

2022 Uniform Commercial Code Amendments Address Emerging Digital Technologies

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The market for digital assets, such as cryptocurrency and nonfungible tokens (NFTs), all of which are considered intangible personal property, continues to evolve and, as a result, digital assets are increasingly sold or conveyed and pledged as collateral for commercial loan transactions. To keep pace with the legal and technological developments associated with digital assets, in 2022 the sponsoring organizations for the Uniform Commercial Code (UCC) — the American Law Institute and the Uniform Law Commission — approved amendments to the UCC addressing transactions involving these emerging digital technologies (collectively, the Uniform Amendments). The Uniform Amendments impact a majority of the articles of the UCC. Most notably with respect to digital assets, the Uniform Amendments include the creation of a new Article 12 and revisions to Article 9 regarding the perfection of a security interest in such assets.

The New Article 12: The new Article 12 proposed by the Uniform Amendments governs a subset of digital assets known as controllable electronic records (CERs). The new Section 12-102(1) defines a CER as a “record stored in an electronic medium that can be subjected to control” and specifically excludes many types of digital assets already sufficiently governed by the UCC under the context of intangible personal property, including electronic chattel paper, investment property, deposit accounts, and electronic money. To ensure future relevance, CERs are broadly defined to include both digital assets using current blockchain technology and digital assets that may be developed in the future using similar technologies. Common examples of CERs are NFTs and bitcoin.

The key to the new Article 12 is the ability to control the digital asset. The concept of “control” as applied to a CER is analogous to possession of a tangible asset — meaning the party with control must have the power to transfer such asset and prevent others from using such asset. The new Section 12-105 provides that a party with control of a CER has the (1) power to enjoy “substantially all the benefit” from the CER and (2) exclusive power to (A) “prevent others from enjoying substantially all the benefit” from the CER and (B) transfer control of the CER. Additionally, the party must be able to identify itself in any way, whether by “name, identifying number, cryptographic key, office, or account number,” to a third party as the one with control.

Control provides two major benefits — one for purchasers and the other for secured parties. First, a party having control of a CER is eligible to become a “qualifying purchaser,” which is “a purchaser that obtains control of a CER for value, in good faith, and without notice of a property claim” to the CER. In general, a purchaser of a CER (including any party obtaining a security interest in the CER) acquires an interest in all rights in the CER that the transferor either had or had the power to transfer. If the purchaser of a CER is a qualifying purchaser (which includes any party obtaining a security interest in the CER), however, the purchaser benefits from the same “take free” rule provided under Article 3 and Article 8 of the UCC, which means that the purchaser acquires its interest in the CER free of any competing property interest or claim in the CER.

Amendments to Article 9: The Uniform Amendments also include revisions to Article 9 that make control of a CER a preferred method of perfection of a security interest in the CER. Under the current version of the UCC, a security interest in digital assets has been typically perfected through the filing of a financing statement (based on the categorization of digital assets as a “general intangible”). Under this method of perfection, priority is only ensured after obtaining a release or subordination from the holder of any competing security interest. However, the Uniform Amendments provide that perfection of a security interest in a CER by the method of control provides the secured party with priority over any competing security interest perfected only by filing, making control the preferred method of perfection.

For states that ultimately adopt the Uniform Amendments, the Uniform Amendments will be considered effective on the date set forth in the enacting state legislation. To protect lenders holding a security interest in CERs perfected under the current version of the UCC, the Uniform Amendments provide a transition period of at least one year from the effective date of the enacting state legislation. As such, the lender’s priority as established on the effective date will be maintained during the transition period to permit the parties to renegotiate any loan terms necessary to comply with the Uniform Amendments.

The Uniform Amendments will allow the UCC to apply to transactions involving digital assets in a manner that is not clearly provided for under the current version of the UCC. The sponsoring organizations have now offered the Uniform Amendments to the states for enactment, which is expected to take place over the course of the next few years. To date, the Uniform Amendments have been introduced for consideration in the legislatures of California, the District of Columbia, Indiana, Maine, Nebraska, New Hampshire, New Mexico, North Dakota, and Washington.

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