Uniform Law Commission
NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS

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Representative Tyler Lindholm
P.O. Box 691
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February 6, 2019

Dear Chairman Lindholm:

Thank you very much for giving the Uniform Law Commission (ULC) the opportunity to provide additional input as a follow-up to our communications of last week. I have asked a number of our commissioners who are experts on the Uniform Commercial Code (UCC) to review SF 125, from a technical perspective, and evaluate its potential impact on transactions governed by the UCC. Their technical comments are contained in the enclosed memorandum.

To briefly summarize, their primary concerns with SF 125 are as follows:

1. SF 125 contemplates a new method of perfection for security interests in digital assets (including virtual currency) – control. The bill's definition of "control" in Section 34-29-103 appears ambiguous.

2. Section 34-29-102(a)(iii) states virtual currency is to be treated as "money" for purposes of UCC Article 9. This choice will likely lead to unintended results with respect to the conflict of laws rules set forth in Article 9 that determine which state's law a Wyoming court will apply.

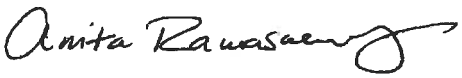
3. It is unclear if SF 125's perfection of a security interest in digital assets via "control" will integrate properly with Article 9 of Wyoming's UCC. Article 9 relates to perfection of security interests by the filing of a financing statement or by possession, in the case of security interests in money (which would include virtual currency under SF 125).

4. The provisions in SF 125 that are designed to protect good faith transferees of digital assets conflict with existing protections provided by Article 9 of Wyoming's UCC to transferees of money. Again, this is problematic because under SF 125 virtual currency is considered "money." SF 125 may, in fact, reduce protections for good faith transferees of digital assets.

We hope that identification of these issues will help the Wyoming legislature avoid enacting a statute in this very important and still-developing area of commerce that does not achieve the results that it intends. Again, the enclosed memorandum from our experts expands on the points

summarized above. Please feel free to contact me if you wish to discuss any of these issues further with the ULC. I may be reached at (206) 616-8441 or aramasastry@uniformlaws.org. ULC Commissioner Ed Smith may be reached at (617) 951-8615 or edwin.smith@morganlewis.com.

Sincerely,



Anita Ramasastry
President, Uniform Law Commission

CC: Commissioner Phil Nicholas
Commissioner Tony Wendtland

MEMORANDUM

TO: Chairman Tyler Lindholm

FROM: Uniform Law Commission

DATE: February 6, 2019

RE: SF 125 Technical Suggestions

This memorandum expands upon the issues highlighted in the cover letter. Our UCC experts noted the following issues:

1. SF 125 contemplates a new method of perfection for security interests in digital assets (including virtual currency) – control. According to paragraph (e)(1) of proposed W.S. 34-29-103, a secured party would have control of a digital asset if it "has the exclusive authority to conduct a transaction relating to [that] digital asset." Taking this language literally, if a debtor has granted authority to a secured party to conduct a transaction relating to a digital asset, and has not granted such authority to anyone else (and has promised not to conduct such a transaction himself or herself), that secured party has "exclusive authority" to conduct such transactions. But what happens if the debtor grants authority to conduct such transactions to a second secured creditor? It would appear that the first secured creditor would still have authority, but it would no longer be "exclusive authority" and, accordingly, the first secured creditor would no longer have control of the digital asset. Similarly, what happens if the debtor revokes the authority that it granted to the first secured creditor? Does this end the secured creditor's control of the digital asset? Using "authority" as the determinant of control seems to risk situations in which the debtor's unilateral actions can deprive a secured party of control (and, thus, perfection). We suspect that the intent of paragraph (e)(1) is to describe situations in which a system exists that deprives the debtor of the *ability* to conduct transactions with respect to the digital assets that are collateral and puts the secured party in a position in which it is the only party that can conduct such a transaction, but that is not what paragraph (e)(1) says.

2. It is also unclear which party, in the case of "multi-signature arrangement," has "control." If the intent is for the secured party to have the exclusive ability to conduct transactions with respect to digital assets in order to achieve "control," a multi-signature arrangement" in which another party may block a transaction may suggest that neither party has "control." It is unclear as well whether, if a digital asset is treated as investment property under Article 8 of the UCC, the concept of control under SF 125 precludes control being achieved under Article 8.

3. W.S. 34-29-104(d), as proposed in SF 125, contemplates a bailment arrangement for digital assets maintained with a bank custodian. That raises the question of whether the bailment construct, typically associated with goods rather than intangibles, supersedes control under Article 8 of the UCC for digital assets treated as financial assets under Article 8 with the custodian acting as a securities intermediary.

4. W.S. 34-29-103(a), as contemplated by SF 125, provides that perfection of a security interest in a digital asset may be achieved through control "[n]otwithstanding the financing statement requirement specified by W.S. 34.1-9-310(a) as otherwise applied to general intangibles." But not all digital assets are general intangibles under SF 125. "Digital consumer assets" are described as general intangibles, but "digital securities" are defined to be securities and investment property (and, thus, are not general intangibles as that term is defined in Article 9), and "virtual currency" is defined to be money (and, thus, not general intangibles). In any event, the rule in W.S. 34.1-9-310(a) that a financing statement is required for perfection of all security interests is subject to exceptions in W.S. 34.1-9-310(b) and W.S. 34.1-9-312(b). We think that what is intended by 34-29-103(a), as it appears in SF 125, is to bring about the result that would be achieved if "digital assets" were included in the list in W.S. 34.1-9-310(b)(8) of types of collateral in which a security interest may be perfected by control (and for which no financing statement would then be required).

5. Security interests in money are subject to a number of special rules in Article 9. With respect to perfection, W.S. 34.1-9-313(a) provides that a security interest in money may be perfected by the secured party taking possession of the money, while W.S. 34.1-9-312(b) provides that, except when money is proceeds of other collateral, a security interest in money may be perfected *only* by the secured party taking possession of the money. Yet, as SF 125 notes, virtual currency is intangible and thus incapable of possession in the ordinary sense of that word. The definition of "control" begins by stating that "'Control' includes the term 'possession'" and "shall not require physical possession of an asset." We suspect that the intent here is to provide that Article 9 requirements that a secured party have possession of money are satisfied by the secured party having control of the money; but that would mean that "possession" includes "control" (rather than the other way around).

6. Another special rule for security interests in money is found in W.S. 34.1-9-332(a), which provides that a transferee of money takes the money free of a security interest in it unless the transferee has acted in collusion with the debtor. Since SF 125 defines virtual currency as money, that rule would seem to apply to virtual currency. Yet, without indicating that W.S. 34.1-9-332(a) does not apply to virtual currency, SF 125 states a different rule for digital assets (including virtual currency). W.S. 34-29-103, as contemplated by SF 125, would provide that "a perfected security interest in a digital asset becomes unperfected two (2) years after a transferee takes the asset for value and does not have notice of an adverse claim." This raises two issues. First, in order for this

provision to apply so that the security interest in the digital asset becomes unperfected, must the transferee be without notice of the adverse claim during the entire two-year period, or is it sufficient that the transferee took the virtual currency without such notice? The sentence structure suggests the latter, but we think that the former may have been intended. More important, this rule, unlike W.S. 34.1-9-332(a), is not a "takes free" rule; rather, it says only that the security interest becomes unperfected. But an unperfected security interest remains enforceable. While W.S. 34.1-9-317 provides some protection for transferees of property subject to unperfected security interests, it is far from clear that that section applies to situations in which the security interest was perfected at the time of transfer and becomes unperfected later. W.S. 34.1-9-515 provides some protection for certain transferees when a security interest becomes unperfected because a financing statement lapsed, but that section would not apply to this situation. Thus, while we suspect that the intent of proposed W.S. 34-29-103 is to provide protection for innocent transferees of virtual currency and other digital assets, the language proposed in SF 125 may fail to achieve that result.

7. In a secured transaction that touches more than one state, W.S. 34.1-9-301 determines whether a Wyoming court will apply Wyoming's UCC, or the UCC of another state, to a decide whether the security interest is perfected and the priority of the security interest as against competing claimants. That section indicates that, in the case of a security interest in money, the state whose law will be applied to determine whether the security interest is perfected is that state in which the *debtor* is located (unless the security interest is a "possessory security interest," in which case that law of state in which the *money* is located will determine whether the security interest is perfected), while the state whose law will govern the priority of the security interest in the money as against competing claimants (whether or not the security interest is a possessory security interest) is the state in which the *money* is located. Thus, in order to determine which state's law will govern priority and, in some cases, perfection, the court needs to determine where the money is located. SF 125 provides that virtual currency is "money" and also that, as a digital asset, it is intangible. Yet, intangible assets have no physical location. We do not know, therefore, how a court in Wyoming would determine which law applies to perfection and priority of a security interest in virtual currency. To complicate matters even more, UCC § 9-301, as enacted in other states, is essentially identical to W.S. 34.1-9-301, but those other states do not define virtual currency as money. As a result, courts in those states might make a different determination of which state's law governs perfection or priority of a security interest in virtual currency in a Wyoming-related transaction than would Wyoming courts. This could lead to unintended incentives for parties to engage in forum-shopping.

8. Finally, the effect of W.S. 34.1-9-301 (and the analogous provision in other states) will be to limit the effect of SF 125 on the rules governing perfection of non-possessory security interests to transactions in which the debtor is located in Wyoming. In a transaction involving a Wyoming lender but an out-of-state debtor, the law of the state in which the debtor is located will govern perfection of a non-possessory security interest.

In cases in which the secured party takes control of the virtual currency, the "location" of that virtual currency will govern perfection if that constitutes a "possessory security interest" but courts outside Wyoming will likely treat such a security interest as non-possessory and apply the law of the debtor's location to perfection, once again leading to the possibility of forum-shopping that will deprive SF 125 of its intended effect.

Thank you for your consideration. Please feel free to contact ULC Commissioners Anita Ramasastry or Ed Smith if you wish to discuss any of these issues further. Anita Ramasastry may be reached at (206) 616-8441 or aramasastry@uniformlaws.org. Ed Smith may be reached at (617) 951-8615 or edwin.smith@morganlewis.com.