



Ep. 46: DeFi and Digital Assets: What do the UCC Amendments Mean for Business Transactions?

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Big changes are coming to the UCC, the Uniform Commercial Code, with regard to cryptocurrency and other digital assets. What will that mean to business transactions involving those digital assets going forward?

Author Rotatori:

Hi, thanks for joining us. I'm **Arthur Rotatori**, a Member of McGlinchey's Financial Institution's Compliance group, resident in the Cleveland office. I'm joined today by **Marshall Grodner**, a Member in our Baton Rouge office, who specializes in commercial finance. Marshall was an observer to the drafting committee for the 2022 Amendments to the UCC.

Marshall, we're doing a "Deep Dive" content series on decentralized finance, DeFi, right now. And this UCC update comes at the perfect time to update our clients about the impact of DeFi on commercial transactions.

Marshall, I want to start us off in this discussion by noting that, I took a look at the new Article 12, which is part of these amendments, and I expected to see all sorts of references to cryptocurrencies or NFTs, and I didn't see anything. I wondered if I was looking in the wrong place, or at the wrong thing?

We have are some definitions and a new acronym. We have "Controllable Electronic Records," or CERs, in Article 12. And also we have a definition now of "electronic money" that is in the revisions to Article 9.

Marshall Grodner:

Well, no, Arthur, you weren't. But what we have are some definitions and a new acronym, if you want you want. We have "Controllable Electronic Records," or CERs, that are covered by Article 12, the new Article 12. And also we have a definition now of "electronic money" that is in the revisions to Article 9 of the UCC. So now [the UCC]

clearly encompasses all digital assets, including cryptocurrency, NFTs, electronic payment intangibles, electronic accounts, and general electronic contracts as well.

Arthur Rotatori: All those things are Controllable Electronic Records, CERs?

Marshall Grodner: Yes, they can be CERs depending on if they meet the definition. And just to be clear, controllable electronic money is under Article 9 now, and is really not a Controllable Electronic Record. But NFTs and other digital assets are clearly Controllable Electronic Records. And a couple of other exceptions are electronic chattel paper and electronic documents of title. But basically everything else electronic is a Controllable Electronic Record, assuming they meet the definition.

Arthur Rotatori: Well, what is the definition? What makes a Controllable Electronic Record, a Controllable Electronic Record?

Think of it as your car. I have my car, my certificate of title. I have the exclusive right to drive it, use it, and sell it, or grant my lender a security interest in it. And that's what exclusivity is, but it's applied to digital assets.

Marshall Grodner: Well, what do you have to do, and actually what they've done, is make a common definition that applies basically to documents of title, electronic money, and electronic records with regard to "controllable." And basically there is a system which gives you the exclusive power to control it. And by control, I mean, give yourself all the benefits of ownership of it, as well as the rights to transfer it. And the system has to be able to do that and distinguish between, you have control of this digital asset, and another person has control of the other asset. So it's really an exclusive basis. You can think of it as your car. I have my car, my certificate of title. I have the exclusive right to drive it, use it, and sell it, or grant my lender a security interest in it. And that's sort of what exclusivity is, but it's applied to digital assets.

Arthur Rotatori: Now you mentioned control. And when I heard that, I was reminded of what we are used to in Article 9, for example, with electronic chattel paper and the concept of control. Is it the same thing, or if not, how does it differ? And do any of these changes also change Article 9?

Marshall Grodner: Yes. The answer is yes. Control is sort of a concept that originally originated in Article 8, dealing with securities, where there are certain intangible assets that you can't take possession of. So this was sort of a way to import possession to tangible assets that started in Article 8, was imported to Article 9 in the 2001 amendments, I believe. And now it's expanded to cover all these digital assets. And again, control is sort of like ownership. Or it can also be used if a secured party, a lender, has control over it, over a digital asset, it's like having a security interest in tangible personal property.

Arthur Rotatori: And these amendments, I guess, didn't just create Article 12, but they made some changes to Article 9. So Article 9 and Article 12 will work well together?

Marshall Grodner: Yes, what they have done, and actually it applies to Article 7 too, is that in Article 9, there is now electronic money. Money, when it was originally instituted, thought about paper, money, and coins, et cetera. Now we have digital currencies, some of which have been adopted by the state. So electronic money, has been brought into Article 9. And basically the same rules for control under Article 12 apply to electronic money under Article 9. Electronic chattel paper under Article 9 was included originally, but they now have coordinated the same sort of control rules for electronic money, electronic chattel paper, and other controllable electronic assets in Article 12. So it's a harmonization of documents of title, electronic money, electronic chattel paper, and other digital assets, such as NFTs, for example.

Arthur Rotatori: And I would imagine, just like Article 9, Article 12 does not require any particular technique, equipment, or software or anything in order to demonstrate control. It's I guess technology neutral, technology agnostic?

Marshall Grodner: Yeah. Yes it is, and I think agnostic is a good term. And it tries to take into account future developments. When Article 9 was originally enacted, the latest revision before this one, it was intended to be medium neutral. I don't even think there was such thing as the blockchain back there, but it's actually adapted to it. And it intends to be applicable for any new version of what the blockchain can or will be or "blockchain 2.0." So it's medium neutral, although it will apply to the blockchain as it's being used now for NFTs, cryptocurrencies, et cetera, and other smart contracts as well.

It's medium-neutral, although it will apply to the blockchain as it's being used now for NFTs, cryptocurrencies, et cetera, and other smart contracts as well.

Arthur Rotatori: That sounds great. It sounds like this is really a good thing. Am I missing something? Does anybody think it's not a good thing? Are they opposed to it in any way, or feel something was left out?

Marshall Grodner: Actually, in the drafting process, there was an attempt, a successful attempt to try to get all the interested parties involved so that there would be no major opposition. The cryptocurrency people were involved in the drafting process. And by cryptocurrency people, I mean the major dealers, and what is normally known as the "wallet people," the custodians of the cryptocurrencies, and the people who trade and deal in cryptocurrencies, either on their own behalf or on the behalf of others.

Arthur Rotatori: With all those different interest groups involved, did it take a long time to draft these changes?

Marshall Grodner: This process was actually fairly rapid. I think they began in 2019, so it's been a fairly rapid process. I think a lot of people have been thinking about these issues. And as a matter of fact, we have been doing legal gymnastics for the last several years to make these sort of assets work under the current law. So the law was kind of well-developed and we mostly knew where we needed to go.

Arthur Rotatori: So give us an example before and after these changes, how a transaction today might be done, perhaps not done smoothly or elegantly, and how it would be done going forward with the new law.

Marshall Grodner: Well, the sort of mental gymnastics we had to do, in particular with cryptocurrencies, in order to take a security interest or lend money on cryptocurrency, you had to declare it was a financial asset under Article 8 of the UCC, like a security, like an interest in a share of stock. And once you declared it that, and you got one of the wallet people to agree that they were a securities intermediary, and that in fact the cryptocurrency was a security, the transaction became a whole lot easier to do. But it was a lot of mental gymnastics to accomplish the same thing as control as they have it under Article 12 or under Article 9. But it was just a lot of drafting and doesn't seem intuitive. And what this has made is those transactions much simpler and more intuitive.

It was a lot of mental gymnastics to accomplish the same thing as control as they have it under Article 12 or under Article 9. And what this has made is those transactions much simpler and more intuitive.

Arthur Rotatori: Interesting. And I also suspect that not everyone wanted to declare the asset to be a security.

Marshall Grodner: Yeah, I don't think the wallet people wanted to have the term "broker-dealer" be tied to their business model.

Arthur Rotatori: And I see now, thinking about Article 12, it sidesteps that whole issue, we don't have to go there. We just have to talk about control.

Marshall Grodner: Exactly.

Arthur Rotatori: Interesting. Now, do you think that vendors will enter the space to provide control like they did with Article 9? Or are they already there?

Marshall Grodner: I think generally they are already there. Like I said, we were doing it in financial assets, and the current vendors in the space for electronic notes under e-sign and electronic chattel paper under Article 9 are already sort of there already. So I think that with these new sort of assets being brought into the fold, that these vendors have already the systems set up to establish exclusive control over all digital assets, not just typically what are electronic notes and electronic chattel paper, right now.

Arthur Rotatori: So not too far into the future, there will be a transaction where someone will pledge these electronic assets, a CER, and someone, a client, a client's lender, whatever, will ask for a legal opinion saying they have a perfected security interest in the CER. And that's when they call you. And then I guess that's something you'll be able to do.

Marshall Grodner: Yes, exactly. And for other digital assets, it's a little bit iffy right now, but once Article 12 and the revisions to Article 9 and the other Articles come into effect in all states, hopefully in the next year or so, then those legal opinions will be a lot easier. And I know some friends of mine are currently working on a project regarding legal opinions in this space right now.

Arthur Rotatori: And you raise a good point. This is not a done deal. This is a uniform law. It has to be adopted by each state separately. And that will take a year, year and a half, probably.

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Marshall Grodner: Yes. And that's what the ALI, the American Law Institute, and the Uniform Law Commission have approved a text for it. I think the last approval came in July. So the text is ready to go to the various state legislatures right now. And several groups in which I am involved are geared up and ready to go in almost every state, to go through the enactment process. We would hope that some people are going to even start this fall with the enactment process. I know in several states, including my home state, the legislature won't be in session until the spring, but we hope to have it introduced then.

Arthur Rotatori: Well, I just think this sounds like a very good thing to tell our audience about changes in the law that are positive rather than negative, and are also anticipating recognizing current technology and anticipating future changes to that technology. So I think this is a great thing to discuss today. So Marshall, thank you for introducing us to this, and I believe we'll have more detail in future discussions.

Marshall Grodner: Yeah. I look forward to having this a done deal and enacted in all 50 states and our territories. And I think that is a positive step and will encourage transactions in digital assets.

Arthur Rotatori: Great. Thanks Marshall.

Marshall Grodner: Thanks for having me.

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