

The Negotiability of Bitcoin and Other Virtual Currencies: A Changing and Uncertain Landscape

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

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

The Problem of Negotiability

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

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

The exclusion of virtual currency from the “free and clear negotiability” rules under the UCC also inhibits the use of cryptocurrency as loan collateral since a lender’s security interest in the virtual currency will be subject to a security interest granted by the transferor. In the absence of a waiver from the transferor’s lender, a lender to the transferee cannot safely rely on the

virtual currency received by the transferee. Indeed, when virtual currency is accepted by the transferee from multiple sources, it is simply not practical to obtain such waivers.

The Solution(s)

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

The Wyoming Approach

The recently enacted Wyoming law^v is very broad in its scope and application. It applies to all “digital assets” – defined as representations of economic, proprietary or access rights stored in a computer readable format. It classifies digital assets into three groups: “virtual currencies” (defined as digital assets used as a medium of exchange, unit of account or store of value, and not recognized as legal tender by the United States Government); “digital consumer assets” (defined as digital assets that are used or bought for consumptive, personal or household purposes); and “digital securities” (defined as contracts, transactions or arrangements where a person invests money in a common enterprise and is led to expect profits from the efforts of a promoter or a third party).

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

The Wyoming law treats “digital consumer assets” as general intangibles, in which a security interest may be perfected either by filing a financing statement or by means of control and treats “digital securities” the same as other securities, pursuant to which the typical method of perfection is also by control.

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

The Uniform Law Commission Approach

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

Criticisms of the Different Approaches

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

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

Correspondence between the Uniform Law Commission and the State of Wyoming discussing their differing approaches and their disagreements can be found here^{viii} and here^{ix}.

Missouri Legislation

During the 2019 legislative session, Rep. Andrew McDaniel, R-Dist.150 (Kennett, Mo.), introduced legislation in Missouri that would essentially adopt the Wyoming approach.^x How much consideration will be given to the adoption of this legislation or the Model Act in future legislative sessions is unknown.

Concluding Observations

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

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

ⁱ § 1-201. General Definitions., Unif.Commercial Code § 1-201.

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

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

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

^v <https://www.wyoleg.gov/Legislation/2019/SF0125>

^{vi} <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=de52d1fe-1f70-a568-9552-d354ade157ca&forceDialog=0>

^{vii} See A. Tinianow, *A Split Emerges In Blockchain Law: Wyoming’s Approach Versus The Supplemental Act*, <https://www.forbes.com/sites/andreatinianow/2019/03/07/a-split-emerges-in-blockchain-law-wyomings-approach-versus-the-supplemental-act/#6b2b95b6719a>

^{viii} <https://www.uniformlaws.org/viewdocument/communications-with-wyoming-1?CommunityKey=e104aaa8-c10f-45a7-a34a-0423c2106778&tab=librarydocuments>

^{ix} <https://www.wyoleg.gov/InterimCommittee/2018/S3-Letter%20to%20Uniform%20Law%20Commission.pdf>

^x Mo. House Bill No. 1159, <https://house.mo.gov/Bill.aspx?bill=HB1159&year=2019&code=R>