risk of their being stolen, since the true owner can recover them from most takers.
The Relevance to Negotiable Instruments

• Negotiable instruments are not money, but they are *substitutes* for money.
  – They too function as payment devices, as media of exchange.

• But if they are to perform this function, they also must pass unquestioned in the marketplace. Commercial actors must be willing to treat them (roughly) like money.
  – So “negotiable instruments” must enjoy the benefits of “negotiability.”
  – The Holder in Due Course Doctrine accomplishes that objective. 
    • It is the negotiable instruments analog to the “money rule” in the law of money.
Principal Advantage
A holder in due course is a “super-plaintiff” who acquires an instrument free of the most common commercial defenses. See § 3.305. Gallery cannot avoid paying on the grounds that it bought a forgery.
7 Elements

• (1) Writing,
• (2) Signed by the maker or drawer,
• (3) Contain unconditional promise or order,
• (4) To pay a fixed amount of money, with or without interest,
• (5) Payable on demand or at a definite time,
• (6) Contain words of negotiability (bearer or order),
• (7) does not state any other promise or instruction, except
  – to give, maintain, or protect collateral;
  – authorization to confess judgment or to collect collateral; or
  – waivers of rights designed to protect obligor.
HOLDINER IN DUE COURSE DOCTRINE & ARTICLE 9

- Painting proves to be a forgery
- Art Broker
- $100k loan
  - Note #2
  - Security Agreement
  - Note #1 as Collateral – “Instrument”
- Gallery
- Bank
- Sues to enforce Note #1
- Qualifies as Holder in Due Course

Painting
Note #1

$100k loan
- Note #2
- Security Agreement
- Note #1 as Collateral – “Instrument”

Qualifies as Holder in Due Course

Note #1 as Collateral

Painting proves to be a forgery

Sues to enforce Note #1

Prof. Dave Hague - St. Mary's University
School of Law
Bank as Your Client

• If Note #1 is **not negotiable** and, therefore, not covered by Article 3, Gallery wins, since ordinary contract law would govern transaction and defenses would apply.

• If Note #1 **is negotiable** and, therefore, covered by Article 3, Finance Company prevails, since it is a HIDC:
  – Holder
  – Instrument bears no apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity
  – Takes for value Acquiring a security interest or other lien in the instrument is “value” - § 3-303(a)(2)
  – Takes in good faith
  – Takes without notice of claims or defenses associated with instrument
Bank as Your Client

- If Note #1 is **not negotiable** and, therefore, not covered by Article 3, Gallery wins, since ordinary contract law would govern transaction and defenses would apply.

- If Note #1 **is negotiable** and, therefore, covered by Article 3, Finance Company prevails, since it is a HIDC.

- Can file a UCC-1 to perfect, but “possession” > UCC-1, so bank should (a) make sure note is “negotiable” and (b) take possession of the note in order to have priority over all parties.
ARTICLE 4’S INTERSECTION WITH ARTICLE 9
SCOPE OF ARTICLE 4

• UCC Article 4 covers the liability of a bank for action or non-action with respect to an “item” – generally, a check – handled by it for purposes of presentment, payment, or collection.
Falls Church Bank v. Wesley Heights Realty, Inc.

Customer: Deposits, then withdraws $140 before Bank learns of stop order

Falls Church Bank:

Drawee Bank: Returns

V.

STOP PAYMENT

Defrauded by Customer

Prof. Dave Hague - St. Mary's University School of Law
Falls Church Bank as Your Client

- Why is your client suing Wesley Heights? Drawer’s liability.
- Bank loses if it is not a HIDC, since fraud defense will apply?
- Does Bank satisfy HIDC elements? Only issue is “value.”
- How does your client prove it has given value?
  - “... [A] bank has given value to the extent it has a security interest in an item...” § 4-211
  - “(a) A collecting bank has a security interest in an item... (1) in case of an item deposited in an account, to the extent to which credit given for the item has been withdrawn or applies...” § 4-210(a)(1).
- Pursuant to these provisions, courts consistently hold that when a bank extends provisional credit to a customer, Article 4 grants a security interest to the bank in checks deposited with that bank. Because the bank has “control” of the account, it prevails against other secured parties, including a trustee in bankruptcy claiming an interest in the debtor’s deposit account.
  - Note: No security agreement is necessary; no filing required to perfect; and the security interest has priority – 4-210(3)
ABA Business Law Section
Annual Meeting
September 12-14, 2019

UCC Article 2

I. UCC Definition of Contract:
• UCC defines “contract” as the total legal obligation of an agreement to buy/sell goods
• Requires all ordinary elements of a contract (offer, acceptance, consideration, satisfaction of Statute of Frauds)
• UCC 2-102
  o unless context otherwise requires, this article applies to goods
• UCC 2-105
  o goods are all things (including specially manufactured goods) which are moveable at the time of identification to the contract for sale; includes unborn young of animals, growing crops, other identified things attached to realty

II. Offer and Acceptance Under the UCC:
• UCC 2-204 - FORMATION IN GENERAL
  o a contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract
  o an agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undermined
  o even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy
• UCC 2-206(1)(a)
  o offer must unambiguously indicate how to accept
  o or objective theory of contracts will prevail & any acceptance reasonable given circumstances will be sufficient
• UCC 2-206(1)(b)
  o offer for prompt shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment
  o may ship conforming or non-conforming goods
  o non-conforming goods is a counter offer if seller notifies buyer that shipment is an accommodation
BUT non-conforming shipment is acceptance and breach if seller ships without notification

III. **Battle of the Forms:**
- UCC 2-207
  - alters the mirror image rule in order to facilitate commerce between merchants who rely on standard forms; determines if additional terms in acceptance becomes part of contract
- UCC 2-207(1)
  - Determines if there is a written contract
- UCC 2-207(2)
  - additional terms are proposals, unless parties are both merchants General Rule: additional terms are part of the contract
  - Exception: unless offer expressly limits acceptance to terms
  - Extra terms fall out if they do not match
  - Arbitration is not a material alteration
  - Forum selection is a material alteration
- 2-207(3)
  - May have a contract by conduct, but still must determine terms of agreement; uses gap fillers
- Drennan Test: Promissory estoppel renders offer non-revocable when:
  1. A clear & definite offer is made;
  2. The offeror has a reasonable expectation that the offer will induce reliance in the other party;
  3. There is actual & reasonable reliance by offeree; and
  4. Detriment can only be avoided by enforcement of the offer.

IV. **Firm Offers:**
- UCC 2-205 FIRM OFFERS
  - A firm offer for goods is the statutory version of the common law option contract, but does not require consideration
  - an offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.
- UCC 2-104 – MERCHANT
o person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill

- UCC 2-205
  o applies in limited circumstances; firm offer can’t be revoked for reasonable time, time stipulated, not more than 3 months; does not require consideration; at least one party must be a merchant; offer must be signed and remain open; special rule for certain circumstances.

V. Insufficient Agreements:
- Insufficient Agreement arises in one of three ways:
  o material term left out and it’s beyond a gap filler—something very material missing
  o something ambiguous—something outside the agreement
  o where “parties agree to agree”

- UCC 2-204(3)
  o Even though one or more of the terms are left open a K for sale does not fail for indefiniteness if the parties have intended to make a K and there is a reasonably certain basis for giving an appropriate remedy.
  o Certainty· terms must be reasonably certain
  o Reasonably Certain· terms of a K are reasonably certain if they provide a basis for determining the existence of a breach and for giving an appropriate remedy

- Determining Sufficiency (Two Prong Test):
  1. Intent to be bound and
  2. Terms are reasonably certain

- UCC 2-305·OPEN PRICE TERM
  (1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if:
    (a) Nothing is said as to price; or
    (b) The price is left to be agreed by the parties and they fail to agree; or
    (c) The price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.
  (2)A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.
(3) When a price left to be fixed otherwise then by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed on is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

- **UCC 2-309 - ABSENCE OF SPECIFIC TIME PROVISIONS; NOTICE OF TERMINATION**
  - Absent agreement as to time, shipment must be timely
  - Where the contract provides for successive performances but is indefinite in duration it is valid for a reasonable time but unless otherwise agreed may be terminated at any time by either party.
  - Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable.

- **UCC 2-310(a)-OPEN TIME FOR PAYMENT OR RUNNING OF CREDIT; AUTHORITY TO SHIP UNDER RESERVATION**
  - Unless otherwise agreed payment is due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery.
  - Intent to be bound, even with missing term (if terms are unknown but we have a reasonable certain basis for giving an appropriate remedy; terms are reasonably certain if there are terms that provide a remedy for breach)

**VI. Preexisting Duty/Modification:**
- **UCC 2-209 -MODIFICATION, RECSSION AND WAIVER**
  - An agreement modifying a contract within this article needs no consideration to be binding.
  - Generally, modification of a contract is unenforceable unless supported by additional consideration.
  - Exceptions to general rule: (1) promise made before K fully performed; (2) underlying circumstances were unanticipated; (3) modification is fair and equitable.

- **UCC 2-103(1)(b)-good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.
- no new consideration required for modifications, just good faith
VII. **Statute of Frauds:**

- **UCC 2-201: FORMAL REQUIREMENTS**
  
  - goods over $500: terms noted should include quantity; “merchants must read mail”; only 10 days to object to confirmation letter; doesn’t require signature.
  
  - Except as otherwise provided in this section a contract for the sale of goods for the price of $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under the paragraph beyond the quantity of goods shown in such writing.
  
  - Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within 10 days after it is received.
  
  - A contract which does not satisfy the requirements of subsection (1) but is valid in other respects is enforceable if (a) the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller’s business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement (applies to everyone buying & selling goods, not just merchants); or (b) the party against whom enforcement is sought admits in his pleading, testimony, or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or (3) with respect to good for which payment has been made and accepted or which have been received and accepted.