

To: Ed Smith and Steve Harris

From: Paul Hodnefield and Juliet Moringiello

Re: Issues List for UCC Study Committee Subgroup on Article 9 Filing System, Remedies, and Other Miscellaneous Issues

This memo contains our list of issues, ranked according to consensus among subgroup members. We had one Zoom call on November 20 in which participants raised several issues for discussion and we followed up with members by e-mail afterwards asking for additional issues. We then asked members to participate in a SurveyMonkey poll to indicate whether they thought the full committee should consider each issue. Twenty subgroup members participated in the survey and one other member sent comments by e-mail. Most of the issues received a positive response.

1) Issues to be pursued on which there is general consensus (75% or more positive responses)

- a. *Examine whether the existing Article 9 filing system rules are sufficiently technology-neutral to allow innovation.* To the extent that the current provisions of the UCC stand as a potential obstacle to technological infrastructure improvements, the Study Committee should consider whether and how to make such provisions technology neutral so as not to unnecessarily or unintentionally obstruct the ability of any given state to adopt a technology upgrade.
- b. *Consider whether to include an address for electronic notice to the secured party of record in a financing statement.* While current Article 9 is designed to be medium neutral, it falls short with respect to notifications required by the code. The Committee should consider whether a secured party may in the UCC record optionally designate an email address or other means of electronic delivery that would constitute a sufficient method for delivery of notices required by Article 9.
- c. *Consider how Article 9 should treat automated repossession.* There are a few issues that should be addressed with respect to automated disablement. Article 9 permits a secured party to disable equipment, although that section was not written with automated disablement in mind. A creditor that disables equipment must do so without a breach of the peace, and a question arises as to whether the “breach of peace” standard is appropriate for automated disablement. In consumer transactions, additional issues arise. If it is not permitted by Article 9, should it be? Should parties be able to agree to it in their security agreements? Should the UCC adopt some of the notice requirements that other states have adopted in their non-uniform amendments to the UCC and their motor vehicle sales finance acts?

- d. *Consider whether Article 9 adequately provides for the enforcement of security interests in digital assets.* We're using the term digital asset broadly to refer to various types of intangible assets. There are two issues here, one related to "digital assets" that arguably have an account debtor (such as an internet domain name) and "digital assets" that do not (those for which there is no intermediary). For the first type of digital asset, § 9-607 allows a secured party to notify the account debtor to render performance to or for the benefit of the secured party. Would that include turning over the digital asset? Even if it does, § 9-406 does not give this power any teeth, because it anticipates only requiring payment to the secured party. If the account debtor pays the wrong person, the payment does not discharge the account debtor's obligation. The section does not address any other kind of performance. For the second type of digital asset, if there is no intermediary, there is likely no account debtor. As a result, § 9-607 may not provide a remedy, even though it refers to both "account debtors" and other persons "obligated on collateral."
- e. *Should Article 9 provide a custody system for digital assets?* The main issue is whether and how to create a custody or other priority system for digital assets when the current system assumes the use of a third party intermediary. The whole point of digital assets is that no such intermediary is necessary (although they are possible). The Study Committee should consider whether and how to address this unique issue presented by digital assets. (see, e.g. the debate between Wyoming and the ULC). Note here that the definition of "digital asset" for the purpose of this question is narrower than the definition in issue 1. d. directly above.

2) Issues to be pursued for which there is majority but no general consensus (between 50.1 and 74.9% positive responses)

- a. *Amend § 9-501 to provide for central filing of fixture filings.* Sixty percent of the respondents agreed that the committee should consider whether to amend § 9-501 to provide for central filing of fixture filings. At one time it made sense to require recording of fixture filings in the real estate records because in the world of paper documents each additional search was costly. Today, with online statewide UCC searches available in all states the added cost of conducting a central search for each transaction is negligible. Moreover, central index searches would produce much more reliable results. The central filing offices are very experienced with UCC records and have systems better suited to indexing and retrieval of UCC records. These systems would also allow for electronic filing of fixture filings, which currently isn't available at many county recording offices. Central filing would make the process much more efficient, more uniform and provide greater certainty for both secured parties and those who search the UCC records. **Concerns:** This may be too tenuously related to emerging technologies and it would require the agreement of the real estate bar.

- b. *Consider whether all blockchain based smart contracts constitute security interests* (52.6% of respondents). Blockchain-enabled smart contracts create self-executing transactions that automatically capture assets to satisfy obligations: they are a form of asset partitioning. They conflate contract and property law functions and mimic both security interests and entities. Blockchain-based smart contracts are a device or platform for transacting, not a deal type. But they have a legal effect in that they accomplish asset partitioning. As such, it is possible to interpret all blockchain-based smart contracts as meeting the statutory requirements for a security interest. At the same time, market actors could proceed as if no blockchain-based smart contract creates an Article 9 security interest given the strong form of partitioning they effectuate, thereby side-stepping Article 9 altogether. **Concerns:** This issue is conceptual and perhaps it is premature to attempt to address it in statutory terms. There is also some concern that this issue needs to be narrowed down – there are some things that can be accomplished with smart contract technology that would not be considered security interests (for example, smart contract technology can create a UCC financing statement).
- c. *Consider whether Article 9 should explicitly address electronic notice to the account debtor* (57.89%). Typically the account debtor and the secured party will not have had prior dealings, and a court will likely scrutinize the communication to see that it was received. Additionally, many account debtors no longer have a reliable location to which a registered letter can be sent. Although we have generally stated in Article 9 (and elsewhere) that anything that was formerly required to be written can be in a communication that is authenticated by the sender, this notice is so important to the secured party's rights that it perhaps deserves further consideration. **Concerns:** Article 9 already allows this; any clarification should be in the Official Comments.

3) **Issues that a minority of the subgroup members believe are worth pursuing.**

- a. *Address data privacy issues in Article 9.* Thirty-five percent of the subgroup members answered that this is an issue worth pursuing. Data privacy issues can intersect with Article 9 in at least two ways. First, the secured party might, in the course of its relationship with the debtor, acquire information about the debtor. Such information might involve sensitive or proprietary information about how the debtor runs its operations. It is likely that, in most cases, the debtor either voluntarily discloses such information to the secured party or voluntarily gives the secured party access to such information. However, emerging technologies increase the likelihood that the secured party might acquire information about the debtor through the secured party's own activities, such as by monitoring the location of the collateral. Second, the collateral might include sensitive information about the debtor's customers. Of course, it has long been the case that some collateral has associated with it information about the debtor's

customers. But emerging technologies have now made it such that the information itself often has independent value and can serve as collateral.

Concerns: There is a lot of legislative action on data privacy and taking it on a part of the UCC project might lead to confusion.

- b. *Consider whether true leases executed as blockchain based smart contracts should be governed by Article 9.* Our subgroup was evenly split, with 9 people answering that we should consider this issue and nine answering that we should not. When a lease is executed on a blockchain platform, if the lessee defaults the equipment may be automatically disabled and transferred from the lessee's assets. There is no longer the intervention point at which a bankruptcy trustee can assess whether the equipment is property of the lessor or is property of the debtor subject to a lien in favor of the lessor, in determining the fate of the asset. Because true leases are not governed by UCC Article 9, creditors of lessees may not have notice of this possibility. Given this risk and the practical difficulties such a "smart lease" creates, investors in lessees should have notice of the existence of this type of transaction so that they can anticipate the risk that these deals present. For this reason, we should consider whether true leases—along with, perhaps, other transactions that typically involve characterization questions—should be within the scope of Article 9. **Concerns:** this issue may be premature.