

TYPES NOT MAPPED YET May 09, 2019 | TTR not mapped yet | Mark V. Bossi

Bitcoin and cryptocurrency negotiability is an uncertain landscape

Many mainstream businesses are beginning to accept Bitcoin and other virtual “currencies” as a form of payment. These businesses treat Bitcoin as a form of currency and assume that it is taken free of any adverse claims asserted by creditors of the transferor of the Bitcoin. But is it? What if before the Bitcoin transfer, the transferor granted its lender a lien on the Bitcoin or on all “general intangibles” owned by the transferor (a fairly common occurrence). Will the transfer of the Bitcoin be free of such an encumbrance? Unfortunately, under the current laws of most states, the answer is likely “no.” The transferee is at risk of having to disgorge the Bitcoin if an adverse claim is asserted against it by a creditor of the transferor.

Some states, including Missouri, are considering changing the law in order to make Bitcoin and other cryptocurrencies more freely and securely negotiable. But the proposed approaches to solving this “negotiability” problem are very different should prompt some serious discussion and debate.

The problem of negotiability

Although Bitcoin and other virtual currencies are often treated as money, the definition of money for commercial purposes is currently limited to a “medium of exchange that is authorized or adopted by a domestic or foreign government” (i.e. fiat currency).[1] Because Bitcoin and other virtual currencies are not officially recognized as legal tender by any government, most commentators and scholars conclude that such virtual currencies are not money, but rather are “general intangibles” under commercial law.[2]

The consequence of classifying virtual currencies as general intangibles is that they are not subject to the “free and clear negotiability” rules under which a transferee will usually take free of a pre-existing encumbrance.[3] Rather, under most current laws, a transferee of virtual currency will take the virtual currency subject to a prior perfected lien unless the transferor’s secured party authorized the transfer free of its lien.[4]

The exclusion of virtual currency from the “free and clear negotiability” rules under the UCC also inhibits the use of cryptocurrency as loan collateral since a lender’s security interest in the virtual currency will be subject to a security interest granted by the transferor. In the absence of a waiver from the transferor’s lender, a lender to the transferee cannot safely rely on the virtual currency received by the transferee. Indeed, when the transferee accepts virtual currency from multiple sources, it is not practical to get such waivers.

The solution(s)

States are now beginning to enact laws to bring cryptocurrencies under the “free and clear negotiability” rules of the UCC. However, a split has emerged on how to resolve the issue. Wyoming, the first state to adopt a new law, has enacted a “direct approach” which expands the free and clear negotiability rules to all virtual currency, regardless of how the virtual currency is held. On the other hand, the Uniform Law Commission has proposed that states adopt an “indirect approach” that would give “free and clear negotiability” only on virtual currency that a securities intermediary holds.

The Wyoming approach

The [recently enacted Wyoming law](#) is very broad in its scope and application. It applies to all “digital assets” - representations of economic, proprietary or access rights stored in a computer readable format. It classifies digital assets into three groups: “virtual currencies” (defined as digital assets used as a medium of exchange, unit of account or store of value, and not recognized as legal tender by the United States Government); “digital consumer assets” (defined as digital assets used or bought for consumptive, personal or household purposes); and “digital

securities” (defined as contracts, transactions or arrangements where a person invests money in a common enterprise and is led to expect profits from the efforts of a promoter or a third party).

The Wyoming law treats “virtual currencies” the same as money for purposes of the UCC. Thus, a transferee of a virtual currency will often take free of a prior encumbrance asserted against the virtual currency. A party taking a security interest in the virtual currency must perfect the security interest by taking “control” of the virtual currency and having the exclusive authority to conduct a transaction involving the virtual currency. The Wyoming law provides that such control may be by means of a private key, the use of a multi-signature arrangement or, by means of a smart contract.

The Wyoming law treats “digital consumer assets” as general intangibles, in which a secured party may perfect a security interest either by filing a financing statement or taking control of the asset. It also treats “digital securities” the same as other securities, pursuant to which the typical method of perfection is by control.

Finally, any lien on a digital asset that is not perfected by control is automatically deemed to expire two years after the transfer of the digital asset to a transferee that does not have actual notice of an adverse claim to the digital asset.

The Uniform Law Commission approach

The Model Act proposed by the Uniform Law Commission is much narrower in its application. It covers only virtual currencies and does not apply to other forms of digital assets. Virtual currencies are characterized differently depending on how the owner holds them. Virtual currencies directly held by the owner will continue to be treated as “general intangibles” and will not be freely negotiable. Virtual currencies held indirectly through a bank, broker or other securities intermediary will be treated as “investment property” and will receive the same benefits of negotiability provided for indirectly-held securities under the UCC. That is, they are freely negotiable by the party having control through the securities intermediary.

Criticisms of the different approaches

The approach taken by the Model Act has been criticized on the grounds that requiring owners of virtual currencies to place such currencies under the control of a securities intermediary to get the benefit of free negotiability ignores the direct ownership nature of virtual currency, creates an advantage for the securities industry and exposes the owner of the cryptocurrency to the risk of an insolvent intermediary.[5]

The Wyoming approach has been criticized on the grounds that its definition of “control” is vague and ambiguous and is difficult to apply in the absence of requiring a third-party intermediary hold the virtual concurrency. The Wyoming law has also been criticized because it takes a non-uniform approach to a multi-jurisdiction problem and imposes unworkable choice of law rules.

Correspondence between the Uniform Law Commission and the State of Wyoming discussing their differing approaches and their disagreements can be found [here](#) and [here](#).

Missouri legislation

Rep. Andrew McDaniel, R-Dist.150 (Kennett, Mo.) has [recently introduced legislation](#) in Missouri that would essentially adopt the Wyoming approach. How much consideration has or will be given to the adoption of this legislation as opposed to the Model Act is unknown.

Conclusion

There are many compelling arguments for adopting Wyoming’s approach and making all cryptocurrency freely negotiable. However, there are some technical and practical application issues with the Wyoming approach, as pointed out by the Uniform Law Commission.

Regardless of which approach ultimately wins out, two things are clear. First, under existing law, purchasers of Bitcoin and other cryptocurrencies are at risk of having to disgorge their holdings if an adverse claim is asserted by a creditor of a prior owner of the cryptocurrency. As a result, current law is outdated and needs to change. Second, unless the state legislatures eventually get on the same page and adopt a uniform solution, applying multiple and differing state laws will be complicated and confusing, which may be a worse outcome than under existing law.

[1] § 1-201. General Definitions., Unif.Commercial Code § 1-201.

[2] See J. Schroeder, Jeanne L. Schroeder, Bitcoin and the Uniform Commercial Code, 24 U. Miami Bus. L. Rev. 1 (2016) (“... bitcoin does not, and cannot be made to fit into, the U.C.C.’s definition of “money.” If held directly by the owner, bitcoin constitutes a “general intangible.”)

[3] See § 9-332. Transfer of Money; Transfer of Funds from Deposit Account., Unif.Commercial Code § 9-332 (a transferee of money or funds in a deposit account takes such funds free of a security interest unless the transferee acts in collusion with the transferor in violating the rights of a secured party).



[4] See § 9-315. Secured Party's Rights on Disposition of Collateral and in Proceeds., Unif. Commercial Code § 9-315 ("a security interest continues in collateral notwithstanding sale, lease, license, exchange or other disposition thereof unless the secured party authorized the disposition free of the security interest.")

[5] See A. Tinianow, A Spit Emerges In Blockchain Law: Wyoming's Approach Versus The Supplemental Act, <https://www.forbes.com/sites/andreatinianow/2019/03/07/a-split-emerges-in-blockchain-law-wyomings-approach-versus-the-supplemental-act/#6b2b95b6719a>

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