

A decorative blue abstract graphic with wavy, overlapping bands of varying shades of blue, ranging from light to dark, positioned at the top of the slide.

The New UCC Article 12: Why, When, and What Does It Do?

Business Law Section of the Florida Bar
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Why Article 12?

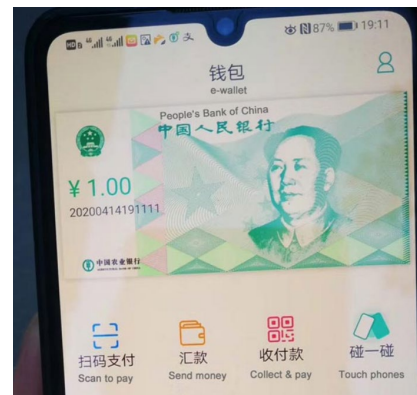
- New types of assets
- New structures & transaction types
- New problems:
 - Cutting off 3rd party property claims/ threats to asset fungibility
 - Questions about secured transactions
 - Unappealing choices for perfection
 - Digital assets that (maybe) become money



DeFi
Decentralized Finance



CeFi
Centralized Finance



Treatment & scope of digital assets under Article 12

- Technology neutral
- What are “Digital assets”?
 - “Asset”?
 - Digital “Tokens”?
- “Rivalrous”
- Increasingly used in commercial transactions
 - cryptoassets, tokens, stablecoins, NFTs, electronic negotiable instruments, digital asset securities
 - Excludes existing assets already covered by UCC (*i.e.* deposits, chattel paper, E-money, etc...)



Why Control?

- The problem of intangibility
- Possession vs. Control
- What do you control when you control a digital asset?

Controllable Electronic Record (CER)

- Electronic +
- Record: “information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form” (UCC 1-201(b)(31)) +
- Subject to Control
 - If not controllable, excluded; also excludes many other existing categories (chattel paper, deposit accounts, general intangibles etc...)

Controllable Electronic Record (CER)

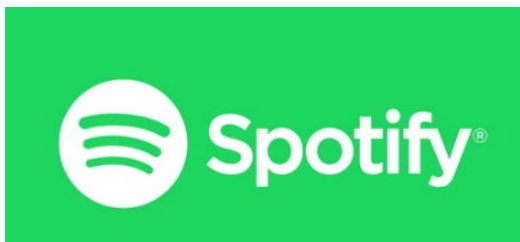
- Control:
 - Non-exclusive power to enjoy “substantially all the benefit”
 - Must have use that one can enjoy to the exclusion of others
 - Prevents others from enjoying “substantially all the benefit”
 - Exclusive power to transfer to another the power to use
 - The transfer must divest the transferor of the power to use the CER
 - Identification (name, station, key, or similar)
- Creates a rebuttable presumption of exclusive control

Controllable Electronic Record (CER)

- Control may be exercised for another
 - A has control but acknowledges that A has control for B. B also has control.
- Exclusivity allows sharing/multi-sig/custodial arrangements by agreement or system design.
- Multi-sig (m of n) hypos:
 - 1/2: Both have control.
 - 3/4: All have control.
 - A can transfer /prevent a transfer but B can only transfer /prevent a transfer with the consent of A: Only A has control.

Controllable Electronic Record (CER)

- Spotify stream
- Facebook page
- Web domain name
- Bitcoin
- Tokenized equity
- NFT



“Take Free” Rules

- Digital assets vs. cash
- Negotiability
- What’s the alternative?

Comparison of unclipped and clipped *Siliqua* from the Hoxne Hoard



An unclipped *siliqua*

Partially clipped *siliqua*

A clipped *siliqua*

c/o Wikipedia

Qualifying Purchaser

- A purchaser of a CER acquires all rights in the CER that the transferor had (*nemo dat*)
- A qualifying purchaser takes free of any property claims to the CER
- A qualifying purchaser is a purchaser who obtains control of a CER:
 - for value;
 - in good faith; and
 - without notice of a property claim to the CER;
 - The filing of a financing statement itself is not notice of a property claim to the CER
- Applies to CER maintained through a custodian or exchange
- UCC 9-326A would provide non-temporal priority to party that perfects by control provided they have control because that party would be a qualifying purchaser and take free from property claims.
- Substantive legal rights associated with a given CER determined by other law

Qualifying Purchaser- Hypo 1

1. Andrea owns a bitcoin controlled by her own wallet. Bob hacks Andrea's wallet and causes the bitcoin to be transferred to a wallet under Bob's control. Bob then sells the bitcoin to Carla for Carla's Lamborghini.

Does Carla have clean title in the Bitcoin?

Under Existing Law: No. Common law would apply and *nemo dat* suggests that Carla can only receive what Bob could convey which was the asset with title subject to the property by Andrea. Bob did not have title to give.

Post-A12: Yes. Carla would be a qualifying purchaser because she took the BTC in good faith for value without notice of any property claim.

Qualifying Purchaser- Hypo 2

2. Andrea owns a MetaBirkin NFT controlled by her own wallet. Bob hacks the wallet and causes the MetaBirkin NFT to be transferred to a wallet under Bob's control. Bob then sells the Metabirkin NFT to Carla for Carla's Birkin bag.

Does Carla have clean title over the MetaBirkin NFT?

Under Existing Law: No. Common law would apply and *nemo dat* suggests that Carla can only receive what Bob could convey which was the asset with title subject to the property by Alice. Bob did not have title to give.

Post-A12 Yes. Carla would be a qualifying purchaser because she took the Metabirkin NFT in good faith for value without notice of any property claim.

- The conveyance may not have conveyed the legal rights to use the Art assets associated with the NFT
- Legal rights tethered to a CER are a function of other law, i.e. contract law, and must be assigned or transacted through a legal transaction.
- The issuer of the NFT may be able to immobilize or invalidate the NFT if its stolen; negotiability may be impaired by using technical means.

Perfection of a Security Interest under existing law

What is a CER under the existing UCC?

- “General Intangible” any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software. (UCC 9-102(42))
- “Investment Property”- means a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity account (UCC 9-102(49))
- “Money” means a medium of exchange currently authorized or adopted by a domestic or foreign government (UCC 1-201(24))
 - El Salvador, Central African Republic

Whose CER is it anyway?

Under Existing Law:

- Possession by lender when third person authenticates holding for secured party (UCC 9-313(c))
- Terms exchange/storage agreements
- Deposit control agreement over debtor's bank account linked to exchange
- Deposit control agreement with the exchange (not technically a deposit)
- Debtor's claims against exchange as account debtor

Digital Asset Exchanges

- Generally regulated as money transmitters
- Not banks, not securities exchanges
- Users accept terms of service via clickwrap/browsewrap
 - Not generally sufficient to create deposit control agreement
- Crypto Exchanges are not generally securities intermediaries
 - A clearing corporation or 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. (UCC § 8-102(14))

Perfection under existing law (*i.e.* pre-A12)

Asset Type	Perfection Method
“General Intangible”	File financing statement. 9-312(a)
“Investment Property”	File financing statement. (9-312)(a) / Control (9-314, 9-106, 8-106) <ul style="list-style-type: none"> • Control has priority. 9-328
“Money”	Take possession. (Private key; Lender’s wallet) 9-312(b)(3)
“Deposit Account”	Deposit Control Ag. 9-104(a)
“Causes of Action”	Financing statement. 9-312(a)
“Commercial Tort Claims”	Financing statement specifically identifying the claim. 9-312

Perfection of Security Interest- Hypo 1

1. On Day 1, Lender makes a secured loan to Debtor and obtains a security interest in “all of Debtor’s Bitcoin.” Debtor executes a security agreement and transfers Debtor’s bitcoin to Lender’s wallet.

Is Lender’s security interest in the Bitcoin perfected?

Under Existing Law: No. There’s no UCC-1 and no agreement to treat the Bitcoin as a financial instrument and no deposit control agreement with a securities intermediary. Lender may have system-level control and a secured interest but is not perfected.

Post-A12: Yes. Under Section 12-105(a)(1) which defines control of a CER, a person must have, among other things, the *exclusive powers* to:

- (i) prevent others from availing themselves of substantially all the benefit from the CER; and
 - (ii) transfer control of the CER to another person.
- Lender now has bitcoin under its own private key control

Perfection of Security Interest- Hypo 2

2. On Day 1, Lender makes a secured loan to Debtor and obtains a security interest in “all of Debtor’s Bitcoin.” Debtor executes and security agreement and transfers to Lender an “open dime,” which embeds access to the private key in a physical device.

Is Lender’s security interest in the Bitcoin perfected?

Under Existing Law: No. There’s no UCC-1 and no agreement to treat the Bitcoin as a financial instrument and agreement to a deposit control agreement with a securities intermediary. Lender may have system-level control and a secured interest but is not perfected.

Post-A12: Yes. Under Section 12-105(a)(1) which defines control of a CER, a person must have, among other things, the *exclusive powers* to:

- (i) prevent others from availing themselves of substantially all the benefit from the CER; and
 - (ii) transfer control of the CER to another person.
- Lender now possesses a physical device that has exclusive control over the private key

Perfection of Security Interest- Hypo 3

3. On Day 1, Lender makes a secured loan to Debtor and obtains a security interest in “all of Debtor’s Bitcoin.” Debtor executes a security agreement and transfers to Lender a copy of the private key but retains a copy of the private key.

Is Lender’s security interest in the Bitcoin perfected?

Under Existing Law: No. there’s no UCC-1 and no agreement to treat the Bitcoin as a financial instrument and agreement to a deposit control agreement with a securities intermediary. They may have system-level control and a security interest but they are not perfected.

Post-A12:? Yes.

Under Section 12-105(a)(1) which defines control of a CER, a person must have, among other things, the *exclusive powers* to:

- (i) prevent others from availing themselves of substantially all the benefit from the CER; and
- (ii) transfer control of the CER to another person.

§ 12-105(b): Subject to subsection (c), a power is *exclusive even if shared*.
Control here is shared but not contingent

Perfection of Security Interest- Hypo 3, cont.

3. On Day 1, Lender makes a secured loan to Debtor and obtains a security interest in “all of Debtor’s Bitcoin.” Debtor executes a security agreement and transfers to Lender a copy of the private key but retains a copy of the private key.

Is Lender’s security interest in the Bitcoin perfected?

...

Assuming that both Lender & Borrower have the power to enjoy the benefit of the Bitcoin, and both Lender and Borrower have the power to transfer the Bitcoin; neither has exclusive power.

- But Article 12 provides that power is deemed exclusive under subsection (a)(1) notwithstanding that the power is shared.
- This allows for parties in control to rely on custodians, and echoes existing law under article 8 and 9 that allows for debtor access to assets held via deposit control agreements.
- CER definition subsection (c) limits subsection (b), but the limitation applies only when a person’s control is contingent on another person’s cooperation.

Perfection of Security Interest- Hypo 4

4. On Day 1, Lender makes a secured loan to Debtor and obtains a security interest in “all of Debtor’s Ether.” Debtor executes a security agreement and transfers the Ether to a multi-sig wallet whereby 2/3 private keys is needed to transact the Ether and the 3 keys are held by: Lender, Debtor, & 3rd Party.

Is Lender’s security interest in the Ether perfected?

Under Existing Law: No. there’s no UCC-1 and no agreement to treat the Bitcoin as a financial instrument and agreement to a deposit control agreement with a securities intermediary. They may have system-level control and a secured interest but they are not perfected.

Post-A12:

Yes. Under Section 12-105(a)(1) which defines control of a CER, a person must have, among other things, the *exclusive powers* to:

- (i) prevent others from availing themselves of substantially all the benefit from the CER; and
- (ii) transfer control of the CER to another person.

§ 12-105(b): Subject to subsection (c), a power is *exclusive even if shared*.

Perfection of Security Interest- Hypo 4, cont.

4. On Day 1, Lender makes a secured loan to Debtor and obtains a security interest in “all of Debtor’s Ether.” Debtor executes a security agreement and transfers the Ether to a multisig wallet whereby 2/3 keys is needed to transact the Ether and the 3 keys are held by: Lender, Debtor, & 3rd Party.

Is Lender’s security interest in the Ether perfected?

...

Assuming that both Lender & Borrower have the power to enjoy the benefit of the Ether, and both Lender and Borrower have the power to transfer the Ether; neither has exclusive power.

- But Article 12 provides that power is deemed exclusive under subsection (a)(1) notwithstanding that the power is shared.
- This allows for parties in control to rely on custodians, and echoes existing law under article 8 and 9 that allows for debtor access to assets held via deposit control agreements.
- CER definition subsection (c) limits subsection (b), but the limitation applies only when a person’s control is contingent on another person’s cooperation.

Perfection of Security Interest- Hypo 5

5. On Day 1, Lender makes a secured loan to Debtor and obtains a security interest in “all of Debtor’s ETH.” Debtor executes a security agreement and transfers the Ether to a multi-sig wallet whereby 2/2 keys are needed to transact the Ether, the Lender and Debtor each have 1 key, and the Debtor can transact without the Lender’s cooperation, but Lender can only transact with the Debtor’s cooperation.

Is Lender’s security interest in the Ether perfected?

Under Existing Law: No. there’s no UCC-1 and no agreement to treat the Ether as a financial instrument and agreement to a deposit control agreement with a securities intermediary. They may have system-level control and a secured interest but they are not perfected.

Post-A12:

No. Under Section 12-105(a)(1) which defines control of a CER, a person must have, among other things, the *exclusive powers* to:

- prevent others from availing themselves of substantially all the benefit from the CER; and (ii) transfer control of the CER to another person.

§ 12-105(b): Subject to subsection (c), a power is *exclusive even if shared*.

Because the Lender can only transact with the cooperation of Debtor, the Lender does not have control.

Priority- Hypo 1

On Day 1, Lender A makes a secured loan to Debtor secured by Debtor's bitcoin. Debtor executes a security agreement. Lender files a UCC-1. On Day 2, Lender B makes a loan to Debtor secured by Debtor's bitcoin. Debtor transacts Debtor's bitcoin to Lender B's digital asset wallet.

Whose security interest has priority?

Under Existing Law : Lender A wins because Lender A has a perfected security interest under Article 9 and Bank merely has system -level control of the bitcoin.

Post-A12: Lender B wins because Bank has control of the bitcoin which under UCC 9-326A confers non-temporal priority.

Priority- Hypo 2

On Day 1, Lender A makes a secured loan to Debtor secured by Debtor's bitcoin. Debtor executes a security agreement. Debtor's bitcoin is maintained on an exchange. The exchange is not a securities intermediary. Lender A files a UCC-1. On Day 2, Lender B makes a loan to Debtor secured by Debtor's bitcoin. Lender B is aware of Lender A's interest in the bitcoin and obtains the exchange's acknowledgement that it is exercising control on Lender B's behalf.

Whose security interest has priority?

Under Existing Law : Lender A wins because Lender A has a perfected security interest under Article 9 and Lender B has a mere contractual right against the exchange.

Post-A12: Assuming Debtor retains title to the bitcoin, Lender B wins because Lender B has control of the Bitcoin which under UCC 9-326A confers non-temporal priority.

Priority- Hypo 2

On Day 1, Lender A makes a secured loan to Debtor secured by Debtor's bitcoin. Debtor executes a security agreement. Debtor's bitcoin is maintained on an exchange. The exchange is not a securities intermediary. Lender A files a UCC-1. On Day 2, Lender B makes a loan to Debtor secured by Debtor's bitcoin. Lender B is aware of Lender A's interest in the bitcoin and obtains the exchange's acknowledgement that it is exercising control on Lender B's behalf.

Important questions:

Who has title to the bitcoin- Debtor or Exchange?

If Exchange has title to the bitcoin is Debtor's pledge effective?

- description of collateral- assets vs. claims?

Priority- Hypo 3

On Day 1, Lender A makes a secured loan to Debtor secured by Debtor's bitcoin. Debtor executes a security agreement. Debtor's bitcoin is maintained on an exchange. The exchange is a securities intermediary. Lender A files a UCC-1. On Day 2, Lender B makes a loan to Debtor secured by Debtor's bitcoin. Lender B is aware of Lender A's interest in the bitcoin and the UCC-1. Lender B enters into a deposit control agreement with the exchange.

Whose security interest has priority?

Under Existing Law : Lender A wins because Lender A has a perfected security interest under Article 9 and Lender B has knowledge of the earlier perfected claim.

Post-A12: Assuming Debtor retains title to the bitcoin, Lender B wins because Lender B has control of the Bitcoin which under UCC 9-326A confers non-temporal priority over the filed UCC-1.

Amendment to UCC Definition of Money

Florida Senate Bill (SB) 7054

Eliminates Central Bank Digital Currencies from UCC Definition of Money

- General definition of Money comes only from Federal law
- No CBDC in the US (yet)
- Result of Florida's amendment
 - Subjects a CBDC to treatment as a CER!
 - Florida is “out of sync” with the rest of the US
 - Additional complexity and costs for Florida parties in secured transactions

Article 12 Does & Does Not

Does:

- Address the rights of private parties transacting using CERs.
 - Address negotiability of CERs
 - Lay the groundwork for enforceable secured transactions in CERs

Does not:

- Affect whether the federal government issues a CBDC
- Address substantive law issues related to CERs:
 - Taxation
 - Regulatory classification
 - IP issues
 - Contractual relationships
 - Regulatory Compliance