

The logo for the New York City Bar, featuring the text "NEW YORK CITY BAR" in a serif font, centered between two horizontal blue bars.

**NEW YORK  
CITY BAR**

**REPORT BY THE TASK FORCE ON DIGITAL TECHNOLOGIES  
IN SUPPORT OF ENACTMENT OF THE NEW YORK VERSION OF THE AMENDMENTS  
TO THE OFFICIAL TEXT OF THE UNIFORM COMMERCIAL CODE (2022)**

**FEBRUARY 2023**

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**CODE (2022)**

**I. EXECUTIVE SUMMARY**

The New York City Bar Association (“**City Bar**”) Task Force on Digital Technologies<sup>1</sup> (“**Task Force**”) endorse enactment in the State of New York of the attached New York version (“**Amendments**” or “**New York Amendments**”) of the Amendments to the Official Text of the Uniform Commercial Code (2022) (the “**Emerging Technologies Amendments**”).

Enactment of the Amendments is necessary to preserve New York’s preeminence as a leading commercial jurisdiction by adapting New York’s Uniform Commercial Code (“**UCC**”) to recent and potential future developments in technology and related new methods of doing business.

**A. What the Amendments Accomplish**

The Amendments are designed to modernize, rationalize and clarify New York’s UCC so that it effectively governs important transactions in digital assets,<sup>2</sup> while applying to certain digital assets the unique characteristics of New York law that facilitate the negotiability of written instruments and, thereby, enhance transactional certainty. The Amendments also further the purpose of New York’s Electronic Signature and Records Act (“**ESRA**”)<sup>3</sup> – now almost a quarter-century old – to make commercial law more media-neutral in order to facilitate electronic

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<sup>1</sup> The Task Force is composed of approximately 90 representatives of 44 committees of the City Bar and adjunct members of the City Bar. Appendix A sets forth the names of the committees along with the representatives who participated in the drafting and/or review of the report. Task Force members represent a wide range of practice areas, and many members represent a range of stakeholders on digital technology issues. The predecessor to the Task Force was a City Bar Working Group on Cryptocurrencies formed in October 2021. The Task Force was established in June 2022. Appendix A also identifies the members of a subcommittee of the City Bar Committee on Commercial Law and Uniform State Laws that formed a drafting subcommittee for this Report.

<sup>2</sup> This Report uses the non-technical term “digital assets” to refer to all assets that depend upon the new concept of a controllable electronic record, as utilized in Articles 7, 9 and 12 of the Emerging Technologies Amendments. Digital assets include “controllable electronic records,” “controllable accounts” and “controllable payment intangibles” defined in new Article 12 and also include assets excluded from the Article 12 definition but dependent upon the concept of control of an electronic record, such as “electronic money,” “electronic documents of title,” “chattel paper in electronic form,” as well as “transferable records,” as defined in the federal Electronic Signatures in Global and National Commerce Act (“**ESIGN**”) and the Uniform Law Commission’s model Uniform Electronic Transactions Act (“**UETA**”). While digital assets include cryptocurrencies, they include far more than that.

<sup>3</sup> N.Y. State Tech. Law Section 301, *et seq.*

commerce,<sup>4</sup> *i.e.*, use of technology to accomplish transactions traditionally based on delivery of signed paper documents.

Most importantly, the Amendments utilize the concept of a “controllable electronic record” to provide legal recognition for, and thereby facilitate the creation of, a broad range of new forms of intangible property or digital assets (rather than limiting digital assets to specifically enumerated types of property)<sup>5</sup> and to define the rights of purchasers of such digital assets in order to enhance their commercial utility. Second, a controllable electronic record is defined broadly, so that it is technology-neutral and not limited to any particular existing technology utilized to establish “control”.<sup>6</sup> Third, the Amendments specifically recognize as digital assets controllable accounts and controllable payment intangibles. These are accounts and payment intangibles which, by their terms, the obligor has agreed are payable only to the person in control of a specified controllable electronic record.

These changes tailor the rules of the UCC to make them more appropriately and usefully applicable to cryptocurrencies, crypto-tokens, electronic money, electronic promissory notes and bills of exchange, and any existing or future forms of payment obligations evidenced by a controllable electronic record payable to the person in control, which are maintained on distributed ledger platforms, or any future technology platforms, satisfying the criteria for a controllable electronic record.

## **B. The Emerging Technologies Amendments to the Official Text of the UCC**

Digital assets began to evolve several decades ago, and the UCC has periodically been amended to accommodate their existence.<sup>7</sup> Since the last comprehensive revisions to the Uniform Law Commission’s Official Text of the Uniform Commercial Code (“UCC”), promulgated in 2010 and substantially adopted by the New York Legislature in 2014, electronic commerce has continued to expand and evolve and become ever more important to the U.S. and world economy. Furthermore, during the past decade, emerging technologies have led to the creation of an entirely new class of digital assets, which exist on distributed ledger or blockchain platforms and can be used to accomplish an increasing number and variety of transactions. These digital assets

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<sup>4</sup> This Report uses the term “electronic commerce” to refer to all commercial and financial transactions utilizing electronic records and electronic signatures, including commerce in digital assets.

<sup>5</sup> The New York UCC currently recognizes only electronic documents of title and electronic chattel paper as digital assets. Other non-UCC law, such as ESIGN, UETA and ESRA discussed below, also recognize electronic notes (and, in the case of ESRA, electronic instruments) as digital assets.

<sup>6</sup> Prior to approval of the Emerging Technologies Amendments, the only technology recognized to fall within the “safe-harbor” of control of a digital asset was technology that permits the creation, maintenance and transfer of an electronic record that is identifiable as the authentic original and which identifies any copies of that record as copies.

<sup>7</sup> As electronic documents of title, electronic securities and electronic chattel paper came into use, UCC Articles 7, 8 and 9 were amended on an ad hoc basis to accommodate them.

dramatically transform commerce, but their legal effect is subject to significant uncertainties requiring a clear modern legal structure if they are to achieve their full potential.

As described in Section IV, below, the Emerging Technologies Amendments are designed to update the UCC, which is in effect in all 50 States and the District of Columbia, to increase commercial activity (and make it more efficient and secure) by more fully recognizing the use of electronic records in lieu of paper documents, and, even more significantly, by providing clear rules governing transactions in digital assets.

The Emerging Technologies Amendments are not intended to change the well-established and proven policies and principles of commercial law embodied in the UCC, but rather to revise the UCC to better apply these tried-and-true principles to commerce involving electronic records and, particularly, to commerce in digital assets.

### **C. Flexibility of the Emerging Technologies Amendments**

The Emerging Technologies Amendments are limited to issues of commercial law and do not address every issue raised by the development or use of electronic records or digital assets. The primary purpose of the Emerging Technologies Amendments is to clarify the rights of market participants who acquire digital assets, in order to incentivize and encourage innovation and increased commercial activity using new technologies. They do this, in particular, by (i) making clear how the existing principles of the UCC apply to transactions in digital assets and traditional transactions utilizing electronic records and (ii) applying the fundamental concepts of negotiability to transfers of certain digital assets.

The Amendments focus on the rights acquired by transferees of interests in digital assets. They are not intended to, and do not, address regulatory or public interest issues outside the scope of the UCC. Thus, they do not concern the technology by which such assets are created, and, in fact, are intended to be neutral on that subject. (*See* footnotes 18, 25, 26 and 27, and accompanying text, below). Such non-UCC issues, which are not the subject of the Amendments, are the subject of other federal and state laws, including environmental, securities, commodities, banking, and investor and consumer protection laws. The Amendments leave such public interest issues to the appropriate regulatory laws and regulators.

### **D. Benefits to New York of Enactment of the Amendments**

As described in Section V, New York commercial and financial law has unique respect for freedom of contract and strong protections for the negotiability of commercial instruments. This has long made New York the preferred U.S. jurisdiction for paper-based commercial and financial transactions; this is currently not yet the case for transactions involving digital assets. If New York were to enact the New York Amendments, New York would retain its commercial primacy. New York is currently the only state which has not enacted the Uniform Law Commission's proposed Uniform Electronic Transactions Act or UETA, with its concept of transferable electronic records.<sup>8</sup>

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<sup>8</sup> In the late 1990's as computer technology became more widespread, questions arose as to the enforceability of contracts that were in electronic form, rather than on paper, and "signatures" that were made electronically (e.g. by checking a box or printing a name on a computer screen), rather than manually. Many statutes

Enactment of the New York Amendments will eliminate existing impediments (described, below, in Sections IV(B) and (C) and V(A)) to the choice of New York law and jurisdiction to govern transactions in, and to resolve disputes concerning, digital assets. More than that, enactment of the Amendments would make choice of New York law and jurisdiction affirmatively attractive for purchasers of digital assets. This will further New York's long-standing goals (i) of encouraging choice of New York law and jurisdiction to govern commercial contracts<sup>9</sup> and (ii) of making the advantages of electronic commerce available to the greatest extent in New York.<sup>10</sup>

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referred to contracts on paper or in writing and to signatures that were written. To deal with this issue, statutes were enacted that provided for the effectiveness generally of electronic contracts and electronic signatures and that thereby overrode other inconsistent statutes. These statutes included ESRA in New York, ESIGN (a federal law), UETA (a uniform law that has been widely adopted by the states) and specific amendments to UCC Article 7 (relating to electronic documents of title) and Article 9 (relating to electronic chattel paper).

ESRA was one of the first such laws to be adopted and was a leader in the area. ESIGN, UETA and the Article 9 amendments followed soon after. One aspect in which ESRA, ESIGN and UETA differed was the treatment of negotiable instruments. UCC Article 3, which governs negotiable instruments, required negotiable instruments to be in writing on paper and to be signed in writing, and they were transferred or negotiated by physical delivery. Accordingly, it was necessary to make special provision in the three new laws for negotiable instruments. ESRA permitted negotiable instruments to be electronic if the electronic system in which it was held allowed only for the existence of one unique unalterable version. However, ESRA did not describe how electronic instruments are transferred or how a transferee becomes a holder in due course. (As noted, Article 3 requires physical delivery, which is not possible for a document in electronic form.)

ESIGN and UETA treat negotiable instruments differently from ESRA in three major ways: (1) UETA applies only to negotiable promissory notes (unlike ESRA which applies to all negotiable instruments), and ESIGN applies only to negotiable promissory notes secured by real property; (2) UETA and ESIGN both provide that a person having control of an electronic note is the holder and that such a person may be a holder in due course if it meets the requirements of Article 3 other than the requirement that the note be in writing; and (3) UETA and ESIGN both have a test of control which does not require one unique version. Because UETA and ESIGN have provisions conferring holder in due course status, they have been relied upon to establish various financing programs, including a federal real estate mortgage note program. Since these programs are running satisfactorily under existing law, the drafters of the Emerging Technologies Amendments did not want to do anything to upset these programs, and accordingly electronic promissory notes under UETA and ESIGN were excluded from the definition of Controllable Electronic Record in new Article 12. Moreover, the Emerging Technologies Amendments could not impact ESIGN, since it is federal law and would preempt any conflicting state law.

Although legislators could not have foreseen it at the time, the ESRA provision requiring one unique version of an electronic instrument has now become problematic due to recent advances in technology. Digital ledger technology (also known as blockchain) permits numerous participants to have an identical version of a document and provides assurance that all versions are identical. Market participants are currently using this technology in the creation of digital assets. The lack of holder in due course provisions in ESRA, together with the requirement of one unique version in ESRA, make ESRA substantially less desirable for market participants than UETA. Over the last 20 years, more and more states have adopted UETA, and today UETA is the applicable law in all states other than New York.

<sup>9</sup> See N.Y. General Obligations Law Section 5-1401 and 1402.

<sup>10</sup> N.Y. State Tech Law Section 301 *et seq.* and NY Executive Law Section 135-c (authorizing electronic notarization).

The Amendments, crafted specifically for New York, are intended to preserve and apply existing New York-specific principles, particularly those (described below, in Section V.B) protecting the rights of good faith purchasers of negotiable instruments and documents, to transactions involving digital assets which are the electronic equivalent of such instruments and documents.

By updating New York's UCC to cover all digital assets that are controllable electronic records, prompt enactment of the Amendments would encourage parties to choose New York law and courts to govern commerce in digital assets, particularly those which function as electronic money or electronic notes, drafts, bills of exchange, or other electronic media. Encouragement of New York-based digital commerce would be expected to increase business revenues, professional service fees and incomes in New York, and, as a result, New York tax revenues, and possibly future tax revenues on digital transactions. New York's failure to enact the Amendments (combined with their enactment in other States) could be expected to reduce governmental revenues that might be derived from digital transactions, including UCC filing fees, court filing fees and entity incorporation fees.

Enactment of the Amendments would not impose any additional expense on New York governmental operations.

#### **E. The Emerging Technologies Amendments Have Been Carefully Vetted**

The study, drafting and vetting process that produced the Emerging Technologies Amendments was organized by the Uniform Law Commission ("ULC") and the American Law Institute ("ALI"), the sponsors of the Official Text of the UCC, which is the foundation for commercial and financial law throughout the U.S. The Amendments are a tailored version of the Emerging Technologies Amendments designed specifically for New York's UCC, which differs in some respects from the current Official Text of the UCC.

Using the Emerging Technologies Amendments as the basis for updating New York's law governing digital assets is the most prudent course of action. It will preserve overall consistency with the commercial law of the other States which have or are expected to adopt the Emerging Technologies Amendments. It is preferable to attempting to draft from scratch a new commercial or financial law limited to digital assets. Most importantly, it recognizes that the commercial law governing electronic transactions and digital assets does not require entirely new legal doctrines, policies or principles, but rather the extension and application of existing legal concepts used for paper-based transactions to transactions executed in electronic media or involving digital assets. No better alternative to the principles embodied in the UCC exists.

#### **F. Summary of This Report**

Section II is the City Bar's recommendation that the Amendments be enacted.

Section III describes the three-year drafting and vetting process that produced the Emerging Technologies Amendments. Six lawyers of the New York bar were leaders of this process, and innumerable other New Yorkers participated.

Section IV summarizes the significant improvements the Emerging Technologies Amendments make to the official text of the UCC.

Section V summarizes the dramatic improvements that enactment of the Amendments, based on the Emerging Technologies Amendments, would make available for New York commercial activity.

Appendix B provides a detailed description of the changes to each Article of the New York UCC (each of which is referred to herein as an “**Article**”) proposed by the Amendments, including, particularly, new Article 12 – Controllable Electronic Records, and the extensive amendments to Article 9 – Secured Transactions, as well as the transition rules for the effectiveness of the Amendments.

Appendix C contains the draft of the proposed amendments to New York’s UCC, tailored specifically to New York’s unique version of the UCC, enactment of which this Report endorses.

Finally, Appendix D describes the function and effect of the Comments to the Emerging Technologies Amendments and the New York Amendments and contains three New York comments to Article 12 of the Amendments, describing modifications of the Emerging Technologies Amendments to deal with issues unique to New York’s UCC.

## **II. CITY BAR RECOMMENDATION OF ENACTMENT OF THE AMENDMENTS**

The Emerging Technologies Amendments were drafted in the form of discrete amendments to the current Official Text of the UCC, rather than as a restatement of the UCC. New York’s current UCC was last updated in 2014 and departs from the current Official Text of the UCC in various respects. In order to preserve, where appropriate, New York’s non-uniform provisions,<sup>11</sup> the drafting committee of this Report, with the assistance of the ULC itself, prepared the Amendments, a modified version of the Emerging Technologies Amendments tailored specifically to New York’s UCC. These Amendments were designed to be proposed for enactment in New York. Appendix C consists of those Amendments. Appendix B, summarizes, article by article, the changes to the New York UCC that will be accomplished by enactment of the Amendments. Appendix B and the New York comments in Appendix D specifically identify the limited respects in which the Amendments need to contain unique New York-focused provisions not present in the ULC’s Emerging Technologies Amendments in order to preserve existing non-uniform New York law from inadvertent substantive change. Other than changes to the numbering or lettering of sections to conform to New York legislative drafting conventions, the changes to the Emerging Technologies Amendments made in Appendix C are located in Article 12, and are necessitated by New York’s adoption of ESRA rather than UETA and its strong policies protecting negotiability of instruments.

For all of the reasons stated in this Report, the City Bar has concluded that prompt enactment of the Amendments is vital to the best interests of New York. Enactment will make fully available to New Yorkers the benefits provided by the legal recognition and encouragement

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<sup>11</sup> *E.g.*, New York’s rules that are highly protective of negotiability, discussed in Section V.B.



of technological innovation in commerce and finance and will preserve and, hopefully, expand New York's status as a commercial, financial and legal capital.

### III. THE CAREFUL VETTING OF THE ULC'S EMERGING TECHNOLOGIES AMENDMENTS

The Official Text of the UCC is sponsored by the ALI and the ULC (“Sponsors”), the two pre-eminent organizations in the United States devoted to State-law legal reform and improvement.

*Evolution of Law Governing Electronic Records and Transactions.* During the past few decades, U.S commercial and financial law has increasingly recognized the value of electronic records and signatures. In 2000, New York was a leader among the States by its enactment of ESRA, providing, generally, for equivalent recognition of paper and electronic records and manual and electronic signatures. That same year, Congress enacted ESIGN,<sup>12</sup> and, in the following year, all States (other than New York) enacted ESIGN and UETA. Like ESRA, ESIGN and UETA provided for legal recognition of electronic records and signatures, but ESIGN's and UETA's introduction of the legal concept of an electronic “transferable record” made them preferable, in this regard, to ESRA. ESIGN and UETA provided that electronic promissory notes<sup>13</sup> could be negotiated by transfer of control and provided that a transferee of control obtained the rights of a holder (and potentially a holder in due course) without the need for delivery, possession or endorsement of a written instrument. They also created a safe-harbor that constituted control by definition; however, this safe harbor required use of technology that created an electronic record that is a single, identifiable, unique authoritative copy, not subject to unauthorized alteration (*i.e.*, the equivalent of an original record). That safe-harbor also required that the authoritative copy identify the person in control, that the authoritative copy be maintained by the person in control or its custodian, that copies which are non-authoritative be identifiable as such and that unauthorized revisions of the authoritative copy be readily evident. In short, UETA and ESIGN took the first steps<sup>14</sup> to analogizing control of an electronic record to possession of a written instrument.

Additional modifications were made to the Official Text of Articles 7 and 9, in 2000 and 2003, to recognize two other forms of digital assets: (i) electronic records evidencing chattel paper (2000) and (ii) electronic documents of title (2003). Those UCC amendments recognized that control of an electronic record (in the manner defined) was an effective method of making a transferee's rights in the record effective against third-parties. Thus, as of 2003, U.S. law recognized four specific types of electronic records as digital assets evidencing rights to payment

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<sup>12</sup> Pub. L. 106–229 (text)(PDF), 114 Stat. 464, enacted June 30, 2000, 15 U.S.C. Ch. 96.

<sup>13</sup> UETA and ESIGN limited transferable records to records which, if in writing, would be promissory notes under UCC Article 3, thus excluding from their coverage all other potential digital assets, including electronic negotiable instruments that are not notes, such as drafts and bills of exchange. In addition, ESIGN limited “transferable records” to such electronic notes secured by interests in real estate and utilized in interstate commerce.

<sup>14</sup> As discussed below, distributed ledger or blockchain technology does not satisfy the requirements for this safe-harbor, although it can be another reliable means of establishing control of a digital asset.

or property which could be transferred by change of control of the record: electronic letters of credit, electronic notes, electronic chattel paper and electronic documents of title.

In the past decade, digital distributed ledger technology has been utilized to develop cryptocurrencies and crypto-tokens. This technology enables an identifiable person to obtain control of an electronic record; however, it does not do so in conformity with the requirements in the Pre-Amendment statutory safe-harbors for electronic notes, electronic chattel paper and electronic documents of title, which include creation of a single “authoritative” copy. As a result, the applicable rules governing transfers of these new digital assets have yet to be specifically codified, creating commercial uncertainty. These digital assets are treated as general intangibles under Article 9.

In response to these and other technological developments, such as self-executing “smart contracts” and the “internet of things,” the UCC’s Sponsors in 2019 appointed a committee (“**Joint Committee**”)<sup>15</sup> to study whether more extensive and systematic changes to the UCC were advisable to facilitate the increasing use of electronic records and electronic signatures in commerce, as well as the technological and business evolution of new forms of digital assets.

Two conclusions of this study were that the UCC as currently drafted (i) with respect to the development of digital assets, is wedded to technologies from the end of the last century and does not adequately provide for the use of technology which has emerged in the past decade or which may evolve in the future; and (ii) does not adequately address the full extent to which commercial and financial transactions may be conducted and administered electronically and free from the constraints of paper documents. In short, the current UCC is not “technology-neutral” and is not yet fully “medium-neutral.”

Until corrected, these features of the UCC will interfere with improvements in efficiency, security and cost-reduction of transactions, will inhibit the optimal use of technology that would stimulate greater commercial activity and will frustrate the expectations of market participants who embrace such advancement. A guiding principle of the Joint Committee was to encourage rather than stifle innovation, by providing for the law to respect the decision-making of market-participants as to the best means to foster transactional efficiency, reliability and security.

To ensure the Joint Committee’s work-product would reflect the best thinking on the subjects to be addressed and would be fully and thoroughly vetted by affected parties, the Sponsors invited a large number of diverse potential stakeholders, including trade organizations, consumer advocates, financial institutions, technology companies, government agencies, bar associations and academicians to participate and opened participation as “observers” to anyone who expressed interest in the project. Approximately 350 individuals ultimately participated as “observers” of the Joint Committee. In addition, the American Bar Association appointed advisors to the Joint Committee who were active in the drafting process.

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<sup>15</sup> The Joint Committee was initially a study committee and, subsequently, a subset of the study committee was constituted as a drafting committee to prepare necessary amendments to the UCC to implement the study committee’s recommendations.

***Participation of the New York Bar.*** The members of the Joint Committee appointed by the Sponsors included six New York-admitted attorneys. Edwin (Ed) E. Smith, a Massachusetts-appointed Uniform Law Commissioner and member of the Task Force and the City Bar Committee on Commercial Law and Uniform State Laws, who practices law as a member of Morgan Lewis & Bockius LLP, chaired the Joint Committee. Other New York-based Joint Committee members were Sandra S. Stern of Nordquist & Stern PLLC, one of New York’s appointed Uniform Law Commissioners and a member of the City Bar Committee on Commercial Law and Uniform State Laws; Sylvia Chin of White & Case LLP; Professor Neil B. Cohen of Brooklyn Law School; Stephanie Heller of the New York Clearing House; and Sandra Rocks of Cleary Gottlieb Steen & Hamilton LLP. Ed Smith subsequently chaired the drafting committee and Sandra Stern and Sandra Rocks served as members of the drafting committee. In addition, a large number of New York observers participated in the drafting process, either individually or representing their organizations. Throughout the drafting process, Chair Ed Smith regularly reported to the Task Force and individual City Bar committees which were following the work of the Joint Committee.<sup>16</sup> The ULC maintained and can provide on request a complete list of the observers and other participants.

***Widespread Embrace of the Joint Committee’s Project.*** The work of the Joint Committee attracted extensive attention nationally and internationally.<sup>17</sup> After formation of the Joint Committee, at least eight States,<sup>18</sup> eager to establish pre-eminence in matters relating to blockchain, cryptocurrency and other new technological areas, adopted legislation based on early drafts, or portions of drafts, of the Joint Committee, providing for ownership of digital assets, or at least cryptocurrency, to be established by control and providing for good faith purchasers to take free of third-party claims. Several of these states, recognizing the value of the work done by the Joint Committee, also have expressed the intent to update their legislation to incorporate the final version of the Emerging Technologies Amendments. Similar bills are pending in other states, which desire to show leadership in the commercial law relating to emerging technologies.

***Joint Committee’s Process and Work Product.*** The Joint Committee prepared numerous drafts, with extensive explanatory Comments and Reporter’s Notes, for review and discussion in open public meetings. The drafts were circulated to all Joint Committee members and observers and were publicly-available on the ULC’s website throughout the process. Public participation in the three-year study and drafting process was enhanced by the fact that thirteen of the fifteen Joint Committee meetings were conducted virtually. Meetings were well-attended, often with more than 100 participants. In addition, the Joint Committee broke into a series of smaller working groups to which various UCC, technology and other experts and stakeholders were invited to give

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<sup>16</sup> Ms. Stern, Mr. Smith and Ms. Rocks are also members of the City Bar Commercial Law and Uniform State Laws Committee.

<sup>17</sup> *Digital Assets: Consulting Paper*, 256, LAW COMM’N, (2022), <https://protect-us.mimecast.com/s/FLpCCDkxvRFoOZkRfWt2ch?domain=s3-eu-west-2.amazonaws.com>. (All websites last visited February 1, 2023.)

<sup>18</sup> Arkansas, Idaho, Indiana, Iowa, Nebraska, New Hampshire, Texas and Utah. The District of Columbia has since proposed adoption of the Emerging Technologies Amendments, and Wyoming is now considering adoption of the Emerging Technologies Amendments to replace its existing digital asset legislation.

advice and guidance to the Joint Committee on selected issues. In particular, one of these groups of special interest to New York Commissioner Stern focused on consumer issues. The Joint Committee also received comments and advice from foreign experts who participated in the work of the Joint Committee with a view to coordinating law reform efforts in their own countries with those in the United States.

In addition, the Joint Committee's drafts were reviewed in detail twice before a Members' Consultative Group of the ALI, once before the Council of the ALI, once before the entire ALI membership, and twice before the entire ULC membership. The Joint Committee made presentations on its work to various stakeholder groups, including the American Bar Association, the Loan Trading and Syndication Association, the American College of Commercial Finance Lawyers, the Association of Commercial Finance Attorneys, the Task Force and various City Bar committees, and other organizations and groups. The Joint Committee worked closely as well with representatives of the American Bankers Association.

At its annual meeting the week of July 8, 2022, the ULC members representing each of the 50 States and the District of Columbia unanimously approved the Official Text of the Emerging Technologies Amendments, which is 120 pages long, accompanied by over a hundred pages of explanatory Official Comments and Reporter Notes. Thus, the ULC's Official Text of the UCC now incorporates the Emerging Technologies Amendments. This Report uses the term "**Pre-Amendment UCC**" to refer to the Official Text of the UCC immediately prior to the ULC's and ALI's approval of the Emerging Technologies Amendments.

The Task Force is unaware of any opposition to the substance of the Emerging Technologies Amendments from any quarter.

The expertise, analysis and care in drafting brought to this project has been unprecedented, as has the public participation and interest it has evoked and the scrutiny to which it has been subjected. By enacting the Amendments, New York State will obtain the benefit of the expertise and intensive efforts of the Joint Committee, as well as the vetting by potentially affected interested parties to which the Joint Committee subjected its work-product.

#### **IV. WHAT THE EMERGING TECHNOLOGIES AMENDMENTS ACCOMPLISH**

*Utility of Electronic Transactions in Commerce and Finance.* The use of electronic records and electronic signatures, in lieu of paper documents and manual "wet ink" signatures, originally authorized by ESRA, UETA and ESIGN, has reduced the cost, while increasing the speed, efficiency, ease and security, of commercial and financial transactions. Electronic transactions (such as online banking, cash machines, online shopping, electronic real estate closings and remote notarization) in many cases increase consumer satisfaction.<sup>19</sup>

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<sup>19</sup> See *A Financial System That Creates Economic Opportunities - Nonbank Financials, Fintech and Innovation*. U.S. DEP'T. OF TREASURY, (Jul. 2018), <https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation.pdf>. (Although focused on electronic real estate closings, the conclusions of this extensive report are equally valid for all forms of electronic transactions involving financing. That report (at pp. 100-110) recognizes the importance of laws authorizing electronic mortgage closings (which require electronic

Electronic records can be signed and authenticated remotely and transmitted instantaneously, and, with appropriate technology, provide greater security against forgery or alteration than paper writings. They can be created, maintained and transmitted in ways that minimize the need for clerical intermediaries and the risks of loss, theft, and misplacement of critical data or evidence. Digital platforms can provide real-time, conclusive evidence of ownership that is both more reliable and more convenient than manually-created data bases of post-closing filing, subject to delays and errors and which are cumbersome to search. Electronic transactions expand consumer financing activities and financial activity generally.

Electronic transactions can be documented, closed and administered by people with computers working in any location where they have internet access.<sup>20</sup> Application of artificial intelligence and “smart contracts” enables such records to be self-executing contracts in many respects. This, and the ability to associate vast amounts of searchable data with electronic transactional records, makes it possible for persons in control of such records to make business decisions necessary to administer transactions more efficiently.

The ability of technology to limit and identify the persons in control of electronic records creates the potential for what otherwise would be merely intangible legal obligations effectively to become a novel form of digital asset that is instantaneously negotiable via the internet.

The potential for electronic transactions to heighten efficiency and security in both the exchange of goods and services in commerce and in the financing of such commercial transactions cannot be overstated, but to achieve this the law must fully recognize and provide clear rules for the legal effect of such electronically documented transactions.

***Inadequacy of the Pre-Amendment UCC for Transactions Involving Digital Assets.*** The UCC, *inter alia*, establishes the rules for the transfer or negotiation of various forms of commercial or financial paper, including promissory notes, drafts and checks (Article 3), documents of title (Article 7) and chattel paper (Article 9). Documents of title evidence ownership of goods, and chattel paper evidences both a monetary obligation and a security interest in or lease of goods. The ability of lenders who act in good faith to obtain the rights of a holder in due course of such documents and paper is essential to enabling consumers to obtain financing for their purchases. The UCC provides that persons who purchase such documents and paper for value, in good faith and without notice of third-party claims, acquire their rights free and clear of third-party claims, including, under Section 9-331, rights of persons with prior perfected security interests in such documents. The UCC also provides some rules for the rights of persons in possession of money.

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mortgage notes and electronic notarizations) and the need for States to enact laws facilitating the use of electronic technologies for such transactions.)

<sup>20</sup> The COVID-19 pandemic made imperative the use of electronic legal tools to enable remote electronic transactions. See Eric Marcus, *Bringing Drafts into the Digital Age*, 49 UCC L.J. 373, text at fn. 30 (May 2020) (describing International Chamber of Commerce April 2020 call for emergency governmental action permitting electronic trade finance transactions). The pandemic was also the impetus in the State of New York for amendments to the Executive Law that made remote electronic notarization lawful, without which electronic real estate finance transactions are impossible. Dorothy Heyl and Alan Kolod, *Remote Notarization Is Here, Now: A Giant Step Forward for New York's Notary Laws*, N.Y.L.J. (Mar. 30, 2022).

The Pre-Amendment UCC, however, did not recognize electronic (non-paper) notes, drafts or checks. Because physical possession of paper negotiable instruments was required, it did not provide a means for a person who purchases an interest in such an electronic record to become a holder or holder in due course of the record. Thus, there was no provision for a person to become a holder of an electronic record that has the characteristics of a negotiable instrument. The Pre-Amendment UCC also did not expressly recognize that distributed ledger platforms accomplish control of an electronic record.

Under the Pre-Amendment UCC, electronic records evidencing payment rights in the form of electronic notes, drafts, cryptocurrency and crypto-tokens all fell within the definition of general intangibles. The Pre-Amendment Article 9 rules affecting the rights of transferees of general intangibles simply did not contemplate that such assets could be subject to publicly-verifiable electronic control and, therefore, required filing of a financing statement to provide public notice of the transfer of such intangible assets in many circumstances (whether intended as a transfer of ownership or a limited transfer to secure an obligation). To the extent those Pre-Amendment rules require the filing of such a financing statement to perfect a transfer of general intangibles, any transferee who acquires rights in such digital assets by acquiring control of the electronic record evidencing such property, nevertheless still would take its interest subordinate and subject to a prior transfer perfected only by a filed financing statement. Application of such a rule would frustrate the utility of controllable electronic records and defeat the reasonable expectations of purchasers of controllable electronic records, for no countervailing public benefit.

Under the Pre-Amendment UCC, the only exception to the foregoing rules applied to electronic letters of credit, electronic documents of title and electronic chattel paper. Although these records were also intangibles, technology had been developed that enabled an identifiable person to obtain exclusive control over electronic records evidencing such rights and that control was recognized to provide evidence of ownership equivalent to that provided by physical possession of documents. Although these Pre-Amendment UCC definitions of control of electronic documents of title and electronic chattel paper<sup>21</sup> arguably were broad enough to cover such distributed ledger platforms, those definitions did not apply to any other type of electronic record, such as electronic money or negotiable instruments, and the use of cryptocurrencies or crypto-tokens hosted on distributed ledger platforms to evidence even documents of title or chattel paper did not fall within the express safe-harbor provision for control.

The continued evolution of technology that developed since the modification of the UCC to recognize electronic documents of title and electronic chattel paper has made it possible to obtain exclusive control over all forms of electronic records. As a result, such asset classes are capable of functioning as money or negotiable instruments, despite the fact that they cannot be subjected to physical possession. A further consequence of this emerging technology is that it is unnecessary to give notice of a security interest in such types of controllable electronic records (via the old filing rules) in order to protect against the fraud of multiple transfers. Control of such

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<sup>21</sup> While this is true as to the Official Text of the Pre-Amendment UCC, it is not true of New York's current Article 9 treatment of control of electronic chattel paper. NY UCC Section 9-105, unlike the ULC's Official Text, remains limited to technology creating an identifiable single, authoritative, electronic record, which is not compatible with distributed ledger technology. For that reason, the NY-tailored Amendments would update and conform that section to the Official Text of Section 9-105.

electronic records by the purchaser is itself adequate protection. Continued application of the rules requiring, and granting priority to, filed financing statements both (i) imposes an unnecessary and inefficient burden on a purchaser of a controllable electronic record and (ii) deprives such purchasers who obtain control of such digital payment rights of the super-priority protection available to holders in due course of payment rights evidenced by paper instruments. In short, the current treatment of various electronic records as general intangibles, despite their being under the exclusive control of identifiable purchasers, impedes commerce and finance by imposing unnecessary expense, risk and uncertainty as to the rights of financing parties and purchasers. The creation of transparent and easily understood rules protecting such purchasers of digital assets will increase the availability of credit based on such digital assets to both consumers and businesses.<sup>22</sup>

***Inadequacy of the Pre-Amendment UCC for Transactions Involving Electronic Money.***

The Pre-Amendment UCC is in urgent need of updating to deal with digital assets that are legal tender or money. Section 1-201(24) of the Pre-Amendment UCC defines “money” broadly as a “medium of exchange *currently authorized* or adopted by a *foreign* or domestic *government*.” (italics added). This definition would appear to apply to any cryptocurrency that has been declared to be legal tender in any foreign country, but Pre-Amendment Article 9 excludes money from the definition of a general intangible in Section 9-102(42), and it provides in Sections 9-312(b)(3) and 9-313(a) that a security interest in money can be perfected *only* by possession. Thus, the Pre-Amendment UCC classifies as money (and not as a general intangible) all digital assets that are created as, or later become, legal tender but fails to provide any means to perfect a security interest in such digital assets, since they are not subject to physical possession, and the filing of a financing statement as to money has no legal effect.

However, the U.S., the European Union and numerous other countries (including Australia, China, Japan and the United Kingdom) are currently exploring the issuance of their own forms of electronic money (colloquially called “**Central Bank Digital Currency**” or “**CBDC**”), and several countries, including the Bahamas and Jamaica, have already issued a CBDC.<sup>23</sup> The Pre-Amendment UCC provides no means for a person actually holding such CBDC (rather than through an intermediary) to perfect its rights. Furthermore, in 2021, El Salvador and the Central African Republic adopted Bitcoin, a pre-existing cryptocurrency, as legal tender. Arguably, that

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<sup>22</sup> This has been demonstrated by the limited and discrete instances in which the rights of purchasers of control of specifically defined digital assets have already been recognized. These include the rights of purchasers of electronic records which qualify as (i) electronic documents of title under UCC Article 7 (ii) electronic chattel paper under UCC Article 9, (iii) electronic real estate mortgage notes under the federal E-SIGN act, which pre-empts the UCC, and (iv) electronic promissory notes which qualify as “transferable records” under the laws of the majority of States which have enacted UETA. UETA Section 16.

<sup>23</sup> See *What is a Central Bank Digital Currency?*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, (Jan. 20, 2022), <https://www.federalreserve.gov/faqs/what-is-a-central-bank-digital-currency.htm>; see generally, *What Are Central Bank Digital Currencies?*, WORLD ECONOMIC FORUM, (Aug. 31, 2022), <https://www.weforum.org/agenda/2022/08/what-are-central-bank-digital-currencies/>; see generally, *Fact Sheet: Treasury Report on the Future of Money and Payments*, U.S. DEP’T OF THE TREASURY, (Sept. 20, 2022), <https://home.treasury.gov/system/files/136/> <https://home.treasury.gov/system/files/136/FactSheet-Treasury-Report-Future-Money-Payments.pdf>; see generally, *Central Bank Digital Currency (CBDC)?*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, (June 10, 2022), <https://www.federalreserve.gov/cbdc-faqs.htm>.

caused what otherwise would have been a general intangible (rights in which could be perfected by filing a financing statement) suddenly to fall within the Pre-Amendment UCC definition of “money” (a change from its prior classification as a general intangible), as to which a financing statement has no effect.

El Salvador’s action arguably had the disruptive effect of causing certain security interests in Bitcoin granted to secured parties in the U.S. under the Pre-Amendment UCC to become unperfected. These security interests had been properly perfected by UCC filing, because Bitcoin had been a general intangible, until Bitcoin became legal tender in El Salvador, upon which Bitcoin arguably fell within the definition of money in the UCC, with no method for perfecting a security interest in it.

This situation is clearly untenable in two respects. Participants in U.S.-based secured transactions cannot be at risk that their security interests in an existing cryptocurrency may be rendered unperfected (and un-perfectible) by the adoption of that cryptocurrency as legal tender in any country in the world. Second, a new CBDC developed by any country, including the U.S., should not be rendered commercially defective by the inability of its users to perfect security interests in the U.S. This would impede commercial development of CBDCs.

***The Emerging Technologies Amendments Make the UCC Suitable for Transactions Involving Digital Assets, Including Electronic Money.*** The Emerging Technologies Amendments corrected these deficiencies in the Official Text of the UCC, and, therefore, enactment of the Emerging Technologies Amendments by a State will correct those deficiencies in that State’s UCC. The Emerging Technologies Amendments did so by enabling various electronic records, which are capable of being subjected to the control of identifiable persons, to function as a new form of intangible digital asset. Thus, new Article 12 utilizes the concept of a “controllable electronic record” to define the functional electronic equivalent of a single authentic original written instrument capable of being transferred by an identifiable controlling person to another controlling person and, thereby, potentially transferring rights to any other assets evidenced by that controllable electronic record. Essentially, “control” of such an electronic record is the equivalent of possession of the asset it evidences. This establishes the legal framework for the creation of digital assets, control of which can be transferred, thereby granting rights to the person who obtains control.

These concepts under the Emerging Technologies Amendments will apply to a myriad of digital assets which may be sold or used as collateral for financings, including Bitcoin or other cryptocurrencies, electronic money created by a government as legal tender, and crypto-tokens evidencing accounts, other payment rights or rights to other types of property.

The Emerging Technologies Amendments also fix the problems, described in the immediately prior subsection, relating to (i) cryptocurrencies that are subsequently adopted as legal tender by any country and (ii) electronic money or CBDCs that may be created in the future. The first, El Salvador-type, problem is fixed by a revision to the definition of “money” to exclude cryptocurrencies that were already media of exchange before being adopted as legal tender by a government. They would continue to be general intangibles and simply fall within the definition of “controllable electronic records” used in Articles 9 and 12. The broader problem of the potential disruption of the creation of new CBDCs is fixed by expressly defining “electronic money” and



providing for perfection of interests in it by control rather than possession, just as for controllable electronic records.

The definition of “control” used in the Emerging Technologies Amendments updates and supplements the more rudimentary definition of control currently used in ESIGN, UETA, UCC Section 9-105 for electronic chattel paper, and UCC Section 7-106 for electronic documents of title. The new definition does not require utilization of technology that creates and maintains a single authoritative original of an electronic record that is unique, identifiable and unalterable. Instead, it allows control to be established by any existing technology (such as distributed ledger platforms) or future technology which (a) gives to a person (i) the power to avail oneself of substantially all the benefit from the record; (ii) the exclusive power to prevent others from doing so; and (iii) the exclusive power to transfer control to another person, and (b) enables such person in control to readily identify itself as such. UCC Section 12-105.<sup>24</sup>

Furthermore, under the Emerging Technologies Amendments, if such controllable electronic records embody payment rights, whether accounts or payment intangibles, expressly agreed by the obligor to be due to the person in control of the electronic record, then those controllable accounts and controllable payment intangibles also are transferable by control of the controllable electronic record. Thus, transferees who are qualifying purchasers of the controllable electronic record are also, *ipso facto*, qualifying purchasers of the payment rights they evidence. Although the terms “electronic note” or “electronic draft” are not used in Article 12, a controllable electronic record evidencing a controllable account or controllable payment intangible may function as an electronic note or electronic draft, without the need to amend Article 3 to include them.

The Emerging Technologies Amendments also revise Article 9 (which provides the rules governing transfers of payment intangibles, accounts and property (other than non-fixture real estate) that secures repayment of obligations) to recognize that transfers of security interests in (as well as full ownership of) controllable electronic records can be effected and perfected by transfer of control, and that control has the same effect as would transfer of possession of a corresponding paper record. It both obviates the need for filing a financing statement and provides priority to the person in control over a person with a prior filed financing statement.

Thus (with the addition of Article 12 to the UCC and the corresponding modification of Articles 7 and 9 to apply Article 12’s definition of control to electronic documents of title and chattel paper in electronic form), the legal concepts underlying negotiability and holder in due course have been made applicable to all electronic records capable of being controlled, including electronic notes, bills of exchange and drafts, controllable accounts, controllable payment intangibles, and cryptocurrencies or crypto-tokens, in addition to the existing rules for electronic documents of title or chattel paper in electronic form. These are the new forms of negotiable property or digital assets, with their own rules to determine the rights of transferees, recognized by the Emerging Technologies Amendments. The statutory rights of persons in control of such

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<sup>24</sup> The new technology-neutral control provisions have been added to supplement the pre-existing control provisions in Articles 7 and 9 for electronic documents of title and electronic chattel paper, respectively, but the pre-existing control provisions are retained in those Articles so as to avoid any inadvertent disruption of existing financing programs utilizing such older technologies.

electronic records are analogous<sup>25</sup> to the rights of persons with physical possession of a single, authentic, original negotiable instrument or document.

**Regulatory Considerations.** It is important to note that the Emerging Technologies Amendments (and, consequently, the New York Amendments) concern only commercial law under the UCC and do not affect any existing or future local, State<sup>26</sup> or federal regulatory laws or regimes for the protection of the public interests that may be made applicable to digital assets, including consumer protection, equitable access to market opportunities, investor protection,<sup>27</sup> environmental protection,<sup>28</sup> anti-money laundering and related banking issues.<sup>29</sup> Neither the Emerging Technologies Amendments nor the Amendments endorse any particular technologies or digital assets nor the use of any such technologies or assets, but simply clarify ownership rights with respect to interests in digital assets. Similarly, the Amendments are not intended to determine characterization questions raised by regulatory or other non-UCC bodies of law, such as whether particular controllable electronic records are or should be deemed to be securities, commodities or instruments for the payment of money only for purposes of the securities or commodities laws or the New York Civil Practice Law and Rules.

**Additional Changes to the UCC Relating to Technology.** The Emerging Technologies Amendments clarify various choice of law rules (i) to preserve freedom of contract as to choice of law governing important aspects of rights in digital assets, (ii) to prevent inclusion of a choice of

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<sup>25</sup> Analogous, but not identical. A holder in due course of an Article 3 (paper) negotiable instrument takes free and clear of third-party claims *and defenses*, but a qualifying purchaser of a controllable electronic record embodying payment rights takes free of third-party claims but only takes free of defenses if the electronic record expressly so provides. Compare UCC Section 3-305(2) with Section 12-105; see also UCC Section 9-403.

<sup>26</sup> See New York State Bill A9275/S8343(2021-2022) (vetoed November 23, 2022), which would have established a New York State Crypto Currency and Blockchain Study Task Force. While recognizing the importance to a wide-variety of stake holders and constituencies, this legislation, with others, was vetoed because of concerns regarding unbudgeted costs, creation of staffing and programmatic burdens on state agencies, and duplication of work already being undertaken by state agencies and authorities.

<sup>27</sup> *Crypto Assets and Cyber Enforcement Actions*, U.S. SEC., <https://www.sec.gov/spotlight/cybersecurity-enforcement-actions>; see also, Gary Gensler, *Kennedy and Crypto*, U.S. SEC (Sept. 08, 2022), <https://www.sec.gov/news/speech/gensler-sec-speaks-090822>; see Also, Marisa Tashman Coppel, *Bankthink SEC's Regulatory Approach Chills Innovation And May Send Crypto Overseas*, AM. BANKER, (Sept. 14, 2022), <https://www.americanbanker.com/opinion/secs-regulatory-approach-chills-innovation-and-may-send-crypto-overseas>.

<sup>28</sup> The beneficial and detrimental environmental and energy implications of digital assets are complex. See *Fact Sheet: Climate and Energy Implications of Crypto-Assets in the United States*, WHITE HOUSE OFF. OF SCI. AND TECH. POLICY. (Sept. 08, 2022), <https://www.whitehouse.gov/ostp/news-updates/2022/09/08/fact-sheet-climate-and-energy-implications-of-crypto-assets-in-the-united-states/>. Not all digital assets have significant energy-consumption or environmental implications. The Amendments supply rules of ownership of all digital assets, and leave regulation of environmental and energy-consumption issues to appropriate legislative and regulatory bodies.

<sup>29</sup> *Virtual Currency Guidance*, N.Y. State Dep't of Financial Services, (Apr. 28, 2022), [https://www.dfs.ny.gov/industry\\_guidance/industry\\_letters/il20220428\\_guidance\\_use\\_blockchain\\_analytics](https://www.dfs.ny.gov/industry_guidance/industry_letters/il20220428_guidance_use_blockchain_analytics).

law provision in a negotiable instrument from impairing negotiability, and (iii) to specify what law applies to electronic transactions (which do not occur in a specific location) involving electronic records (which have no physical location) when the market participants fail to specify the controlling law. The Emerging Technologies Amendments also (i) render the entire UCC more medium-neutral than it had been as to paper versus electronic records and (ii) as to technology, render the UCC “technology neutral” as between pre-existing and future technologies. In particular, they (i) state the different rules for transferring intangible assets not subject to control from the rules applicable to transfers of intangible assets that are subject to control, *i.e.*, digital assets; (ii) facilitate the financing of digital assets by use of control rather than the filing of UCC financing statements; (iii) clarify the different rules for perfecting financing transactions involving tangible forms versus electronic forms of previously existing asset-types such as money, documents of title and chattel paper; (iv) provide that existing cryptocurrencies are not money as defined in the amendments but are negotiable digital assets; and (v) confirm the existing commercial practice and legal effect of treating digital assets held through an intermediary as financial assets credited to a securities account, transfers of which may be perfected by control under Article 8.

## **V. WHY ENACTMENT OF THE AMENDMENTS IS ESSENTIAL FOR NEW YORK**

### **A. If New York Fails to Enact the Amendments, the Law of Any State that Does Enact Them Will Be Preferred by Purchasers of Digital Assets.**

New York does not impose duties of objective due care or investigation on transferees of paper negotiable instruments or documents of title who act in good faith.<sup>30</sup> This encourages financings and other commercial transactions by protecting the rights of purchasers so long as they act honestly. For that reason, New York is often the preferred jurisdiction to govern commercial financings involving paper negotiable instruments and documents of title.

This preference does not, however, extend to New York law in the case of financings or securitizations involving digital assets. This is because New York’s commercial law, including ESRA and Article 9, currently does not adequately deal with electronic negotiable instruments or electronic chattel paper utilizing distributed ledger technology. Most significantly, New York does not recognize control of an electronic negotiable instrument as the equivalent of possession for purposes of holder in due course status.<sup>31</sup> New York’s UCC (i) provides no safe-harbor for transferees of electronic documents of title that utilize distributed ledger technology; (ii) requires financing statements to be filed to perfect transfers of cryptocurrencies and crypto-tokens (unless they are treated as investment property held in a securities account); and (iii) determines the priority of the rights of transferees of such cryptocurrencies and crypto-tokens based on the order of filing of UCC financing statements. New York’s ESRA does not grant the protections for electronic records provided by that act to any electronic negotiable instrument on a distributed

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<sup>30</sup> See Section V(B), below.

<sup>31</sup> See Eric Marcus, *Bringing Drafts into the Digital Age*, 49 No. 2 UCC L.J. 373, at 376 (May 2020) (Eric Marcus’ excellent discussion of relevant issues under New York law).

ledger platform. N.Y. State Tech. Law Section 307.2.<sup>32</sup> In short, New York law is currently deficient as compared to that of other States in that (i) it does not recognize persons in control of electronic promissory notes as holders or holders in due course (which other States accomplish through UETA), (ii) it does not recognize persons in control of cryptocurrencies or crypto-tokens (unless they are treated as investment property held in a securities account) as holders of a perfected security interest or ownership interest (which some other States have accomplished by means of non-uniform legislation), and (iii) its non-uniform version of Section 9-105 does not recognize chattel paper created utilizing digital ledger technology (which is recognized by most other States, which previously adopted the official text of UCC Section 9-105).<sup>33</sup>

Unless New York adopts the Amendments, none of the above issues will be corrected, and the situation will become even more dire for New York. This is because the law of every State that does adopt the Emerging Technologies Amendments<sup>34</sup> will have corrected the above-described issues and will also become vastly preferable to New York law in other respects.

If New York fails to enact the Amendments, New York law will continue to incorrectly classify Bitcoin (and potentially other cryptocurrencies in the future) as money, rather than as controllable electronic records. New York law will continue to fail to provide any means for perfection of security interests in existing or future digital assets that are legal tender. This matters because secured parties frequently take security interests in all of a debtor's assets, tangible and intangible, including electronic records. Thus, even financing parties who look to the security of a debtor's digital assets only as secondary supplemental collateral will have reason to avoid New York law and venue. And purchasers and financiers who are looking *primarily* to the value of digital assets will have no choice but to avoid New York. Furthermore, the Emerging Technologies Amendments of other states will expressly permit such financing parties and purchasers to opt out of New York law and venue, and to select the law of States which enact the Emerging Technologies Amendments as the governing law, without any risk that a court might

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<sup>32</sup> Electronic negotiable instruments and documents of title are excluded from all protections provided by ESRA, including court admissibility, unless they are created and maintained on a system that permits a "unique, identifiable and unalterable version which cannot be copied except in a form that is readily identifiable as a copy." N.Y. State Tech. Law Section 307.2. This exclusion of distributed ledger platforms was corrected as to electronic documents of title by N.Y. UCC Section 7-103(d) but not as to electronic negotiable instruments.

<sup>33</sup> Clause (i) of the quoted text describes one of the differences between ESRA and UETA, which is more fully described in note 8 above. Clause (ii) refers to non-uniform provisions which have been adopted in those states eager to attract crypto-currency and crypto-token investors. New York has not adopted such laws, but the 2022 UCC Amendments will deal with these issues and provide an even playing field. Clause (iii) refers to New York's non-uniform implementation of 9-105, which provides the method for control of electronic chattel paper. Although the official text of 9-105 does not require one unique version of the electronic chattel paper, New York omitted one sentence of the original text and as a result New York does require one unique version. The Task Force is unable to explain the reason for this difference, and it may possibly have been an oversight. It is difficult to assume there was a policy reason because New York's 7-106, which provides the method for control of electronic documents of title, follows the UCC original text and does not require one unique version.

<sup>34</sup> As of the date of this Report, at least 16 States and the District of Columbia have introduced a bill on the Emerging Technologies Amendments.

find that such a choice of law or forum selection provision impairs negotiability.<sup>35</sup> If such a shift away from New York occurs, it may be irreversible.

New York law in its current form cannot feasibly be used to govern the ever-increasing number of financings and securitizations involving digital assets. If New York does not enact the Amendments, purchasers of digital assets, particularly those who affirmatively select the law of other States or foreign law, can be expected to avoid any New York connections with those digital assets that might expose them to being involuntarily subjected to New York law and to risk loss of negotiability of those assets under present New York law. This would not bode well for New York's status as a commercial and financial capital.

**B. When New York Enacts the Amendments, Its Policies Protecting Good Faith Purchasers as Holders In Due Course Will Make New York the Preferred Governing Jurisdiction and Venue for Digital Asset Transactions.**

Enactment of the Amendments would dramatically improve the situation and make New York law a highly desirable choice of law for transactions involving digital assets. Section 12-104(e) of the Amendments, in essence, provides qualifying purchasers the equivalent of holder in due course protection against property claims of third-parties with respect to controllable electronic records, controllable accounts and controllable payment intangibles, and Section 12-102(a)(2) defines a qualifying purchaser as a purchaser who obtains control for value, in good faith and without notice of a claim of a property right. First, New York's general definition in NY UCC Section 1-201(b)(20) of "good faith" as honesty in fact would apply to a qualifying purchaser. Second, Section 12-102(a)(2) of the Amendments makes clear that New York's UCC Section 3-304(7), specifying that notice of a claim requires the purchaser to have knowledge of the claim or knowledge of such facts as to render his action bad faith, would protect the qualifying purchaser of any controllable electronic record that would be an instrument under Article 3 if in writing. These rules would make New York law highly protective of the rights of a qualifying purchaser. Third, the Amendments would explicitly provide that inclusion of a New York choice of law clause would not impair holder in due course or qualifying purchaser status, with respect to digital assets. This is consistent with New York's policy embodied in General Obligations Law Section 5-1401 and 5-1402 of encouraging and respecting choice of New York law and venue with regard to significant transactions, regardless of contacts with New York. As a result, choice of New York law and venue would be highly attractive to purchasers of digital assets.

In addition, enactment of the Amendments would ameliorate the potential negative consequences of New York's position as the only State that has enacted ESRA rather than UETA. As noted above, ESRA does not have the provision in UETA recognizing that electronic notes are transferable records transferable by control and fully protecting the rights of purchasers of such records who obtain control. Sections 12-102(a)(3) and 12-103(c) of the Amendments ensure that Section 307.2 of ESRA does not (i) deprive electronic notes or drafts of the enforceability

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<sup>35</sup> New York UCC Section 3-112 contains a list of provisions not affecting negotiability, but the list does not specify choice of law or choice of forum provisions, creating uncertainty as to whether such a provision might impair negotiability. See, Eric Marcus, Eric Marcus, *Bringing Drafts into the Digital Age*, 49 No. 2 UCC L.J. 373, cited in fn. 30. Sections 3-112(I)(h) and (i) and 12-102(a)(2) of the Amendments correct this Section.

protections of ESRA merely because control is established by use of a distributed ledger platform or (ii) subject such records to Article 3 rather than Article 12 because they would have been negotiable instruments had they been in writing. (*See* Appendix E discussion of New York Comments on the Amendments).

Finally, the Amendments' functional definition of controllable electronic records and definition of control, which cover both existing methods of establishing control and any future methods which are effective to do so, open the door to both the evolution of new technologies and to new commercial and financial applications which may give rise to new types of digital assets and new digital transactions.

## VI. CONCLUSION

In sum, enactment of the Amendments would preserve the desirable unique features of New York's existing UCC and also provide New York with all the advantages of the Emerging Technologies Amendments to the UCC described, above, in Section IV.

These include:

- Providing for perfection of interests in electronic money by control and preventing misclassification of cryptocurrencies that were not originally legal tender as money, thereby rendering security interests in them incapable of being perfected;
- Facilitating commercial transactions under New York law involving existing and future digital assets, by protecting the rights of purchasers of such assets, and thereby encouraging innovation and increased commerce;
- Making the New York UCC more technologically neutral, by utilizing definitions of control and controllable electronic records that will cover both existing and future technologies;
- Defining controllable electronic records to cover electronic notes, electronic drafts, cryptocurrencies,<sup>36</sup> crypto-tokens and other digital assets that may be developed in the future;

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<sup>36</sup> The Amendments do not endorse or encourage the use of cryptocurrencies or any other form of digital asset, nor do they address any regulatory restraints outside the scope of the UCC to which any type of digital assets might or should be subjected to protect society generally or any segment of society. The actual commercial, investment and societal utility of digital assets, such as cryptocurrencies, ultimately will be determined by market participants, subject to such appropriate financial, investor, environmental and other regulatory protections and constraints. But to the extent any digital assets prove to have utility, the Amendments clarify the laws governing the rights of purchasers of such digital assets and the means of using them to secure financings. This will encourage continued development and experimentation by eliminating unnecessary uncertainty and business risk for good faith purchasers and financing parties of such digital assets.

- Recognizing the potential of good faith purchasers of many such digital assets to become “qualifying purchasers” with protections similar to holder in due course status applicable to purchasers of paper instruments and documents;
- Freeing purchasers (including secured parties) who obtain control of such digital assets from the need to file financing statements to protect their interests and protecting them from risk of challenge by third-parties with prior-filed financing statements covering such assets;
- Providing a practical rule for determining which state’s UCC will apply to transactions in digital assets that respects freedom of contract and eliminates uncertainty;
- Eliminating numerous other impediments to the use of digital assets, electronic records and electronic signatures in commerce and finance.

The technological and business advances these legal changes permit should decrease transactional costs and enhance the efficiency, certainty and security of commercial and financial transactions governed by New York law. This will encourage commercial and financial expansion based on evolving technology. As financial instruments continue to evolve from paper to electronic format, these changes to New York law are essential to New York’s maintaining its status as a legal, commercial and financial capital. Enactment of the Amendments will help ensure New York’s leadership in commercial and financial progress and growth, and will prevent migration of digital commerce to other U.S. jurisdictions which move more quickly to embrace the Emerging Technologies Amendments.

With all of these features, including New York’s strong protections of purchasers of financial instruments who act in good faith, New York might well become the preferred jurisdiction for financings involving digital assets when it adopts the Amendments. If it fails to adopt the Amendments, New York will jeopardize its status as a commercial and financial capital.

## Appendix A

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Commercial Law & Uniform State Laws Committee  
Compliance Committee  
Consumer Affairs Committee  
Copyright & Literary Property Committee  
Corporation Law Committee  
Criminal Law Committee

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Emerging Companies and Venture Capital Committee  
Energy Committee  
Entertainment Law Committee  
Environmental Law Committee  
Foreign & Comparative Law Committee  
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Hospitality Law Committee  
In-House Counsel Committee  
Insurance Law Committee  
Intellectual Property, Council on  
International Commercial Disputes Committee  
International Environmental Law Committee  
International Law Committee  
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Litigation Committee  
Mergers, Acquisitions & Corporate Control Contests Committee  
Personal Income Taxation Committee  
Private Investments Funds Committee  
Project Finance Committee  
Public Finance Committee  
Science & Law Committee  
Securities Litigation Committee  
Securities Regulation Committee  
State & Local Taxation Committee  
Structured Finance Committee  
Taxation of Business Entities Committee  
Technology, Cyber and Privacy Law Committee  
Trademarks & Unfair Competition Committee  
Trade Secrets Committee  
Transportation Committee  
Trusts, Estates & Surrogate's Courts Committee  
White Collar Crime Committee

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## Appendix B

### ARTICLE-BY-ARTICLE SUMMARY OF CHANGES TO NEW YORK LAW

The following subsections summarize more specifically the changes the Amendments make to each Article of the New York UCC. For this purpose, new Article 12 is summarized first and out of numerical sequence. This is because it is entirely new and contains new concepts that are important throughout the UCC and drive many of the changes to other Articles. These new concepts include definitions of controllable electronic assets and control; the identification of controllable accounts and controllable payment intangibles; and the rule providing the “qualifying purchaser” equivalent of holder in due course status for good faith purchasers of controllable electronic records, controllable accounts and controllable payment intangibles.

#### **A. Article 12 (Controllable Electronic Records)**

Overview. New Article 12 is the centerpiece of the Emerging Technologies Amendments to the UCC and, therefore, of the proposed New York Amendments. Article 12 establishes standards for obtaining and transferring legal ownership and rights with respect to a novel electronic form of property, the existence of which has been made possible by modern technology only recently: “controllable electronic records.” This is a new subclass of intangible property, which can function, and be transferred, like paper negotiable instruments, documents of title, securities or currency.

#### ***Recognition of Controllable Electronic Records as Intangible Property***

The oldest and best-known examples of this asset-type are electronic notes, electronic documents of title and electronic chattel paper, which obtained legal recognition in the early 2000’s in ESIGN, UETA and amendments to Articles 7 and 9, respectively, as the first electronic records designed to be subject to control by the creation, essentially, of the electronic equivalent of an identifiable unique original. In the past decade, virtual currencies or cryptocurrencies, such as Bitcoin, and, more recently, crypto-tokens using the Ethereum platform have arisen. These use distributed ledger technology as an alternative means to achieve the same goal of control, without the creation of a single identifiable “original.” These developments are perceived to have enormous present, and even greater future potential, utility.<sup>1</sup>

As technology evolves, and validation methods<sup>2</sup> continue to develop, the utility of controllable electronic records in commerce and finance will become increasingly important.

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<sup>1</sup> The creation of crypto-tokens, such as those utilizing the Ethereum 2.0 platform, whose value is not as volatile as pure cryptocurrencies because it is tied to other assets and which rely on “proof of stake” validation, rather than the environmentally unfriendly “proof of work” validation method, illustrates the value of encouraging technological development of digital assets.

<sup>2</sup> Permissioned distributed ledger platforms and “proof of stake” validation appear to hold particular promise. *See, Cryptocurrencies: Looking Beyond the Hype, Bank for International Settlements*, (June 17, 2018), [www.bis.org/publ/arpdf/ar2018e5.htm](http://www.bis.org/publ/arpdf/ar2018e5.htm), text at fn 28; *see also*, Karl Montevirgen, *Proof-of-Work vs. Proof-of-Stake: Comparing Two Blockchain Verification Types*, BRITANNICA MONEY, (Sept. 22, 2022), <https://www.britannica.com/money/proof-of-work-vs-proof-of-stake>; *see also*, *Proof of Stake vs. Proof of Work: Differences & Functions*, LEARN BYBIT, (Nov. 25, 2020), [B-1](https://learn.bybit.com/blockchain/proof-</a></p></div><div data-bbox=)

Controllable electronic records have all the characteristics that made currency and paper instruments so crucial to commerce, but they are even more useful because they provide even greater security as to authenticity and transmissibility than paper records. Technology precludes alteration, counterfeiting, duplication and “double-spending” of such electronic records. They also permit the creation and instantaneous and secure transfer by an identifiable person(s) of control to another person, from one computer to another anywhere in the world, enabling commerce and finance to occur under virtually any circumstances. (*See* fn. 19, above.)

### ***Use of Concept of Control to Determine Rights to Controllable Records***

Article 12 utilizes the existence of these features of *de facto* technological “control” over electronic records to construct a regime of legal rights with respect to such records. This regime builds on the analogy of the rights of ownership of traditional money, negotiable instruments and certificated securities that arise from (i) *possession* of tangible coins and paper fiat currency, (ii) *possession* of negotiable paper instruments under existing Article 3, and (iii) *possession* or *control* of tangible title documents, certificated securities and tangible chattel paper under existing Articles 7, 8 and 9.

Enactment of the Amendments, including Article 12, will transform *de facto* control of a controllable electronic record into legal rights enforceable by courts. This should minimize legal uncertainty as to ownership and prevent unnecessary uncertainty from impairing the future use and development of controllable electronic records as digital property. Enactment of the Section 12-105 rule of control (which is also duplicated in Sections 7-106(c), 9-105(c), and 9-105A, for electronic documents of title, electronic chattel paper and electronic money, respectively) would minimize unnecessary obstacles to investment in and financing of controllable electronic records.

Because the amendments to Articles 7 and 9 concerning control of electronic documents of title, electronic chattel paper and electronic money have their own definition of control and specify the legal rights of a purchaser of such control, those particular digital assets are excluded from the application of Article 12. Similarly, electronic “transferable records,” under ESIGN, which otherwise would fall within the definition of controllable electronic records under Article 12, are excluded from that Article because ESIGN provides its own governing rules. Section 12-102(a)(3) of the New York Amendments departs slightly from the wording of the Emerging Technologies Amendments. This is necessary because the Emerging Technologies Amendments Section 12-102(a)(3)(B) presumes that an enacting State will have enacted UETA and, therefore, would exclude from Article 12 any electronic record that provides that it is a “transferable record” under UETA. New York’s ESRA, however, has no concept of or governing rules for “transferable records” and, instead, would subject to Article 3 any electronic record that has the terms of a negotiable instrument and is the single, identifiable, unalterable, authentic electronic original, and, as a result, if such an electronic record failed to satisfy the requirement of authenticity, it would be excluded from the benefits of ESRA. To avoid these undesirable outcomes, Section 12-102(a)(3)(B) excludes an electronic record identified as a “transferable

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of-stake-vs-proof-of-work-differences/; *see also*, David Rosenthal, *EE380 Talk February 2022 Stanford Lecture*, DSHR’s BLOG, (Feb. 09, 2022) at [blog.dshr.org/2022/02/ee380-talk.html](http://blog.dshr.org/2022/02/ee380-talk.html).

record” under UETA only if that record would actually be governed by UETA, and Section 12-103(c) protects a controllable electronic record under Article 12 and prevents ESRA (absent express intention of the issuer) from subjecting any newly created controllable electronic record to Article 3 rather than Article 12.<sup>3</sup>

Finally, the Amendments correct the deficiencies of ESRA discussed in the Report at Point V, above, which are unique to New York. The Amendments contain a provision not found in the Emerging Technologies Amendments, which provides that N.Y. State Tech. Law Section 307.2 (which excludes from the protections of ESRA certain electronic records which, if in writing, would be negotiable instruments) does not apply to any negotiable instrument that satisfies the definition of a controllable electronic record in Article 12. As a result, all electronic records that are controllable, whether by virtue of distributed ledger technology or any other future technology, have the benefits of ESRA recognition even if such technology does not satisfy the older technology described in ESRA Section 307.2.<sup>4</sup>

### ***Recognition of Controllable Accounts and Controllable Payment Intangibles***

Article 12 utilizes the concept of control to convert what otherwise would be merely a general intangible, a controllable electronic record, into a unique asset class, which encompasses cryptocurrencies, in order to specify the rights of person who purchases and obtains control of such electronic record. Article 12, however, goes further. If an account or payment intangible is evidenced by a controllable electronic record by which the obligor has agreed to pay only the person in control of that electronic record, then the right to payment itself is tethered to, and transferable by transfer of control of, the electronic record. The payment right, as well as the electronic record that evidences it, is no longer merely an intangible, transfers of which must be evidenced or perfected by a UCC filing.

As explained below in subsection I, the terms “controllable account” and “controllable payment intangible,” and the means of control of such asset classes, are defined in Article 9 by reference to the rules set out in Section 12-105 concerning the controllable electronic records which evidence them.

In this regard, Article 12 not only governs rights arising from a transfer of control of, and with respect to, controllable electronic records, but it also governs the rights of ownership of accounts and payment intangibles evidenced by (and therefore “tethered” to) such controllable electronic records. These are newly defined (in Article 9) as “controllable accounts” and

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<sup>3</sup> This exception to Section 12-103(c) protects participants in pre-Amendment digital asset programs that were designed to rely on ESRA and Article 3.

<sup>4</sup> ESRA, N.Y. State Tech. Law Section 307.2 arguably would exclude digital assets that are electronic documents of title and electronic negotiable instruments on distributed ledger platforms from legal recognition for any purpose. NY UCC Section 7-103(d) already protects such electronic documents of title from that exclusion. Article 12 of the Amendments, particularly Section 12-103(c), would now protect controllable electronic records that evidence controllable payment intangibles and controllable accounts from exclusion despite their inability to satisfy the condition of Section 307.2 of ESRA.

“controllable payment intangibles,” and are assets of persons in control of electronic records evidencing the promise of an obligor to make payment to the person in control of such records.

***Negotiability of Controllable Electronic Records, Controllable Accounts and Controllable Payment Intangibles***

With respect to controllable electronic records, controllable accounts and controllable payment intangibles, Article 12 uses the analogy of negotiable instruments payable to bearer. A negotiable instrument payable to bearer is a writing by which an obligor has promised to make payment to the person in possession of the writing who presents it for payment in accordance with its terms. When an obligor promises in a controllable electronic record (rather than a writing) to make payment of an obligation to the person in control of that controllable electronic record, then the electronic record, in essence, has itself become a kind of “bearer” electronic instrument, similar to a right to payment evidenced by a writing. It is then appropriate to apply the same concepts, such as the “shelter” principle and “take-free” rights of negotiability, which apply to negotiable instruments, to such controllable electronic records and the payment rights they evidence.

Article 12 does exactly that in Section 12-104(a), (d) and (e). A purchaser of a controllable electronic record that evidences a controllable account or controllable payment intangible acquires the rights of the transferee *in both* the record and the payment right. A qualifying purchaser of the controllable electronic record, in addition, acquires its rights *in both* the record and the payment rights free of third-party property rights. A qualifying purchaser under Article 12 is a person, similar to a holder in due course of a negotiable instrument under Article 3 or a protected purchaser of a security under Article 8, who takes control (i) for value, (ii) in good faith, and (iii) without notice of third-party rights. In addition, because New York’s Article 3 has a unique provision (Section 3-304(7)) clarifying what constitutes notice of a defense or adverse claim to a negotiable instrument, the New York Amendments have a special Section 12-102(a)(2) which expressly preserves application of Section 3-304(7) to notice of an adverse claim to a controllable payment intangible or controllable account which would be a negotiable instrument if in writing.

Controllable electronic records also include digital assets or crypto-tokens that may evidence, if certain conditions are met, ownership or rights (other than accounts or payment intangibles) with respect to other types of property, such as rights to receive contractual performance or rights to real estate, goods or intangibles such as copyrighted images. This use of controllable electronic records purportedly governing Article 12 to evidence the rights of persons in control of such records to other forms of property identified in such electronic records may greatly reduce the costs of transfers of the referenced property and to enhance both its liquidity and the certainty and security of transfers of such referenced property.

The take-free rule just described, with one important exception described below, does not apply to other rights that might purport to be evidenced by a controllable electronic record. Such other rights might, for example, consist of rights to securities, real estate interests or intellectual property. Whether the transferee of the controllable record also took rights in the property evidenced by the record free of adverse claims would be determined under the law governing transfers of rights in such types of property. The one important exception relates to controllable accounts and controllable payment intangibles. A transferee of a controllable electronic record who takes free of competing property claims to that controllable electronic record also takes free

of competing property claims to any controllable account or controllable payment intangible evidenced by that controllable electronic record.

Thus, for example, the rights of a purchaser of a digital asset that is an electronic document of title, electronic chattel paper or an electronic mortgage note under ESIGN, would not be controlled in any respect by Article 12 because Article 12, Section 12-102 expressly excludes them since other UCC articles or laws address them. With respect to a controllable electronic record purporting to grant rights in a work of art or parcel of real estate, Article 12 would specify the rights of the purchaser of such electronic record, but the rules of intellectual property or real estate law would determine what interest the purchaser acquired in any work of art or parcel of real estate referenced in such electronic record. Purchasers of controllable electronic records do not obtain the benefit of the take-free rule of Article 12 as to their rights in the property evidenced by the record, unless either those rights are controllable accounts or controllable payment intangibles or that other applicable law as to such property so provides for the take free rights to apply. However, the door is opened for intellectual property or real estate law to utilize the benefits of digital assets to reduce transactions costs and make transfers more secure in order to facilitate the liquidity of such assets.

### ***Updating of Concept of Control to Permit Technological and Business Advances***

Most importantly, the new concept of control of a controllable electronic record used in Article 12 supplements the more rudimentary concept of control of electronic records currently in New York's Articles 7 and 9, applicable to electronic documents of title and electronic chattel paper, and in ESIGN and UETA, applicable to electronic promissory notes.

Section 12-105 provides a functional concept of control involving an electronic record that (a) gives to a person (i) the power to avail oneself of substantially all the benefit from the record; (ii) the exclusive power to prevent others from doing so; and (iii) the exclusive power to transfer control to another person and (b) enables such person in control to readily identify itself as such. The present concept of control in New York's safe-harbors for electronic documents of title and electronic chattel paper, in contrast with this new concept, requires the use of technology that creates, maintains and transfers a single identifiable "authentic" original of an electronic record. This older, more rudimentary concept, which is based on the definition of a "transferable record" found in UETA and ESIGN, is wedded to technology developed at the end of the last century. Article 12 (rather than requiring technology that creates a single "authoritative" or "authentic" original electronic record) uses a functional definition of control that provides the flexibility to accommodate new forms of technology, so long as the purposes of control specified in Section 12-105 are achieved. The Reporter's Prefatory Note to the Emerging Technologies Amendments captures this by stating that Article 12 "aspires" to apply to controllable electronic assets that may be created using technology that does not currently exist.

### ***Consumer Protection***

Section 12-106 contains numerous consumer protection rules for account debtors. Most essential, an account debtor cannot be obligated to pay a person in control of a controllable electronic account or controllable payment intangible unless such obligor agrees to do so and has agreed to the nature of the evidence of control that is acceptable. Secondly, an obligor is protected



in paying the original obligee unless she receives notice to pay another person that complies with stringent requirements, including the provision of detailed evidence of the person in control and specification of a commercially reasonable method for payment. Absent compliance, the account debtor is protected in paying any person formerly in control, including the original obligee. Furthermore, the obligor cannot be required to divide or make multiple payments or pay by more than one method.

The Amendments also incorporate in Section 12-103 the general principle that a transaction subject to Article 12 is subject to all applicable rules of law that establish a different rule for consumers, credit regulations and any other consumer-protection statutes or regulations. The enhanced definition of “conspicuous,” discussed below in subsection B, is also protective of consumers.

### ***Choice of Law***

Finally, Article 12 provides for controllable electronic records a clear and certain choice of law rule governing control and the rights that flow from control. It rejects as unfeasible any choice of law rule for control based on the location of the transferor or transferee, and gives primacy to the law specified by the parties to the subject record. It also provides certainty and uniformity in those cases where the parties fail to specify applicable law in the record itself. Section 12-107 sets out a “waterfall” to determine the controllable electronic record’s jurisdiction, looking first to the law specified in the controllable electronic record or a record associated with the controllable electronic record, then to the law specified in the rules of the system in which the controllable record is recorded, and, in default of any of the those, to the law of the District of Columbia, or, if the District of Columbia has not enacted the Official Text of Article 12 without substantial modification, finally, to the Official Text of Article 12. There is every expectation that the District of Columbia will adopt the Emerging Technologies Amendments, given its historic embrace of the work of the ULC and the fact that those amendments are already under consideration for adoption.

### **B. Article I (General Provisions)**

Overview. Article I contains general provisions and definitions applicable to all Articles of the UCC. Consistent with the primary purpose of the Emerging Technologies Amendments to make existing rules of commercial law applicable to transactions involving digital technology and related business practices that have evolved since the UCC was last revised or that may evolve in the future, the Amendments include new key definitions and concepts and modify existing definitions to make them more compatible with the Amendments to other Articles. In particular, the new definitions are essential to Article 12’s recognition of the new asset-type “controllable electronic records.” The Amendments define the term “electronic” and modify, to accommodate new electronic technology and business developments, the definitions of “sign” (as in signature), “holder,” “conspicuous” and “person.” In addition, to distinguish between electronic money created as legal tender, for which new rules for perfection by control are added to Article 9, and controllable electronic records which are subsequently designated as legal tender by a government, but are to continue to be classified as general intangibles rather than as money for Article 9 purposes, the definition of “money” is restricted to exclude electronic records that are recorded and transferable in a system that existed and operated before adoption as legal tender.

With respect to the definition of “conspicuous” (a term relevant to disclaimers of warranties in connection with the sale or lease of goods (Sections 2-316(2) and 2A-214 and 303), “full payment” checks (Section 3-311) and transfer restrictions for certificated securities (Section 8-204(a)), the court is charged with determining whether, “based on the totality of the circumstances,” a reasonable person against which it is to operate ought to have noticed the particular provision (Section 1-201(b)(10)). In the case of an electronic record, the totality of circumstances will include the technology used to display the term and the Official Comments provide further guidance as to the evaluation of such circumstances.

### **C. Article 2 (Sale of Goods) and Article 2-A (Leases)**

Overview. The primary Amendments relevant to New York’s Articles 2 and 2-A of the UCC recognize “hybrid” transactions and provide a new rule for determining the applicable law for such transactions. A hybrid transaction, in essence, is a single transaction involving either (i) both a sale of goods and a lease of other goods or (ii) (a) the sale or lease of goods and (b) the provision of services or property other than goods. Section 2-106(5); 2-A-103(1)(h.1). The amendments to Articles 2 and 2-A mirror each other in dealing with such hybrid sale or lease of goods transactions.

Hybrid transactions are not limited to transactions involving new technology, but such new technology is a major reason for the continuing increase in the volume of hybrid transactions. The incorporation of software into goods, and the development of goods that require connection to the “internet of things,” increasingly require that agreements for the sale or lease of goods also address issues concerning provision of technological services, cloud services, software updates or similar technology-related matters. As the number of hybrid transactions involving both goods and software or intellectual property licenses increases, these amendments will be increasingly important.

#### ***Determining the Law Applicable to Hybrid Transactions***

The Amendments clarify what body of law supplies the rules governing issues that may arise under, but have not been specifically dealt with in, the governing agreement, when a single contract governs several different aspects of a transaction, each of which aspect has its own body of controlling law. A contract governing such hybrid transactions frequently fails to clearly specify the rules, or even what body of law would supply specific rules, applicable to the different aspects of the transaction. This may result in uncertain choice of law litigation producing inconsistent or unpredictable results.

The amendments to Articles 2 and 2A set out rules to rationalize currently conflicting and unpredictable case law in order to minimize uncertainty over these choice of law issues. To clarify, if the sales (or lease) aspect predominates the transaction, Article 2 (or 2A) governs the entire transaction. Section 2-102(2)(b); Section 2A-102(2)(b). If the sale of goods (or lease) aspect does not predominate, then only the provisions of Article 2 (or 2A) which relate primarily to the sale (or lease) of goods aspects of the transaction would apply; other provisions of Article 2 (or 2A) which relate to other matters, such as general contractual rules, would not apply. Section 2-102(2(a)); Section 2A-102(2(a)). Case law rather than the Article 2 and 2A guides the decision as to whether the sale or lease of goods aspect predominate.

Thus, the Amendments combine two currently alternative approaches (one which looks at the “predominant purpose” of the entire transaction and the other which “bifurcates” the type of issue in question) into a single two-tier approach to decide which law applies to which aspects of the hybrid transaction.

### ***Reinforcement of Medium Neutrality***

In addition, consistent with New York’s ESRA, which requires that electronic records be given the same effect as written documents, the Amendments promote medium neutrality by replacing the term “writing” with the broader term “record” in various sections.

The modification of the definition of “conspicuous” in Article 1 is relevant to disclaimers of warranties contained in electronic records.

#### **D. Article 3 (Negotiable Instruments)**

Overview. During the drafting process, when consideration was being given to the recognition of electronic negotiable instruments, the decision was made to do so through the enactment of new Article 12 rather than by changes to Article 3, governing negotiable instruments such as promissory notes, drafts and checks. Given the long history of written negotiable instruments and the detailed requirements for holder in due course status of tangible written instruments, the Joint Committee determined it was best not to attempt to revise Article 3. Thus, the status of a person in control of an electronic record as, in effect, a “holder” of the record and the legal effect of such a person’s being a purchaser for value, in good faith and without notice, are set forth in Article 12 rather than depending on a revision of Article 3 to make it applicable to controllable electronic records. In this connection, a specific provision has been added to the Amendments for New York, which would prevent a controllable electronic record that satisfies the requirements of Article 12 from being deprived of the protections of ESRA on the ground that it fails to satisfy Section 307.2.<sup>5</sup>

Rather than making Article 3 applicable to controllable electronic records, the Amendment’s changes to Article 3 make modest but important accommodations that facilitate the use of technology to copy and transmit images of tangible instruments electronically in order to enable remote issuance, deposit and collection of such instruments. The Amendments also permit the inclusion of a choice of law or choice of forum provision in an instrument, eliminating risk that contractual efforts to obtain the benefits of New York’s law on negotiability might themselves impair negotiability.

Despite the above and as noted in the discussion of new Article 12, electronic analogues of paper negotiable instruments identified as “controllable electronic records,” “controllable payment intangibles” and “controllable accounts” would now be recognized legally and, if the requirements

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<sup>5</sup> Absent this provision, New York’s ESRA Section 307.2 arguably might deprive an Article 12 controllable electronic record which would be a negotiable instrument if it were in writing of any protections under ESRA unless it were created, stored or transferred utilizing a specific technology that allows for the existence of only one unique, identifiable and unalterable version which cannot be copied except in a form that is readily identifiable as a copy. A controllable electronic record maintained on a distributed ledger platform, arguably, would not satisfy Section 307.2.

of Article 12 were satisfied, would have the attributes of “negotiability” under Article 12 with respect to adverse third-party claims. Most importantly, an electronic record with the terms required of a note or a draft would constitute a “payment intangible”. If that electronic record were controllable under Article 12, a person with control would, in essence be a ‘holder’, who might meet the conditions (purchaser for value, in good faith and without notice) for being a “qualifying purchaser” of that record and, thereby, would obtain the protection from adverse third-party property claims associated with a ‘holder in due course’ of a written negotiable instrument. Relying on Section 9-403 of the UCC, the account debtor may also agree not to assert claims or defenses against a transferee who obtains control. Thus, Article 12 makes it possible to create electronic records that are the functional equivalent of negotiable instruments, without the need to amend Article 3 or to depend on the application of Article 3.

#### **E. Article 4A (Funds Transfers)**

Overview. As with Article 3, the Joint Committee determined that there was no need to amend any provisions of Article 4 to accommodate electronic records. However, limited changes were made to Article 4A, dealing with electronic funds transfers. These changes were not extensive and do not employ the new concept of a controllable electronic record. However, they do recognize electronic records and facilitate the electronic transmission of electronic records.

#### **F. Article 5 (Letters of Credit)**

Overview. The existing rules and terminology of Article 5, governing letters of credit, do not require changes to enable Article 5 to accommodate recent or emerging technologies apart from the Amendments made to reflect the new Article 1 definition of “sign”. The Amendments, however, make a technical change to Article 5 to eliminate ambiguity as to the applicable choice of law when a letter of credit is issued by a bank branch and expressly states its governing law.

#### **G. Article 7 (Documents of Title)**

Overview. As discussed above, the Amendments essentially update and supersede the definition of control of an electronic document of title that was originally added to New York’s Article 7 in 2014, when the definition of documents of title was expanded to include electronic documents of title. The purpose of the Amendments with respect to Article 7, thus, is to expand the definition of electronic documents of title to include electronic records created, maintained or transferred by technology that provides a means for establishing control over the electronic record (such as distributed ledger technology) but does so without using the older technology that creates a single identifiable “authentic” record. This will open the door to the market’s use of all existing and any future technologies that satisfy the definition of control established by Article 12, as described above, and which is replicated in Section 7-106.

The 2014 changes to Article 7 freed commerce in goods from the constraints of paper documents of title and opened the door to the efficiencies, cost-savings and additional security protections made possible by the use of electronic bills of lading, electronic transport documents, electronic dock warrants and electronic warehouse receipts and delivery orders, each evidencing or transferring rights to specified goods; however, those 2014 amendments inadvertently locked Article 7 into technology developed at the end of the last century, impeding the adoption of new

technology. As technology continues to develop and evolve, Article 7 may become increasingly inadequate.

The changes to New York’s Article 7 provide for an expanded definition of “control” for electronic documents of title. The expanded definition, largely influenced by the definition of “control” in Article 12, would permit control of an electronic document of title to be obtained using a broader category of present and future technologies, including distributed ledger technologies. Those Article 12 concepts should open the door to new and future technologies as they gain acceptance in the marketplace. The Amendments will prevent New York’s Article 7 from impeding technological advances that improve methods for commerce in goods and frustrate the commercial expectations of market participants.

## **H. Article 8 (Investment Securities)**

Overview. Investment property constituting or evidenced by controllable electronic records, including cryptocurrencies and crypto and non-fungible tokens, has drawn significant attention from investors. A broad range of technologists, business strategists, entrepreneurs and others are actively exploring new opportunities to create such intangible investment assets. These investment assets would fall within the definition of “controllable electronic records” created by new Article 12 of the UCC.

Investors in such controllable electronic records may not care to own such investment assets directly by exercising “control” of them on a blockchain or other technology platform. Instead, such investors might elect to treat such assets as “financial assets” credited to a “securities account” with a “securities intermediary” under Article 8 and to hold interests in such controllable electronic records indirectly, in accounts held with a securities intermediary, much as investors in stocks and bonds hold their securities through accounts with brokers. The Amendments make clear that Article 8, the well-established set of rules governing ownership and transfers of interests in property held in the indirect holding system for securities, applies also to accounts holding investments in controllable electronic records and to the interests in controllable electronic records themselves.

## I. Article 9 (Secured Transactions)

Overview. The Amendments' modifications of New York's Article 9, in conjunction with new Article 12, are a major part of the effort to adapt the UCC to a world that includes digital assets. The UCC before the Emerging Technologies Amendments recognized the creation and perfection of security interests by three different methods: possession, control and filing of financing statements, with each method applicable to specified types of property. One primary purpose of the Amendments is to create new categories of digital assets not recognized under the Pre-Amendments Article 9. These include controllable electronic records (defined in Section 12-102(1), controllable accounts and controllable payment intangibles (defined in Section 9-102(27)(a) and (b)), and money that is not tangible (electronic money defined in Section 9-102(31A)). The primary (or exclusive in the case of electronic money) method to create and perfect a security interest in these new asset categories is to obtain control of the electronic record that evidences the property, in the manner specified in Sections 9-105(A) and 107(A), which rely on the concept of control set out in Section 12-105. As to other forms of property which previously were evidenced by electronic records subject to control, such as electronic documents of title and electronic chattel paper, the Amendments retain the pre-existing definition of control but also add the Article 12-105 definition as to that type of property. Thus, the Amendments largely preserve familiar concepts from Article 9 but specifically recognize the new methods for control of electronic records made possible by new technologies and use them, as applicable, to modify the methods for creation and perfection of security interests already dependent on control or even to create new asset categories based on such control.

Thus, the Amendments provide clear rules for the creation, perfection and priority of security interests in controllable electronic records, as defined in Article 12, and in related "controllable accounts" and "controllable payment intangibles," which are evidenced by or "tethered" to controllable electronic records. These assets include virtual currencies and cryptocurrencies, as well as crypto-tokens, including non-fungible tokens and other digital assets. The Amendments apply to such assets created using now-existing technologies, such as distributed ledger technology, but also to digital assets that may be created using technologies that have not yet been developed, so long as such assets satisfy Article 12's new requirements for "control."

The Amendments also update the rules for creation, perfection and priority of security interests in other categories of assets, which fall outside the definition of controllable electronic records, but nevertheless are evidenced by electronic records which are subject to control, such as electronic chattel paper, electronic documents of title and electronic money.

In essence, the Amendments recognize that (in addition to the presently existing methods for perfection of security interests in such digital assets by filing) in the case of digital assets subject to being "controlled," a security interest may be created and perfected entirely by such control (without the need for either a separate written security agreement or filing of a financing statement). The Amendments further provide that security interests in such controllable electronic records have priority over security interests perfected by filing even if the filing was made first.

Adoption of the Amendments in New York to implement these changes to Article 9 is essential to providing clear and practical rules for the financing of digital assets. Except for specified circumstances, current Article 9 permits security interests in general intangibles

(including payment intangibles) and accounts to be perfected *only by the filing of UCC financing statements*. Electronic records (other than electronic documents of title and electronic chattel paper) are considered by most practitioners as general intangibles under current Article 9. Thus, current New York law generally requires a UCC financing statement to be filed to perfect a security interest in an electronic record; transfer of control of a record is insufficient for perfection of the rights of a secured party of a general intangible or account except in limited situations, such as sale of a business. Thus, under current New York law the secured party who obtains control of the electronic record (within the meaning of the Emerging Technologies Amendments) still cannot be certain that it takes its interest free of security interests in that electronic record (and the property it evidences) which were previously perfected by a UCC financing statement filing. This requirement of filing of a financing statement to evidence or give notice of a transfer of an intangible is unnecessary when applied to electronic records, just as it is to negotiable instruments in which security interests can be perfected by the delivery of physical possession of the instrument. Use of technology that gives a person control of an electronic record evidencing an asset (like physical possession of the asset itself) renders UCC financing filings unnecessary and not optimally efficient to give adequate notice to others of the security interest. This current feature of New York law impedes financing transactions involving electronic records if they are governed by New York's Article 9, making New York jurisdiction and choice of law undesirable.

Parties desiring to use electronic instruments in trade finance already avoid New York choice of law (because of the deficiencies in ESRA) in favor of the law of States that have enacted UETA, which includes the concept of a controllable electronic "transferable record." New York can reverse this by enacting the Amendments, which will repair the ESRA deficiency. In the absence of adopting the Amendments, in addition to failing to correct the issues with ESRA, market participants who desire to take advantage of the new types of electronic assets recognized by the Emerging Technologies Amendments will be further incentivized to select the law of States, other than New York, that adopted these UCC amendments (or the laws of foreign countries that adopt other laws to accommodate digital assets). This is likely to result in market participants avoiding New York governing law and, potentially, jurisdiction, on contracts governing such financings.

If the volume of electronic financing transactions continues to increase, generating ever greater amounts of digital payment rights, as many industry participants expect, the failure of New York to adopt the Amendments can only have a detrimental effect on commercial and legal activity governed by New York law, further jeopardizing its status as a capital of commerce and finance and leader in commercial law.

The Amendments also provide for different methods of perfection of security interests in money, depending on whether it is tangible or electronic. Given the new definition of "money" in Article 1, the term "money" now includes both tangible money and intangible tokens authorized or adopted as a medium of exchange or accounts with a central bank. Because the only currently available method of perfection is by physical possession of the money, the current rule does not work for money that is not tangible. Thus, the Amendments introduce new rules that govern the perfection of security interests in electronic forms of money. But the Article 9 definition of "money" is slightly narrower than the Article 1 definition and expressly excludes deposit accounts. Thus, the rules in Article 9 specifically governing "deposit accounts" would apply to accounts with a central bank, even if a government has adopted these accounts as money. The Article 9 definition

of “money” also (i) expressly excludes money in an electronic form that cannot be subjected to control and (ii) defines a new term “electronic money” to mean money in electronic form. Under the Amendments, a security interest in electronic money as original collateral can be perfected only by control under Section 9-105A. The requirements for obtaining control of electronic money are essentially the same as those for obtaining control of a controllable electronic record under Article 12.

Finally, the Amendments will also incorporate into Article 9 the choice of law rules, described above, set out in Article 12 for security interests in controllable electronic records, controllable accounts and controllable payment intangibles. They also extend to controllable electronic records the discharge protections for obligors on controllable accounts and payment intangibles, particularly consumers, set out in Article 12 and described in subsection A, above.

## **J. Transition Rules**

Overview. Although the Amendments generally would take effect upon or shortly after enactment, the Amendments provide for a delay of at least a year in the effectiveness of certain provisions to allow parties to secured transactions to modify existing transactions to deal with the new priorities granted to transfers effected or perfected by control which would modify priorities established before the effective date.



## Appendix C

### PROPOSED NEW YORK UNIFORM COMMERCIAL CODE AMENDMENTS

The Emerging Technologies Amendments approved by the ULC and ALI were drafted to be used by individual States to amend each State's UCC. They are a model because they were drafted to modify the current Official Text of the UCC, rather than the actual UCC of any particular State. For that reason, they must be customized, to a greater or lesser degree, depending *inter alia* on how closely a State's UCC hews to the Official Text.

The Amendments that follow are a version of the Emerging Technologies Amendments specifically designed for enactment in New York State to update the New York UCC.

As discussed in the Report, the New York UCC departs from the current Official Text of the UCC in numerous respects. Many departures are non-substantive and involve numbering or lettering conventions for sections and subsections. Some are necessitated by differences in the wording of specific sections, where a New York provision is substantially similar to but worded differently than the Official Text. However, as the Report discusses, New York law is substantively different than the Official Text in a few instances, particularly its enactment of ESRA, rather than UETA, to authorize the use of electronic records and its special rule defining "notice" of defenses and claims to a negotiable instrument. The Official Text of the Emerging Technologies Amendments has been modified to make it applicable to and adoptable in New York despite these discrepancies between the Official Text of the UCC and New York's UCC, by preserving the New York differences.

In addition, the Official Text of the Emerging Technologies Amendments contain "Legislative Notes" that call attention to drafting choices that individual State Legislatures may have to address, and the drafting committee has used the convention of "New York Legislative Notes" to identify the substantive provisions of these Amendments that warrant explanation as to how they comport with or respect New York's existing UCC or related law.

These Amendments also follow the drafting style of the Emerging Technologies Amendments by setting forth only the language proposed to be deleted or added to each identified section of the New York UCC (with some immediately surrounding language for context). The operating premise is that no provision of the New York UCC is to be amended in any way other than as expressly set forth in each identified section. Underscoring identifies words that are added and strikeouts identify deletions. Asterisks are used to indicate that there is other text in the identified section of the New York UCC that is not being modified in any respect and is to be retained. Many of the changes, resulting in much of the size of this document, merely replace the word "writing" with the word "record" or "authenticated" with "signed." There are many other changes, but the core ones are the addition of new Article 12 to deal with a novel property class, controllable electronic records, and the elaboration of the concept of "control" in Articles 7 and 9.

*The proposed bill is available upon request. Please contact Elizabeth Kocienda, New York City Bar Association Director of Advocacy, at [ekocienda@nycbar.org](mailto:ekocienda@nycbar.org).*

## Appendix D

### NOTE ON THE COMMENTS TO THE EMERGING TECHNOLOGIES AMENDMENTS AND THE NEW YORK AMENDMENTS

The New York courts, when appropriate, use the legislative history provided by the Official Comments to the Official Text of the UCC (and the New York Annotations<sup>42</sup> to the New York version of the UCC), as an aid to interpretation of the UCC. *See Worthy Lending LLC v. New Style Contractors, Inc.*, 2022 N.Y. Slip Op. 06631, 2022WL 17095585 (Nov. 22, 2022) (relying on original Official Comment 23 to UCC 9-102 and consistent 2020 comments of the UCC Permanent Editorial Board explaining UCC 9-607, in order to interpret NY UCC 6-607); *Banque Worms v. Bank America Int'l*, 77 N.Y.2d 362 (1991); *The Receivers of Sabena SA v., Deutsche Bank A.G.*, 142 A.D.3d 242, 36 N.Y.S.3d 95, (1st Dept. 2016). Courts have observed, “Official Uniform Comments do not have the force of law, but are nonetheless the most useful of several aids to interpretation and construction of the UCC,” *LTV Energy Prods. Co. v. Northern States Contracting Co. (In re Chateaugay Corp.)*, 162 B.R. 949, 955 n. 5 (Bankr.S.D.N.Y.1994) (citing J. White & R. Summers, *UCC* Section 4, at 12 (3d ed.1988)); *see, also, In re Adoni Group, Inc.*, 530 B.R. 592, 597-98 (Bankr. S.D.N.Y. 2015); *In re Westfall*, 376 B.R. 210 (Bankr. N.D. Ohio 2007) (reviewing the drafting of the UCC and treatment of the Comments).

The amendments to the Official Comments issued in conjunction with the Emerging Technologies Amendments include Comments explicating provisions added to the Official Text of the UCC, or modified by, the Emerging Technologies Amendments. But they also include new or modified Comments with respect to pre-existing sections of the UCC, which were not modified by the Emerging Technologies Amendments. These revisions to the Official Comments on unchanged provisions of the UCC are not gratuitous. They are intended to explain how a proposed amendment to another section of the UCC is intended to relate to or interact with the unchanged UCC section to which the revised Comment refers.

New York’s uniform legislative practice has been not to take action to adopt or approve any Comments as authoritative or binding. The Amendments do not include either the Official Comments to the Emerging Technologies Amendments nor Comments to the sections of the Amendments that deviate from the Official Text of the Emerging Technologies Amendments. However, if the Comments are called to the attention of the Legislature and included in the Bill Jacket, they will constitute part of the legislative history of the Amendments, and such Comments will explain how the changes to the UCC are to be interpreted or how they may affect or interact with other unchanged provisions of the UCC.

The Official Comments to the Official Text of Article 8, as amended by the Emerging Technologies Amendments, illustrate this. Article 8 was not amended to expressly provide that controllable electronic records are “financial assets,” but the revised Official Comments explain why the pre-existing, unamended version of Article 8 permits (without the need for amendment)

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<sup>42</sup> The New York State Commission on Uniform State Laws in the early 1960s published Annotations to the UCC and several reports on the UCC to the New York Legislature in connection with its enactment in 1962.

treatment of “controllable electronic records” as “financial assets,” the rights to which are “security entitlements” under Article 8 despite the fact that such controllable electronic records were not a specifically identified asset-type prior to new Article 12 of the UCC.

The three New York Annotations below explain the reasons for the proposed modifications of the Official Text of Sections 12-102 and 12-103 of Article 12.

**New York Comment to Section 12-102(a):** One major purpose of the Official Text of new Article 12 is to enable a controllable electronic record evidencing a controllable account or controllable payment intangible to have a limited form of the “negotiability” provided in Article 3 to tangible instruments, which can be physically possessed. This modification to the Official Text of Section 12-102(a)(2) is necessary to ensure that New York’s version of Article 12 preserves and implements, as to controllable electronic records, a unique feature of negotiability found in New York law.

A key criterion that an assignee must satisfy to qualify as a “holder in due course” of an instrument under Article 3, or as a “qualifying purchaser” of a controllable electronic record under proposed Article 12, is to have taken possession of the instrument or control of the controllable electronic record *without notice of a claim to it* (and, in the case of an instrument, without notice of defenses to it). New York’s Article 3, however, contains a special rule that applies to the determination of whether an assignee of an instrument took it free of notice of claims or defenses to it. This rule, which is unique to New York, appears in Section 3-304(7), which provides that “In any event, to constitute notice of a claim or defense, the purchaser must have knowledge of the claim or defense or knowledge of such facts that his action in taking the instrument amounts to bad faith.”

Consistent with the policy of the Official Text to make existing commercial law applicable to controllable electronic records rather than changing such law, the modification to the Official Text appearing in the first sentence of the additional language will make applicable to controllable electronic records New York’s unique statement of the law governing notice of claims as to paper instruments, thus maintaining a parallel between the criteria for becoming a holder in due course of an instrument and for becoming a qualifying purchaser of a controllable electronic record that would be an instrument if in writing. (The “as if” clause at the end of the sentence is structured so as to be parallel in style to the definition of “value” in Section 12-102(a)(4).)

The purpose of the second added sentence is to foreclose any argument that the presence of an agreement by an obligor with respect to a controllable electronic record not to assert defenses or claims against an assignee might cause the record not to qualify as a draft or note under Article 3 if it were a signed writing. Foreclosing that argument is important because drafters of controllable electronic records are likely to consider adding such an agreement to those records because a “qualifying purchaser” of a controllable electronic record (and its associated controllable account or payment intangible), unlike a holder in due course of a negotiable instrument, does not automatically take free of most defenses of the obligor; rather, the Official Text contemplates that a purchaser’s protection against such defenses can be provided by negotiated agreement with the obligor. As a result, controllable electronic records may routinely contain such agreements. It

would be disruptive to the utility of controllable electronic records if such agreements or waivers of defenses ironically had the effect of defeating application of New York's special notice rule that protects purchasers. The language in the second added sentence, describing the agreements or waivers that are protected, is modeled on Section 9-403(b), which validates an account debtor's agreement not to assert claims or defenses against an assignee who satisfies what is essentially the holder in due course/qualifying purchaser test.

**New York Comment to Section 12-102(a)(3):** This New York modification of the Official Text preserves the intent to exclude from the definition of "controllable electronic record" and, thus, the scope of Article 12, electronic records that are "transferable records" governed by either ESIGN or UETA and, thus, are already governed satisfactorily by the rules that apply to such records and provide a form of negotiability essentially identical to that provided for instruments in Article 3. The modified language departs from the wording of the Official Text because New York, unlike other states, has not adopted UETA. As a result, excluding from the scope of Article 12 an electronic record that would be governed by UETA (but not ESIGN) does not effectuate that intent unless the record not only satisfies the definition of a "transferable record" in UETA but also is actually governed by the law of a State that has enacted UETA. Thus, under the proposed New York change to the Official Text, an electronic record governed by New York law will be governed by Article 12 even if it would qualify as a transferable record under the law of other states.

This modification is intended to avoid situations in which an electronic record that was expressly intended to obtain the benefits of negotiability provided by UETA would obtain neither those benefits nor those provided by Article 12.

**New York Comment to Section 12-103(c):** As noted with respect to the New York modification of Section 12-102(a)(3), New York has not adopted UETA, and New York's recognition of electronic records is set forth in ESRA. This requires a modification of the Official Text, in addition to that in Section 12-102(a)(3), to accommodate two features of ESRA. First, ESRA applies to all electronic records and electronic signatures (unless specifically excluded under Section 307 thereof). ESRA provides in Section 304.2 that electronic signatures have the same validity and effect as a signature affixed by hand. It also provides in Section 305.3 that electronic records shall have the same force and effect as records not produced by electronic means. Additionally, Section 306 provides that electronic records and electronic signatures may be admitted into evidence under New York's CPLR. However, Section 307.2 provides that ESRA shall not apply, *inter alia*, to any negotiable instruments or other instruments of title wherein possession of the instrument is deemed to confer title. That section then exempts from its exclusion such instruments if "an electronic version of such record is created, stored or transferred pursuant to [ESRA] in a manner that allows for the existence of only one unique, identifiable and unalterable version which cannot be copied except in a form that is readily identifiable as a copy."

The manner in which ESRA is drafted arguably could produce three undesirable consequences. First, Section 307.2 arguably would exclude from the protections of ESRA provided in Sections 304, 305 and 306, an electronic record which, if in writing, would be a negotiable instrument subject to Article 3 but which does not satisfy the requirements of

Section 307.2. This could include controllable accounts or controllable payment intangibles maintained on a blockchain or distributed ledger platform, which does not allow for the existence of a unique, identifiable and unalterable version. Second, in the case of any controllable account or controllable payment intangible which satisfied the Section 307.2 exemption from exclusion under ESRA, it might open the door to the argument that such an electronic record is subject to the rules of Article 3 rather than Article 12. Third, a purchaser of such a controllable electronic record, because it was incapable of being physically transferred and subjected to possession, arguably could never achieve holder in due course status under Article 3.

Section 12-103(c) is intended to avoid these negative possibilities. This section, first, makes clear that an electronic record that is a controllable electronic record under Article 12 is not excluded from the benefits or protections of ESRA (as to electronic signatures, validity, enforceability or admissibility into evidence) merely because it does not satisfy the “unique, identifiable and unalterable” requirement of Section 307.2; the fact that the record is controllable within the meaning of Article 12 is sufficient for ESRA protection. Second, this provision negates any argument that ESRA causes such controllable electronic records to be governed by Article 3 rather than Article 12. These rules, however, do not apply to an electronic record created prior to the effective date of adoption of the Amendments in New York nor do they apply to the extent an electronic record expressly provides otherwise.