DTTF UCC Amendments

[00:00:00] **Intro/Outro Voiceover:** Welcome to the New York City Bar Association podcast.

In this episode: Updating New York's Uniform Commercial Code

Opinions expressed are those of the speakers and not necessarily of the City Bar.

[00:00:13] **Sandra Rocks:** Greetings listeners and welcome to our brief presentation on the proposed amendments to the New York Uniform Commercial Code. I'm Sandra Rocks, and I'm here with several other members of the New York City Bar Association Task Force on Digital Technologies. First, a soundbite on what the Uniform Commercial Code is. It is a set of proposed uniform laws developed as a joint project of the American Law Institute and the Uniform Laws Commissioners of all the states to promote uniformity across a wide variety of areas, most notably for us, commercial law, designed to facilitate both intra and interstate commerce. Of course, the Uniform Commercial Code needs to be adopted by each state, sometimes with some non-uniform amendments particular to that state. And for today, what we're going to be talking about is why the 2022 amendments have been proposed as a new set of uniform laws for consideration by the states. Principally, you'll hear more detail later, they were developed in order to address market developments, principally in the area of various types of electronic activity involved in creating and evidencing both assets and obligations. Of note representatives of the American Law Institute, the Uniform Laws Commission and the New York City Bar Task Force on Digital Technologies coordinated on a report supporting the adoption of the New York Uniform Commercial Code amendments. That activity culminated in February 2023 report and two of today's panelists were intimately involved in that Ed Smith and Lorraine McGowen. Now, the lineup today is going to be Ed Smith, who will focus on digital assets, aspects of the amendments. Then Eric Marcus, who will focus on the trade finance aspects of the new, proposed New York UCC amendments. Then Neil Cohen, who will focus principally on electronic commerce aspects of the proposed New York UCC amendments. And then Lorraine McGowen will highlight the many reasons why adoption by New York is very important. So with that, I will turn it over to Ed Smith to start off with digital assets.

[00:02:45] **Edwin Smith:** Thank you, Sandy. The current uniform commercial code doesn't work for certain types of new technologies, especially distributed ledger technology and blockchain transactions. The amendments create a new article 12 and expand other provisions of the uniform commercial code to provide for commercial rules for these transactions.

The transactions affected not only include new digital asset classes, but also traditional assets consisting of installment sales, leases, bills of lading and warehouse receipts. The amendments also provide greater clarity and liquidity for certain digital asset transactions, whether these are in digitized securities, non-fungible tokens, or cryptocurrencies.

In particular, they protect innocent buyers of these assets against unknown, adverse property claims to the assets. In addition, the amendments facilitate the ability of borrowers, small and large, to obtain credit using assets subject to these transactions as collateral for loans, enabling businesses to obtain needed funds for working capital and capital improvements and individuals to obtain funds for living and other expenses without needing to sell the assets if the assets are otherwise to be retained for investment.

[00:04:11] **Sandra Rocks:** Thank you, Ed. And now, as promised, I'm going to switch us over to Eric Marcus, who will focus on trade finance aspects of the New York UCC amendments.

[00:04:22] **Eric Marcus:** Thank you, Sandy. The UCC amendments are likely to be transformative for the trade finance and supply chain finance industry. I practiced in this area for many years, and I would like to provide some background on why the amendments will be so significant. Currently, most cross border trade transactions are paper based, involving a bill of lading and a document evidencing the payment obligation, which is typically a bill of exchange or a draft.

The payment obligation is the purchase price owed by the buyer of the goods to the supplier and is typically due in 30 or 60 days. Often, the supplier discounts this payment obligation to a bank so that the supplier can obtain immediate payment. New York and other states previously revised their versions of the UCC to follow the 2003 UCC amendments, which authorized electronic documents of title, including bills of lading, but prior to the 2022 UCC amendments, it was not possible in the United States to create an electronic version of the paper-based bill of exchange or draft. Under the amendments, this will now be possible using the new asset class known as a "controllable account," which is effectively an account receivable evidenced by an invoice in electronic form.

The International Chamber of Commerce, or ICC, estimates that four billion paper documents move through the trade finance system at any one time. During the pandemic, there was tremendous disruption of trade finance transactions because workers were not in their offices and could not process paper documents.

In April 2020, the ICC called for emergency action by governments to enable the use of electronic trade documents including both documents of title and payment obligations. The call to action has been heard, and several countries, including Singapore, and just this past summer the United Kingdom, have enacted laws validating trade documents in electronic form.

The savings in switching to electronic trade documents are real and substantial. The ICC has estimated that the transaction costs incurred in a trade finance transaction can be reduced by 75 percent. And those four billion pieces of trade finance paper, they represent 500, 000 trees which could be spared, so there's a huge environmental benefit as well.

I would like to provide a more detailed example of how the amendments can be expected to reduce transaction costs and the cost of credit in many types of commercial financing transactions. The example I will use is Supply Chain Financing, also known as SCF.

In a typical SCF transaction, a buyer of goods that has a high credit rating wishes to provide support for the suppliers in a supply chain to assure that the buyer maintains a continuing supply of quality goods. The suppliers are often small or medium sized enterprises without credit ratings of their own.

The buyer's support consists of an agreement to pay for the goods on their due date and without the assertion of any set offs or defenses against an assignee of the right of payment. Such a support arrangement enables a financial institution to provide funding to the suppliers at a price comparable to the funding cost of the highly rated buyer, thereby, substantially reducing the supplier's cost of credit. Many of the SCF programs are paper based and clients have been asking me for years why the documentation, and in particular the payment obligation, cannot be made electronic. The clients were eager to avoid the time consuming and cumbersome process of obtaining wet ink signatures on the paper documents, and they also wanted to avoid the expense of having to store and maintain large volumes of paper documents. The amendments will allow these programs to convert to digital form, which will mean that funding of individual payment obligations can be accomplished more quickly and with less expense, resulting in reduced costs for the suppliers.

Not only do SCF programs benefit small and medium sized suppliers, they can also further other societal goals. Many large banks active in New York, including Bank of America, Citibank, and JPMorgan Chase, have established SCF programs for their customers, which contain an environmental, social and governance component, also known as ESG.

Many buyers are eager to promote ESG within their supply chain, and these programs incorporate an ESG rating for each supplier. Suppliers with higher ESG ratings receive an extra reduction in funding costs.

Today, most trade finance and SCF program documents are governed by either New York or English law. One of the express reasons behind the United Kingdom's adoption of its new law, validating electronic trade documents, was the desire to maintain London's importance as a financial center for these types of transactions. New York must adopt the New York UCC amendments to stay in the game.

[00:10:17] **Sandra Rocks:** Thanks so much, Eric. And I particularly appreciate, and I hope listeners do too, what you've highlighted here about the bread and butter nature of what these proposed amendments focus on, because it's not all about crypto. And I know Neil Cohen's remarks will support that as well. And so now I turn it over to Neil to talk about electronic commerce.

[00:10:40] **Neil Cohen:** Well, thanks very much, Sandy. I think that the best way to summarize the benefits of the New York UCC amendments is that they will facilitate New York keeping a leadership role in electronic commerce. In this regard, it's important to be aware that there are two distinct, although related aspects to electronic commerce.

One aspect is commerce in electronic assets. Including digital assets like the controllable electronic records discussed by Ed or controllable accounts discussed by Eric. The second aspect is electronic commerce in ordinary assets. And the New York UCC amendments advance both. With respect to commerce and electronic assets the bill not only addresses the new category of controllable electronic records but also addresses an older problem that's grown in importance in recent years and that is determining the rules, the legal rules that will govern transactions that combine electronic assets or services with traditional goods. Uncertainty with respect to those transactions has a cost too. And the failure of New York to address pressing issues about commerce and electronic assets will likely lead to a significant portion of that commerce moving elsewhere or perhaps the party's selection of law other than New York law to govern even transactions occurring in New York.

With respect to electronic commerce in ordinary assets, New York was a leader when in 1999, it enacted the Electronic Signatures and Records Act, usually referred to as ESRA, E S R A, as part of the state technology law. And this was before almost any other state had addressed issues arising from electronic commerce.

But two subsequent developments, the later enactment by other states of the Uniform Electronic Transactions Act, and the enactment by Congress of the Electronic Signatures in Global and National Commerce Act, along with some key gaps and uncertainties in the New York statute, has caused significant transactional difficulties with respect to electronic commerce and how to finance it in New York.

The New York UCC amendments, as crafted by the City Bar, respect the New York policy choices made in ESRA, while at the same time enabling New York law To mesh better with the law of commerce in digital assets reflected in UCC article 12. This can avoid the undesirable result of transaction parties shunning New York law for their transactions, which I'm told happens with some frequency Finally the New York UCC amendments perform some very useful cleanup of various writing requirements in commercial law that were enacted before electronic communication became routine and unremarkable, but now add unnecessary expense and complication to communications and record keeping for a wide range of basic transactions.

So for a number of reasons the New York UCC amendments will help facilitate New York keeping a leadership role in electronic commerce.

[00:13:46] **Sandra Rocks:** Thanks, Neil. And now I think we turn it over to Lorraine McGowen, who will explain a bit more on why adoption of New York's UCC amendments is important for our state.

[00:14:03] **Lorraine McGowen:** Thank you, Sandy. I'm going to talk about the urgency for adopting the New York UCC amendments now. As Neil, Ed and Eric have explained, New York has long been recognized as the preferred jurisdiction for paper based commercial and financial transaction. And to facilitate that continued recognition, as Neil explained, our legislature has enacted various legislation to encourage parties engaged in significant commercial, trade, and financial transactions to select New York law as the governing law, regardless of whether the underlying transaction bears any relationship to New York and to select New York courts as the forum to resolve any disputes. New York is recognized as a global financial center to govern, enforce and resolve contractual disputes. However, as you have heard from Ed, Eric, and Neil, more and more transactions are no longer paper based, and more and more assets are becoming digitized.

New York's adoption of the New York UCC amendments is essential to ensure that New York continues as a preferred jurisdiction for parties transacting business, especially those now transacting business electronically or using digital assets. For commercial trade and financial transactions involving emerging technologies and digital assets, market participants will prefer those jurisdictions that adopt the UCC amendments, or, as Eric explained, the law of other countries, such as England, that are reforming their commercial laws to facilitate electronic commerce.

And the use of digital assets so far, 11 states have already enacted the UCC amendments and another 15 states and the district of Columbia have introduced bills covering the UCC amendments. We need New York to adopt the New York UCC Amendment now and during this legislative session. We really cannot wait until the legislative session in 2025 or beyond.

States that have enacted the UCC Amendments are already encouraging market participants to transact business in their states. And market participants and their attorneys will select the law of the states such as California or Delaware, or when the District of Columbia enacts the UCC amendments, the District of Columbia, to be the governing law of the transactions involving digital assets or electronic commerce. So that market participants do not resort to the law of other states, not New York, we really need the New York UCC Amendment to be adopted now to preserve New York's preeminent position as a global financial center, not just on paper-based products, but on emerging technologies and for digital assets.

[00:17:38] **Sandra Rocks:** Well, thank you to our listeners and to all our panelists for trying to focus this discussion on what is a very wide-reaching set of amendments and to bring it down to refer to specific transaction types and natures of the business that New York is engaged in to help us understand how important it is to adopt.

And I know we're all aware of healthy competition with other countries and, for example, Delaware, when it comes to selecting where an entity will be organized. But New York really has held its own when it comes to commercial finance. And as noted, Delaware has already adopted these amendments and the choice of law analysis here will become quite complex. And New York judges and practitioners will have to deal with the fact that the choice of law rules in New York's Uniform Commercial Code will nevertheless at times be sending participants to jurisdictions that have adopted the new amendments. And that is going to make for some very challenging and probably expensive situations. And with that, I will sign off and say everyone should have a wonderful rest of whatever part of the day applies at this point.

[00:18:59] **Intro/Outro Voiceover:** Thank you for listening to this episode of the New York City Bar Association podcast. Opinions expressed are those of the speakers and not necessarily of the City Bar.

If you enjoy this podcast, please like and subscribe wherever you listen.

Find more City Bar podcasts on Apple, Spotify, Google, iHeart, or at our website at www.nycbar.org/podcasts.

Be sure to check out This Lawyer's Life: a professional development podcast, where we talk with lawyers about seizing opportunities, learning lessons, the hard way, and about what makes them tick.

And don't miss Building Belonging: a podcast that embraces authentic conversations about DEIB solutions by amplifying the most marginalized voices in the legal industry and exploring spaces others dare not.

This podcast was produced and edited by Eli Cohen.