
OLR Bill Analysis

SB 353

AN ACT CONCERNING THE DEPARTMENT OF ECONOMIC AND COMMUNITY DEVELOPMENT'S RECOMMENDATIONS REGARDING DIGITAL ASSETS.

SUMMARY

This bill establishes a set of commercial laws that apply to “digital assets.” It specifically subjects digital assets to selected provisions of Articles 8 and 9 of the Uniform Commercial Code (UCC), but in some instances it applies UCC provisions to them in a way that differs from the code’s typical application (e.g., “take free” rules and choice of law).

Under the bill, a digital asset is a representation of economic, proprietary, or access rights that is stored in a computer readable format, including digital consumer assets, digital securities, and virtual currencies. The bill classifies digital assets and these three subcategories using existing UCC categories (e.g., money). Among other things, it also establishes provisions for the following:

1. perfecting a security interest in a digital asset, including through “control” (i.e., establishing priority over other security interests);
2. perfecting a security interest in proceeds from a digital asset;
3. taking a digital asset free of a security interest; and
4. choice of law (i.e., which jurisdiction’s laws apply to a dispute).

EFFECTIVE DATE: July 1, 2022

DIGITAL ASSET CLASSIFICATION

As described below, the bill establishes three specific subcategories of digital assets, each of which is mutually exclusive (e.g., virtual currency cannot also be a digital consumer asset or a digital security). (It is unclear whether digital assets may also include other assets not in

these categories.) The bill (1) deems assets in each of these subcategories to be intangible personal property and (2) provides that its digital asset classifications must be construed to give the greatest effect to the bill's provisions, but cannot be construed to apply to any other asset.

Digital Consumer Assets

Under the bill, a digital consumer asset is a digital asset used or bought primarily for consumptive, personal, or household purposes. It includes (1) an open blockchain token constituting intangible property and (2) any other digital asset that is not a digital security or virtual currency.

The bill deems digital consumer assets to be general intangibles for purposes of UCC Article 9. With respect to general intangibles, generally Article 9 allows entities to grant a security interest in the intangible and establishes restrictions on assignment. (It also limits a transferee's ability to take a general intangible free of a perfected security interest. But, as described below, the bill establishes take-free provisions that differ from those in Article 9.)

Digital Security

Under the bill, a digital security is a digital asset that is a security, as defined in UCC Article 8. Generally, this means an obligation of an issuer or a share, participation, or other interest in an issuer, or in property or an enterprise of an issuer, that meets the following criteria:

1. is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by, or on behalf of, the issuer;
2. is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and
3. (a) is, or is of a type, dealt in or traded on securities exchanges or securities market or (b) a medium for investment with terms that expressly provide that it is a security governed by Article 8.

The bill deems digital securities to be securities for purposes of

Article 8 and investment property for purposes of Article 9. Generally, Article 8 governs the ownership and transfer of securities (e.g., settling transactions). With respect to investment property, generally Article 9 establishes provisions for acquiring control, perfection, and priority of security interests.

Virtual Currency

By law, with certain exceptions virtual currency is a digital unit (1) used as a medium of exchange or form of digitally stored value or (2) incorporated into payment system technology (see BACKGROUND). The UCC does not currently refer to virtual currency specifically, but it appears to be encompassed by Article 9's definition of "general intangible."

The bill instead deems virtual currency to be money for purposes of Article 9, therefore allowing transferees increased ability to take virtual currency free of a security interest (i.e., through possession). Generally, Article 9 provides that a transferee takes money free of a security interest unless it colluded with the debtor to violate the secured party's rights (CGS § 42a-9-332).

Digital Assets Treated as Financial Assets

Under Article 8, property held by a securities intermediary for another person in a securities account may be treated as a financial asset for Article 8 purposes if the intermediary and other person agree to do so (CGS § 42a-8-102(a)(10)(C)).

The bill specifically allows a digital asset to be treated as a financial asset through a written agreement with the digital asset's owner, in which case it remains intangible personal property. Generally, Article 8 establishes provisions on the acquisition of financial assets, these assets' relationship to security entitlements, and entitlement holders' property interest in these assets.

PERFECTING SECURITY INTERESTS

Perfection Through Control

Under the UCC, a perfected security interest is an attached security

interest that will generally prevail over a creditor that is using the courts to obtain a lien on the collateral. Depending on the type of collateral, a security interest is perfected under Article 9 (1) when a secured party files a financing statement in the appropriate office (e.g., the secretary of the state), (2) when a secured party takes possession or control of the collateral, or (3) automatically on attachment. With certain exceptions, priority is established by time of filing or perfection.

The bill instead allows a security interest in a digital asset to be perfected through control (which includes an agreement). It provides that an interest perfected this way has priority over a security interest held by a secured party that does not have control of the asset (e.g., a party that perfected its interest in the asset by filing a financing statement).

Under the bill, a secured party must enter into a control agreement with the debtor before taking control of a digital asset. The agreement may include terms for a secured party to pledge its security interest as collateral for another transaction. The bill provides that perfection by control creates a possessory security interest in the digital asset, but does not require physical possession of it.

Under the bill, “control” means that a secured party or its agent, fiduciary, or trustee has the exclusive legal authority to conduct a transaction relating to a digital asset, including by using a private key or multi-signature arrangement. The bill deems control as being equivalent to “possession” when the latter term is used in Article 9, but it specifies that control does not require physical possession.

The bill defines “multi-signature arrangement” as a system of access control relating to a digital asset to prevent unauthorized transactions. It requires at least two private keys or a substantially similar analogue. A “private key” is a unique element of cryptographic data, or any substantially similar analogue, that is held by a person; paired with a unique, publicly available cryptographic data element; and associated with an algorithm necessary to carry out an encryption or decryption to execute a transaction.

Security Interest in Proceeds

The bill allows a secured party to perfect a security interest in proceeds from a digital asset by filing a financing statement with the secretary of the state. Under Article 9, proceeds are, among other things, whatever is received on the sale, exchange, collection, or other disposition of collateral. Generally, Article 9 provides that a security interest in proceeds becomes unperfected on the 21st day after the interest attaches to the proceeds unless certain conditions are met (e.g., the secured party files a financing statement) (CGS § 42a-9-315(d)).

“Take Free” Provisions

Article 9 contains several provisions specifying when a transferee may take an asset free of a security interest (i.e., “take free” provisions). These provisions vary based on the type of asset (e.g., money or a general intangible) and security interest (e.g., perfected or unperfected).

For security interests perfected through a method other than control, the bill instead allows a transferee to take a digital asset free of any security interest beginning two years after the transferee takes the asset for value and does not have actual notice of an adverse claim.

Choice of Law

For multi-state transactions (e.g., transactions where the parties are in different states), generally Article 9 provides that the applicable governing law to the security interest (e.g., for disputes about perfection and priority) is the law of the jurisdiction where the debtor is located.

The bill instead provides that, for Article 9 purposes, a digital asset is located in Connecticut if the debtor or secured party is physically located in the state or is incorporated or organized here. It grants the Superior Court jurisdiction of any suit, action, or proceeding relating to digital assets, including those arising from the bill’s provisions or the UCC.

BACKGROUND***Related Bill***

sHB 5320, reported favorably by the Banking Committee, requires

persons conducting virtual currency business activity (e.g., receiving, storing, holding, buying, selling, issuing, or exchanging virtual currency) to register with the Department of Banking, for a fee the banking commissioner sets.

Virtual Currency

By law, virtual currency is a digital unit (1) used as a medium of exchange or form of digitally stored value or (2) incorporated into payment system technology. It includes digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized without a centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort.

Virtual currency does not include digital units used in the following manner:

1. solely in online gaming platforms with no other market or application or
2. exclusively in a consumer affinity or rewards program that (a) can be used only as payment for purchases with the issuer or another designated merchant and (b) cannot be converted into, or redeemed for, fiat currency (government-backed currency, such as the U.S. dollar) (CGS § 36a-596).

COMMITTEE ACTION

Commerce Committee

Joint Favorable

Yea 21 Nay 1 (03/22/2022)