

October 11, 2022

The UCC's Proposed Article 12: Controllable Electronic Records

Written by: [Rick S. Rein](#) with contributions made by Ben Dockery. “The 2022 Amendments to the Uniform Commercial Code (UCC) update and modernize the UCC to address emerging technologies. A new UCC Article 12 on Controllable Electronic Records governs transactions involving new types of digital assets (such as virtual currencies and nonfungible tokens), and corresponding changes to UCC Article 9 address security interests in digital assets.”^[1] A member of the uniform law commission explained that two underlying themes of Article 12 are functionality and tech neutrality.^[2] This article will examine sections of the UCC’s proposed Article 12, which focuses on controllable electronic records including blockchain and ledge currencies, nonfungible tokens and potential non-fiat currencies.

Summary

Article 12 outlines some important definitions and rules of controllable electronic record’s control, transfer, obligations and discharge of obligations. The rules do not yield to any specific type of controllable electronic record (defined in 12-102). Instead, Article 12 provides a broad framework of definitions and rules which can be applied to technologies and digital assets that may be created in the future.

Section 12-102

DEFINITIONS Two of Article 12’s most important terms are “controllable electronic record” and “qualifying purchaser.” Controllable electronic records and qualifying purchasers are defined in Article 12 as follows.

"Controllable Electronic Record" A “controllable electronic record” (CER) is a record stored in an electronic medium which can be subjected to “control” under 12-105 but does not include a controllable account, payment intangible, deposit account, electronic copy of a record evidencing chattel paper, electronic documents of title, electronic money, investment property or a transferable record. 12-102(a)(1). **"Qualifying Purchaser"** A “qualifying purchaser” is a purchaser of a CER or an interest in a CER that obtains control of the CER for value, in good faith and without notice of a competing claim of property right. 12-102(a)(2). Another important term is “control,” and what it means to have control of a CER. What it means to “control” a CER is explained in Section 12-105.

Section 12-103

RELATION TO ARTICLE 9 & CONSUMER LAWS Section 12-103 politely concedes that if a conflict arises between Article 12 and Article 9, then Article 9 governs. This section also provides that transactions falling within the ambit of Article 12 are subject to other rules of law which may establish different rules or practices. Note, UCC Article 9 is currently being revised as well. “The provisions applicable to purchasers of CERs are carefully coordinated with corresponding changes to lending secured by security interests in CERs under Article 9 and are designed to preserve the availability of existing transaction patterns. Under the proposed

amendments, there would be no need to change collateral descriptions in security agreements or collateral indications on financing statements. A CER is a “general intangible,” a controllable account is an “account” and a controllable payment intangible is a “payment intangible,” as those terms are already defined in Article 9. The normal rules for attachment would continue to apply, and a security interest in a CER, a controllable account or a controllable payment intangible could still be perfected by the filing of a financing statement.” ^[3] Under the new Article 12 regime, a security interest in CERs may be perfected by the secured party obtaining “control” of the CER. What it means to “control” a CER is defined in 12-105. A security interest in a CER, a controllable account or a controllable payment intangible perfected by “control” would have priority over a security interest in the CER, controllable account or controllable payment intangible perfected only by filing a financing statement (or by another method other than control). For example, SP-1 lends to Debtor, obtains a security interest in Debtor’s accounts, payment intangibles and other general intangibles and perfects the security interest by the filing of a financing statement. SP-2 later lends to Debtor, obtains a security interest in a CER functioning as an electronic promissory note payable to the person in control of the CER and files a financing statement to perfect its security interest. Here, SP-1’s security interest has priority under the first to file rule of Article 9. But if SP-2 obtains control of the CER, SP-2’s security interest in the CER/electronic promissory note will beat SP-1’s security interest.

Section 12-104

RIGHTS IN CONTROLLABLE ACCOUNT, CONTROLLABLE ELECTRONIC RECORD & CONTROLLABLE PAYMENT Section 12-104 governs the acquisition and purchase of rights in a controllable account or controllable payment intangible in the same manner this section applies to a CER, even though controllable accounts and payments intangible are not considered CER. Section 12-104(b) states that a purchaser is a “qualifying purchaser” of a controllable account or a controllable payment intangible if they obtain control of the CER that evidences the account or payment intangible. State law will determine if a person acquires a right in a controllable electronic record and the right the person acquires. 12-104(c). Article 12 provides a “take free” provision for qualified purchasers of CER so long as they satisfy 12-102(a)(2). Section 12-104(e) states that “a qualifying purchaser acquires its right in the controllable electronic record **free of** a claim of a property right” (security interest) in the CER. Section 12-104(h) notes that merely filing of a financing statement under Article 9 is not notice of a claim of a property right in a controllable electronic record and thus will not defeat a qualified purchaser’s claim to a CER. Article 12’s take free rule does not extend to other property not fitting the definition of CER. For example, Section 12-104(f) states that for “a controllable account and a controllable payment intangible or law other than this article, a qualifying purchaser takes a right to payment, right to performance or other interest in property evidenced by the controllable electronic record subject to a claim of property right in the right to payment, right to performance or other interest in property.” 12-104(f). In action Section 12-104 looks like this – when a person in control of a CER transfers control to another person, the transferee obtains whatever rights in the CER that the transferor had and if the transferee is a “qualifying purchaser,” the transferee also benefits from the “take-free” rule. But, if the transferred asset is not a CER the transferee takes the property **subject to** other parties claims such as, the right to payment, right to performance or other interest in the property.

Section 12-105

CONTROL OF CONTROLLABLE ELECTRONIC RECORD The definition of what constitutes “control” of a CER is likely to be one of the most impactful sections of Article 12. One of the biggest hurdles in the realm of digital assets can be determining who has control or perhaps exclusive control of the asset. Article 12 provides some guidance on this issue by defining what control and exclusivity look like for CERs. Under Section 12-105(a), a person has control of a CER if the electronic record, a record attached or logically associated with the electronic record or a system in which the electronic record is recorded: (1) Gives the person: (A) power to avail itself of substantially all the benefit from the electronic record; and (B) exclusive power, subject to subsection (b), to:

- Prevent others from availing themselves of substantially all the benefit from the electronic record; and
- Transfer control of the electronic record to another person or cause another person to obtain control of another CER as a result of the transfer of the electronic record; and

(2) Enable the person readily to identify itself in any way, including by name, identifying number, cryptographic key, office or account number, as having the powers specified in paragraph (1) For example, a “virtual (non-fiat) currency would be an example of a CER. If a person owns an electronic “wallet” that contains a virtual currency, the person would have control of the virtual currency if (a) the person may benefit from the use of the virtual currency as a medium of exchange by spending the virtual currency or exchanging the virtual currency for another virtual currency, (b) the person has the exclusive power to prevent others from doing so and (c) the person has the exclusive power to transfer control of the virtual currency to another person.” ^[4] Section 12-105(b) explains that a power is exclusive even if (1) the CER limits the use of the electronic record or has a protocol programmed to cause a change, including a transfer or loss of control or a modification of benefits afforded by the electronic record; or (2) the power is shared with another person. Section 12-105 also discusses (c) when power is not shared with another person; (d) the presumption of exclusivity of certain powers; (e) how a CER can be controlled through another person; and (f) there is no requirement for another person to acknowledge that it has control of a CER on behalf of another person. Note – Article 12 will not govern an electronic record that is not susceptible to control under 12-105. A CER is not every imaginable digital asset. Additionally, certain assets which fit the definition of a CER are nonetheless excluded. These assets include electronic chattel paper, electronic documents, investment property, transferable records under the federal E-SIGN law or the Uniform Electronic Transactions Act (“UETA”), deposit accounts and, to some extent, electronic money. “These assets are excluded because commercial law rules already exist and generally work well for these assets.” ^[5]

Section 12-106

DISCHARGE OF ACCOUNT DEBTOR ON CONTROLLABLE ACCOUNT OR CONTROLLABLE PAYMENT INTANGIBLE Section 12-106 explains how an account debtor of a controllable account or payment intangible can discharge their obligations. Article 12 states that a debtor may discharge their obligation by paying (1) the person who has control of the CER which evidence the controllable account or the payment intangible, or (2) a person that formerly had control of the controllable electronic record, unless the debtor received notice from the person formerly in control of the CER that the person formerly in control transferred the CER to another party. Section 12-106(a)-(b). If a person who formerly had control of the CER elects to notify the account debtor that the CER is transferred to a new party the notice must:

- Be signed by the person who formerly had control or the person to which control was transferred
- Reasonably identify the CER, controllable account, or controllable payment intangible
- Notify the account debtor that control of the CER, which evidences the controllable account or payment intangible, was transferred
- Reasonably identify the transferee
- Provide a commercially reasonable method by which the account debtor is to pay the transferee

See, 12-106(b). After receiving a notice that complies with 12-106(b) the account debtor may only discharge its obligation by paying the transferee – the party then in control of the CER. Note, the account debtor and the person in control of the CER may agree in signed writing to a “commercially reasonable method by which a person may furnish reasonable proof that control has been transferred.” 12-106(d)(1). However, a notice is ineffective under 12-106(b), at the option of the account debtor, if the notice tells the debtor to divide a payment, pay less than the full amount of a periodic payment or pay any part of a payment by more than one method or to more than one person. 12-106(d)(3). After receiving notice that the CER is transferred, and at account debtor’s request, the person giving the debtor notice must furnish “reasonable proof” of the transfer, using the pre-agreed upon method that control of the CER has been transferred. 12-106(e). If the party who gave the notice fails to comply with the account debtor’s request, the account debtor may discharge its obligation by paying the party who formerly had control of the CER despite the notice it was provided. 12-106(e). A party furnishes “reasonable proof” under 12-106(e) by using the commercially reasonable method agreed to in writing under 12-106(d) which should demonstrate that the transferee has the power to:

- Avail itself of substantially all of the benefit from the CER
- Prevent others from availing themselves of substantially all of the benefit from the CER
- Transfer the powers specified in paragraphs (1) and (2) to another person

In summary of 12-106, a debtor may ask for reasonable proof of the CER’s transfer. The method of providing that reasonable proof of transfer must have been agreed to by the account debtor in writing, presumably as part of the CER when it was created. Absent an agreed method of providing reasonable proof, the CER transfer notification is not effective, and the account debtor may obtain a discharge of its payment obligations by continuing to pay the debtor. Generally, few account debtors question a transfer notification or ask for reasonable proof. However, if an account debtor does ask for reasonable proof, the relevant parties have the flexibility to develop for market acceptance methods for providing the reasonable proof. [\[6\]](#)

Section 12-107

GOVERNING LAW Article 12 provides that the local law of the CER’s jurisdiction governs matters covered by Article 12, unless an agreement determines that the local law of another jurisdiction governs. 12-107(c) (5) states that, unless expressly provided for otherwise, the CER’s jurisdiction is the District of Columbia. However, the CER, a record attached to or logically associated with the CER, or the rules of the system in which the CER is recorded can expressly provide that a particular jurisdiction is the CER’s jurisdiction and/or expressly provide that the law of a particular jurisdiction will govern the CER. 12-107(c).

[\[1\] https://www.uniformlaws.org/discussion/ulc-wraps](https://www.uniformlaws.org/discussion/ulc-wraps) [\[2\]](#) Carla Reyes: Participated in the drafting formulation of the new UCC updates; Chair of the Texas Working Group on Blockchain matters; ABF Fellow; Research

Director of the Uniform Law Commission's Technology Committee; Associate Research Director of the Permanent Editorial Board of the UCC; Scholar and academic specializing in emerging technologies and blockchain currencies. See <https://www.smu.edu/Law/Faculty/Profiles/Reyes-Carla-L> [3]

<https://businesslawtoday.org/2022/03/proposed-2022-amendments-uniform-commercial-code-digital-assets/> [4]

<https://businesslawtoday.org/2022/03/proposed-2022-amendments-uniform-commercial-code-digital-assets/> [5]

<https://businesslawtoday.org/2022/03/proposed-2022-amendments-uniform-commercial-code-digital-assets/> [6]

<https://businesslawtoday.org/2022/03/proposed-2022-amendments-uniform-commercial-code-digital-assets>