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Changes to the UCC Addressing Digital Assets Up for Consideration

BY STEPHEN WEISS, MICHAEL S. POSTER, SAMUEL M. LICKER ON MAY 11, 2022

It is no secret that buying, using and trading cryptocurrency and non-fungible tokens has become more and more commonplace. Less clear is whether

crypto, like Bitcoin or Ethereum, is to be treated as money. Even more of a mystery to regulators and market participants alike is how security interests in digital assets can be perfected—this so that other parties cannot improperly claim ownership. If adopted, a newly proposed Article 12 of the Uniform Commercial Code would address these issues by governing transfers (including sales and financings) of digital assets.

Article 12 as Proposed

As of this writing, crypto does not fall under the definition of “money” here in the U.S. because it has not been adopted by a domestic or foreign government, intergovernmental organization, or by agreement between multiple countries. To make matters even fuzzier, the only way to perfect a security interest in a cryptocurrency or NFT is to file a financing statement fully describing the coin or token—control over a digital wallet is simply not enough. Article 12 as proposed would remedy this.

Among other things, the proposed Article 12 would update the UCC by:

- Addressing the transfer of digital assets and cryptocurrencies, providing conforming changes to Article 9 to deal with secured transactions in these assets, and coining the new term “controllable electronic records” (CERs) to define cryptocurrencies and NFTs
- Facilitating secured lending against CERs
- Providing protections for qualifying lenders and purchasers so they could take security interests in cryptocurrencies and digital assets free and clear of conflicting property claims

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- Promulgating rules regarding assignment of controllable accounts and payment intangibles
- Specifying other changes such as updates to the definition of “chattel paper” and revisions to requirements for transfers and perfection of security interests in chattel paper, as well as modifying certain rules regarding negotiable instruments and payment systems

Who Would Be Affected By Article 12?

A new Article 12 would affect crypto and NFT companies, financial institutions, investment banks and parties to equipment finance or lease transactions.

For their part, blockchain-related companies would be impacted to the extent Article 12 as proposed would govern the transfer of property rights in digital assets, like cryptocurrencies, NFTs and other CERs that these companies purchase, sell and finance. Article 12 (if adopted) would specify the rights purchasers acquire in these digital assets to facilitate transactions. Doing so would reduce risk among claimants when companies use digital assets as an exchange mechanism for payment, right to receive services or goods, or interests in personal or real property.

Financial institutions and others that finance digital assets would find it easier to arrange secured lending transactions if Article 12 comes to fruition. This is because an Article 12 would provide lenders with a perfected security interest in a given underlying digital asset assuming the lender has “control” over it or the system on which the asset is recorded (read: the blockchain).

In light of the foregoing, lenders and other secured parties would be wise to take note of the proposed Article 12 and they may want to amend current credit facilities that are secured by blanket or broad liens on “substantially all assets” of the debtor, including intangibles. To be sure, lenders should carefully craft their credit facilities and provide for an express security interest in CERs, controllable accounts, and controllable payment intangibles. If Article 12 becomes effective, the failure to do so could result in the loss of their position should another party obtain “control” over assets in this class.

Further, Article 12 would also have an impact on structured finance and securitization transactions because they often involve bundles of various types of secured loans. Any party involved in investments in—or underwriting of—these types of deals should become familiar with the relevant sections of Article 12 as proposed, especially those relating to payment obligations, assignments of accounts, and discharge of obligors on digital assets, as well as the provisions which set out the requirements for a purchaser to acquire protection as a good faith purchaser for value of a CER, controllable account and controllable payment intangible.

Finally, parties to equipment financing and/or lease transactions should pay close attention to the changes that an Article 12 would bring to the UCC. In its current form, Article 9 defines “chattel paper” as a monetary obligation that is either secured by specific goods (like a car or other tangible asset) or arises in connection with a lease of specific goods. A new Article 12 would change all that.

What Is Excluded?

Article 12, if adopted, would be limited in scope and apply only to CERs for cryptocurrencies and other digital assets. Likewise, it would not (1) define who has rights in or title to digital

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assets; (2) touch on federal or state securities laws, data privacy, cybersecurity or other regulations; (3) incorporate banking laws; (4) provide rules for the taxation of digital assets; (5) tackle anti-money laundering laws; or (6) affect transferable records under the Uniform Electronic Transactions Act or E-SIGN.

What Is Next?

The American Legal Institute (ALI) has until this month to approve the draft of Article 12 as proposed. If approved, the provisions would go to the Uniform Law Commission for approval no later than July 2022. After that, Article 12 would be submitted to the states for adoption.

Of course, we will continue to monitor the status of Article 12 and provide updates as they develop.

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