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Abstract

The Uniform Law Commission and American Law Institute have recognized the need for commercial law to govern digital transactions and responded with the proposed addition of a new article to the Uniform Commercial Code (the "Code" or "UCC"), Article 12. Article 12 will govern the transfer of property rights in a particular category of digital assets (controllable electronic records), which would include commonly known digital assets, such as bitcoin and non-fungible tokens ("NFTs"). Although the addition of Article 12 should provide more certainty in transactions involving current and emerging technologies, there is a fundamental problem with the article as it is currently drafted, which, left unresolved, will instead invite legal uncertainty and litigation. The problem is the drafters' choice to cast the "qualifying purchaser" in the role of the dramatis personae of Article 12. Article 12's "qualifying purchaser" benefits from a generous rule that allows them to take controllable electronic records free from competing claims. The drafters include a person who obtains a controllable electronic record from a thief or hacker as someone who could be a "qualifying purchaser." However, in order to be a "purchaser" under the current definition in the UCC, a person must take through a transaction that creates an interest in property. Thieves and hackers obtain no property interest when they steal a controllable electronic record, so a person who takes a controllable electronic record from a hacker could not be participating in a transaction that creates an interest in property. Thus, they could not be a "qualifying purchaser," as the drafters claim.

Most of the uncertainty of the result could have been avoided had the drafters chosen a term other than "purchaser" to describe the beneficiary of Article 12's liberal take-free rule and defined it in a manner that would effectuate the drafters' statutory aim. However, despite making the drafters aware of this glaring issue, they have failed to remedy the mistake. This is unfortunate and will likely lead to legal uncertainty and, thus, needless litigation after the article's enactment. Why rely on courts to tweak sections of the Code if ambiguities are recognized and can be eliminated by careful drafting? If inartful statutory drafting is a source of uncertainty that can easily be reduced without offsetting social costs, efforts should be made to do so.

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I. INTRODUCTION

It has now been almost 70 years since the Code[1] gained widespread acceptance by states and became the centerpiece of commercial law in the United States.[2] However, sometimes codification is made difficult because of the problem of changed circumstances. New developments involving technological capacity and business practices give rise to a serious risk of obsolescence.[3] Thus, from its inception, the Code was perceived by its drafters to be a "semi-permanent . . . piece of legislation . . . ."[4] In particular, we are told in comment 1 to § 1-103 that the drafters intended "to make it possible for the law embodied in [this Act] to be applied by the courts in the light of unforeseen and new circumstances and practices."[5] Because the Code cannot be amended often enough to account for changed circumstances, a grant of interpretive

1. Unless otherwise indicated, all references to Proposed Article 12 (Controllable Electronic Records) and its sections are to the most recent version of Article 12. All other references to the UCC are to the most recently revised version of the cited UCC articles.

2. William A. Schnader, *A Short History of the Preparation and Enactment of the Uniform Commercial Code*, 22 U. MIA. L. REV. 1, 8–10 (1967). The first version of the UCC, the 1952 Official Text of the UCC, was enacted only by Pennsylvania. *Id.* at 8. By 1968, the 1957 revised Official Text (along with minor changes promulgated in 1958 and 1968) was enacted by all but one state. *Id.* at 9–10. The UCC, in one form or another, is now the law in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. BRADFORD STONE & KRISTEN DAVID ADAMS, UNIFORM COMMERCIAL CODE IN A NUTSHELL XIII (8th ed. 2012).

3. For a somewhat dated, but still informative, catalogue of commercial innovations that have arisen since the adoption of the Code, see John F. Dolan, *Changing Commercial Practices and the Uniform Commercial Code*, 26 LOY. L.A. L. REV. 579 (1993).

4. U.C.C. § 1-103 cmt. 1 (AM. L. INST. & UNIF. L. COMM'N 2022).

5. *Id.* In particular, UCC § 1-103 provides:

> (a) [The Uniform Commercial Code] must be liberally construed and applied to promote its underlying purposes and policies, which are:
> (1) to simplify, clarify, and modernize the law governing commercial transactions;
> (2) to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and
> (3) to make uniform the law among the various jurisdictions.

Id. § 1-103.

authority to courts seems to be a valuable corrective.[6] Notwithstanding this original intent, the Code has continued to thrive as the primary source of commercial law only because of the willingness of the Uniform Law Commission ("ULC") and the American Law Institute ("ALI") to revise and refine its provisions when necessary.[7]

In addition to the normal, periodic fine-tuning of existing UCC articles to reflect case law and significant societal change,[8] several supplementary articles have been enacted as formal amendments to the Code in response to technological advances and modern business practices.[9] For example, the development of computers, reader-sorter machines, image processors, and other electronic communication and processing equipment has given rise to new paperless systems for accomplishing high-value wire credit transfers.[10] The task of "lawmaking" in response to this development could have been left to the marketplace by allowing the financial players who embraced the new payment system to drive a slowly developing common law. Instead, the ULC and the ALI added a new Article 4A to the Code in 1989 to avert uneven or unwelcome common law developments.[11]

In recent years, commercial law reformers have taken particular aim at the governing law (or lack thereof) that governs digital transactions.[12] The basic concern voiced by the ULC and the ALI is that the

6. *See* Steven L. Schwarcz, *A Fundamental Inquiry into the Statutory Rulemaking Process of Private Legislatures*, 29 GA. L. REV. 909, 918 (1995) ("It takes anywhere from three to five years for a statutory change to have been studied, drafted, and first proposed for legislative enactment. This requires an enormous devotion of human and professional capital.").

7. *See Agreement Describing the Relationship of the American Law Institute, the National Conference of Commissioners on Uniform State Laws, and the Permanent Editorial Board with Respect to the Uniform Commercial Code*, 64 A.L.I. PROC. 769, 770 (1987) (discussing the need to revise the Code when necessary).

8. Within the past 35 years, the ULC and the ALI have revised or amended (not always with the necessary state buy-in) U.C.C. Articles 1 (2001), 2 (2003), 2A (2003), 3 (2002), 4 (2002), 5 (1995), 6 (1989), 8 (1994), and 9 (1998 & 2010). *Uniform Commercial Code: Summary*, UNIF. L. COMM'N, https://www.uniformlaws.org/acts/ucc [https://perma.cc/QD5H-6JKP]. Although the particular impetus for each revision project has been somewhat different, the basic objective has always been to prevent the Code from becoming outdated. *See id.*

9. *See* U.C.C. art. 2A (AM. L. INST. & UNIF. L. COMM'N 2022); *see also id.* art. 4A.

10. *See* U.C.C. art. 4A prefatory note.

11. For example, the Article 4A drafting committee took issue with leading cases such as *Evra Corp. v. Swiss Bank Corp.*, which explained that consequential damages could be awarded if a bank, with notice of particular circumstances giving rise to damages, refuses to execute a payment order. U.C.C. § 4A-305 cmt. 2; Evra Corp. v. Swiss Bank Corp., 673 F.2d 951, 955–59 (7th Cir. 1982). The result is a statutory provision that bars consequential damages unless the bank expressly assumes such liability in writing. *See* U.C.C. § 4A-305 cmt. 2. Article 4A does not apply to consumer funds transfers governed by the Electronic Fund Transfer Act. *Id.* § 4A-108(a). Typical of these transfers are: point-of-sale transactions in which retail customers pay with a debit card, automated teller machine transactions, direct deposit of paychecks in consumer accounts, and preauthorized withdrawals from consumer accounts. *See* 15 U.S.C. § 1693a(7).

12. This Article does not attempt to address the fundamental question of whether we need a special set of rules to govern digital asset transactions or whether traditional

current lack of commercial law rules for digital assets could result in legal uncertainty and, therefore, have a chilling effect on marketplace participation.[13] After all, legal uncertainty is especially pernicious in those areas of human activity, such as commercial transactions, in which the unpredictability of legal outcomes renders individuals unable to plan their affairs without taking undue risk. At their core, commercial transactions involve "deals," the principal end of which is to secure a value-maximizing exchange of property. The practical task facing contracting parties is to shape their transaction so that the burdens and risks are allocated in a manner acceptable to each party. In order to do so effectively, it is absolutely essential that the parties have a basic understanding of applicable law.[14] If the parties cannot feel secure at the outset that a court will act in a specific and predictable fashion, a coherent contract will not be possible, and neither party will be able to price his or her performance accurately. Deals will be less efficient, and some that would have been mutually beneficial will likely not take place at all; thus, the law, due to legal uncertainty, will have hindered rather than facilitated commerce.[15]

Therefore, it is not surprising that the UCC is once again the subject of proposed amendments. In 2019, a Joint Study Committee was appointed by the ULC and the ALI to review the practical application of various provisions of the UCC and consider whether changes "are advisable to accommodate emerging technologies, such as artificial intelligence, distributed ledger technology, and virtual currency."[16] After

commercial law principles are sufficient—that is, whether digital assets should be treated as a discrete property type. It has been suggested, for example, that commercial law should not recognize distinctions between tangible and intangible property. *See* Juliet M. Moringiello, *False Categories in Commercial Law: The (Ir)relevance of (In)tangibility*, 35 FLA. ST. U. L. REV. 119, 120 (2007) (arguing that "[c]lassifying property according to its tangibility or intangibility creates false categories unrelated to significant legal distinctions, and these false categories hinder the ability of commercial law to expand to adequately accommodate electronic assets").

13. *See* U.C.C. Prefatory Note to Article 12 prefatory note.

14. *See, e.g.*, Lewis F. Powell, Jr., *Stare Decisis and Judicial Restraint*, 47 WASH. & LEE L. REV. 281, 286 (1990) (noting that predictability of outcome "is especially important in cases involving property rights and commercial transactions").

15. *See, e.g.*, Anthony D'Amato, *Legal Uncertainty*, 71 CALIF. L. REV. 1, 5 (1983) ("If rules relating to sales, commercial paper, negotiable instruments, deeds, wills, and the like approach . . . complete uncertainty, the underlying commercial activities will be deterred if not stifled."); Julian N. Eule, *Temporal Limits on the Legislative Mandate: Entrenchment and Retroactivity*, 12 AM. BAR FOUND. RSCH. J. 379, 440 (1987) ("Advance planning is necessary for economic development. Investments that will be legally as well as financially speculative are less likely to be undertaken. Those who rely on existing law are undoubtedly entitled to certain assurances that their interests will not be undervalued or ignored by future lawmakers."). Consider also the ALI's command to its restatement reporters "to help make certain much that is now uncertain and to simplify unnecessary complexities." *Report of the Committee on the Establishment of a Permanent Organization for the Improvement of the Law Proposing the Establishment of an American Law Institute*, 1 A.L.I. PROC. 1, 14 (1923).

16. Prefatory Note to 2022 UCC Amendments cmt. 1 (AM. L. INST. & UNIF. L. COMM'N 2022).

the Committee identified a number of problems with the current Code that needed fixing, it was given the go-ahead to begin drafting amendments "dealing with digital assets, bundled transactions (*i.e.*, transactions involving the sale or lease of goods together with the provision of services, the licensing of information, or both), and payments, as well as for certain discrete amendments to the UCC unrelated to emerging technologies."[17] Included among the amendments is the addition of a new Article 12 that will govern the transfer of property rights in a particular category of digital assets (controllable electronic records) that have been or may be created using new technologies.[18]

In July 2021, the ULC gave its first reading to a draft of proposed amendments.[19] In May 2022, the ALI, for the first time, formally considered and approved the amendments, subject to the discussion at the meeting and to "editorial prerogative."[20] Next, the second and "final" reading by the ULC occurred at its annual meeting in July 2022, and the new UCC Article 12 was officially promulgated later that year after final review by the ULC style committee. The 2022 Amendments to the Code have now been adopted in 11 jurisdictions and are already effective in 10 of those jurisdictions. Bills have been introduced in at least 17 more.

Although this Article briefly touches on some of the proposed amendments to existing UCC articles and other aspects of those articles, its primary focus is on new Article 12. To a great extent, Article 12 simply attempts to mirror the good faith purchase doctrine—the basic common law exception to what can best be described as the first principle of Anglo-American property law: the transferee of property can receive no greater interest than that possessed by the transferor.[21] This

17. U.C.C. Reporter's Prefatory Note to Jan. 17, 2022 Draft cmt. 1 (UNIF. L. COMM'N, Draft Jan. 17, 2022).

18. U.C.C. art. 12 prefatory note (AM. L. INST. & UNIF. L. COMM'N 2022). Since it is the authors' purpose in this Article to point out a serious problem with Article 12, its provisions will be discussed in some detail. *See infra* notes 23, 36, 39, 55, 57, 75–78, 85, 87, 91, 97, 118 and accompanying text.

19. U.C.C. Reporter's Prefatory Note to Apr. 11, 2022 Draft (AM. L. INST. & UNIF. L. COMM'N, Tentative Draft No. 1, 2022).

20. *2022 Annual Meeting: Daily Update – Wednesday, May 18*, AM. L. INST., https://www.ali.org/annual-meeting-2022/updates/wednesday-may-18/ [https://perma.cc/222U-33AF].

21. This principle has also been labeled the "derivation principle." *See* RANDAL C. PICKER ET AL., SECURITY INTERESTS IN PERSONAL PROPERTY 75–76 (3rd ed. 2002). Or, put in more eloquent terms: "Title, like a stream, cannot rise higher than its source." Barthelmess v. Cavalier, 38 P.2d 484, 490 (Cal. Dist. Ct. App. 1934). This first principle often appears as the Latin maxim *nemo dat quod non habet*. *Nemo Dat Quod Non Habet: Legal Concept Explained*, LEGAL BUDDIES, https://getlegalbuddies.com/blog/nemo-dat-quod-non-habet-legal-concept-explained/ [https://perma.cc/35Y9-YMC4] (Jan. 1, 2024). It has been trumpeted that "[t]he triumph of the good faith purchaser has been one of the most dramatic episodes in our legal history." Grant Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057, 1057 (1954). With this victory came the correlative commercial doctrine of good faith purchase—a doctrine that allows for the chipping away of "security of ownership" in favor of "security of

Article examines one facet of the Article 12 exception to this first principle. In particular, it takes aim at the unforced blunder of the Article 12 drafters in their choice to cast the "qualifying purchaser" in the role of the dramatis personae of Article 12.[22]

Part I of this Article provides an overview of Article 12 and illustrates how it interacts with common types of controllable electronic records. Part II describes the key concepts of control and the "qualifying purchaser" to demonstrate both the scope of Article 12 and how the good faith purchase doctrine is reflected in it. Part III discusses how other articles of the UCC have dealt with the introduction of a thief into the chain of title. Part IV explains the fundamental problem with Article 12 that results from the drafters' use of the term "purchaser." This Article will then conclude that action must be taken to correct the problem resulting from the use of "purchaser" to prevent legal uncertainty.

II. Overview of Article 12

UCC Article 12 applies to a particular type of digital asset, which is defined as a "controllable electronic record" ("CER").[23] These CERs range from certain forms of virtual currency to so-called non-fungible tokens.[24] They also are intended to include those CERs that evidence certain rights to payment where the obligor has agreed to make payments to the person that has control of the electronic record—controllable accounts and controllable payment intangibles.[25] As the drafters make clear in the Prefatory Note to the 2021 draft of the amendments,

purchase." For a discussion of this conflict, see generally John F. Dolan, *The U.C.C. Framework: Conveyancing Principles and Property Interests*, 59 B.U. L. Rev. 811 (1979); Grant Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 Ga. L. Rev. 605 (1981); William D. Warren, *Cutting Off Claims of Ownership Under the Uniform Commercial Code*, 30 U. Chi. L. Rev. 469 (1963); Harold R. Weinberg, *Markets Overt, Voidable Titles, and Feckless Agents: Judges and Efficiency in the Antebellum Doctrine of Good Faith Purchase*, 56 Tul. L. Rev. 1 (1981). The good faith purchase doctrine makes it possible for the transferee of property to receive under certain circumstances a property interest superior to that of the transferor.

22. *See infra* notes 76–77, 81, 85, 87, 91, 118–19 and accompanying text. Interspersed throughout the Code one finds several characters with different names, but all are entitled in certain situations to good faith purchase treatment. *See, e.g.*, U.C.C. § 2-403(1) (Am. L. Inst. & Unif. L. Comm'n 2022) (good faith purchaser for value); *id.* § 2-403(2) (buyer in ordinary course); *id.* § 3-302 (holder in due course); *id.* § 7-502 (holder to which a negotiable document of title has been duly negotiated); *id.* § 8-303 (protected purchaser).

23. U.C.C. § 12-102(a) (defining a CER as "an electronic medium that can be subjected to control under Section 12-105. The term does not include a controllable account, a controllable payment intangible, a deposit account, an electronic copy of a record evidencing chattel paper, an electronic document of title, electronic money, investment property, or a transferable record").

24. Prefatory Note to 2022 UCC Amendments cmt. 2.

25. U.C.C. Reporter's Prefatory Note to Article 12 (Am. L. Inst. & Unif. L. Comm'n, Draft Dec. 13, 2021).

Article 12 is designed to respond to existing digital assets that are made possible by newly developed technologies, such as distributed ledger technology, and technologies that may be developed in the future.[26]

For those who may not be entirely comfortable with important trends in technology and electronic commerce, we thought that it might be helpful, when conceptualizing the scope of Article 12 and the rights acquired by purchasers in different CERs, to begin by thinking metaphorically in terms of three tangible box types. These three box types correlate to some of the main types of CERs that would be governed by Article 12: fungible tokens, non-fungible tokens, and controllable accounts and payment intangibles.

A. *The Three Metaphorical Boxes*

BOX 1: Imagine a tangible box that contains absolutely nothing and is purchased because the purchaser views it, for whatever reason, as an attractive item (e.g., an empty jewelry box). When purchased, the purchaser acquires rights in the box and nothing more. This simple metaphor is meant to correlate to the various virtual (non-fiat) currencies that qualify as CERs. Consider, for example, the cryptocurrency Bitcoin.[27] When one purchases a Bitcoin, one receives a Bitcoin, nothing more or less. Whatever its assigned economic value happens to be on a particular day, it bears no relationship to extrinsic rights and interests. In common parlance, this particular type of CER can also be described as a fungible token—each Bitcoin is the same as another.

BOX 2: This box is not a stand-alone box but contains something else. Suppose, for example, what our purchaser desires is a watch. After making the purchase, the purchaser leaves the store clutching a box with a watch inside. Here, the point of the transaction is not to acquire the box but the watch. The box merely serves as the storage container or method of conveyance. This box correlates to the so-called NFT. The idea behind an NFT is that by owning a unique digital token that is

26. *See id.*

27. Interestingly, on June 8, 2021, the Congress of El Salvador passed a law that conferred "legal tender" status upon Bitcoin. Brian M. McCall, *How El Salvador Has Changed U.S. Law by a Bit: The Consequences for the UCC of Bitcoin Becoming Legal Tender*, 74 OKLA. L. REV. 313, 313–14 (2022) ("The law took effect in El Salvador on September 7, 2021; starting that day, Bitcoin could be used to pay taxes and buy goods and services in El Salvador."). As the first country to adopt Bitcoin as legal tender, El Salvador has made this particular cryptocurrency money for purposes of the UCC. *Id.*; *see* U.C.C. § 1-201(b)(24) (AM. L. INST. & UNIF. L. COMM'N 2022) (defining money as "a medium of exchange that is currently authorized or adopted by a domestic or foreign government"). The 2022 amendments to the Code changed the definition of money to exclude any "medium of exchange recorded and transferable in a system that existed and operated for the medium of exchange before the medium of exchange was authorized or adopted by the government." U.C.C. § 1-201(b)(24). So, in the future, Bitcoin would lose its status as money, but not as a CER.

tracked on a blockchain, one can acquire ownership of some other asset, either digital (e.g., digital art,[28] digital collectibles like CryptoKitties,[29] tweets,[30] and newspaper columns[31]) or real world (e.g., securities,[32] deeds of real property,[33] and bills of lading[34]). In sum, unlike the Box 1 fungible CER, the Box 2 non-fungible CER is both unique and designed to transfer property rights and the related economic value to some other asset. However, Article 12 only governs the purchaser's rights in the box, the token on the blockchain, not their rights in the watch, the tethered asset.

BOX 3: In this scenario, there is again a box with a watch, and what the purchaser really desires is just the watch. So, the CER that is represented by this box is similar to the second in that its value and purpose is to convey rights to something else. Here, that something else is a specified payment right that satisfies the currently existing definition of an "account" or "payment intangible" in UCC Article 9.[35] When the account or payment intangible becomes embedded in a CER, it is now a "controllable account"[36] or "controllable payment intangible"[37] if the account debtor (the person obligated on the account or payment intangible) has agreed to pay the person in control of the CER.[38] Therefore, the controllable accounts and payment intangibles (the watch) are, essentially, rights to payment evidenced by a controllable electronic record (the box). Unlike Box 2, however, Article 12 would govern the purchaser's rights in the box and the watch in this case.

28. *See* Manas Sen Gupta, *The Most Expensive NFT Artworks Ever Sold*, PRESTIGE (Feb. 1, 2022), https://www.prestigeonline.com/my/pursuits/wealth/most-expensive-nfts-sold-till-date/ [https://perma.cc/4N5T-9X2P] (listing various NFTs that are digital art).

29. *See* Tonya M. Evans, *Cryptokitties, Cryptography, and Copyright*, 47 AIPLA Q.J. 219, 250 (2019).

30. *See* Elizabeth Howcroft, *Twitter Boss Jack Dorsey's First Tweet Sold for $2.9 Million as an NFT*, REUTERS (Mar. 22, 2021, 12:50 PM), https://www.reuters.com/article/us-twitter-dorsey-nft/twitter-boss-jack-dorseys-first-tweet-sold-for-2-9-million-as-an-nft-idUSKBN2BE2KJ [https://perma.cc/T6WR-9LCL].

31. *See* Kevin Roose, *Buy This Column on the Blockchain!*, N.Y. TIMES, https://www.nytimes.com/2021/03/24/technology/nft-column-blockchain.html [https://perma.cc/RC7H-ZH5X] (June 23, 2023).

32. *See* Juliet M. Moringiello & Christopher K. Odinet, *The Property Law of Tokens*, 74 FLA. L. REV. 607, 618–22 (2022), https://doi.org/10.2139/ssrn.3928901.

33. *Id.* at 622–24.

34. *Id.* at 624–25.

35. *See* U.C.C. § 9-102(a)(2), (61) (AM. L. INST. & UNIF. L. COMM'N 2022) (defining "account" and "payment intangible").

36. *Id.* § 9-102(a)(27A).

37. *Id.* § 9-102(a)(27B).

38. *Id.* § 12-104(b), (e).

III. Key Concepts in Article 12

A. *The Possessory Concept of Control*

Each of the preceding three metaphorical boxes is only a CER if it is susceptible to "control."[39] Control substitutes for the concept of possession in the intangible context. Operating in conjunction with the concepts of title and seisen,[40] possession,[41] and the expectations it arouses have long been the touchstone in defining the application and reach of the good faith purchase doctrine.[42] Possession has also always been an appropriate method for perfecting a UCC Article 9 security interest in goods and in various forms of indispensable paper.[43] Since intangible forms of property, in contrast, are not capable of being possessed, a different concept is called for to settle conflicting claims in a manner consistent with reasonable expectations based on what would otherwise be possession and, perhaps, to provide an analogous method for perfecting security interests.[44] To perform this role, the UCC drafters have chosen the idea of control.

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39. *Id.* §§ 12-102(a)(1), 12-105(a).

40. For a discussion of the concept of seisen as applied to personal property, see generally F.W. Maitland, *The Seisin of Chattels*, 1 L.Q. Rev. 324, 324–25 (1885).

41. Professors White and Summers make the point that what constitutes possession can often be a difficult and challenging task:

> Possession is a notoriously plastic idea. Historically it has taken many different shapes depending on the circumstances. Property law recognizes and distinguishes among constructive possession, physical possession, actual possession, mere custody, and other similar notions. . . . In some property cases the courts must decide whether a deed has been delivered into the possession of the transferee, whether a party has commenced adverse possession, or whether possession was sufficient to put some other party on notice of an interest. In the course of the many decisions which have dealt with its meaning, the word "possession" has taken varied form and has accommodated itself to the needs of real property law, the law of consignment, insurance, and criminal law. The drafters of the UCC were aware of this history, and they have declined the futile task of defining possession in the Code.

James J. White et al., Uniform Commercial Code 1120 (7th ed. 2022).

For purposes of this discussion, it is thankfully not necessary to attempt to formulate a precise definition of what constitutes possession. If the reader adopts the intuitive everyday meaning of what constitutes possession, that should be sufficient.

42. *See supra* note 21 and accompanying text (describing the good faith purchase doctrine which includes a wide array of rules that allow a transferee of property to acquire a greater interest than her transferor had).

43. White et al., *supra* note 41, at 1120 ("Traditionally, possession of personal property in the law of security interests has been important because of the notice it gives to prospective creditors, a fundamental policy of this branch of law."). Currently, § 9-313(a) authorizes perfection by possession of "tangible negotiable documents, goods, instruments, money, or tangible chattel paper . . . ." U.C.C. § 9-313(a). Moreover, this same section permits a secured party to perfect a security interest in a certificated security by taking delivery of the certificate (i.e., possession) as provided in § 8-301. *Id.*

44. We say "perhaps" because the filing of a financing statement has always been a substitute method for perfecting a security interest in certain types of intangible forms of personal property, such as accounts and general intangibles. In fact, Article 9's

Control as the intangible's equivalent of possession first made its appearance in the UCC by way of the 1994 revision to Article 8.[45] That revision of Article 8 made control a central feature to the application of several provisions dealing with the rights of purchasers of investment property, including secured parties.[46] As part of this revision project, control was also introduced into Article 9 by way of former § 9-115.[47] Next came the 1999 revision to Article 9, which expanded the role of control significantly.[48] It was made the exclusive method of perfecting a security interest in deposit accounts[49] and letter-of-credit rights[50] and an optional perfection method for investment property[51] and electronic chattel paper.[52] Then, when Article 7 was revised in 2003 to accommodate electronic documents, control was recognized as a method of perfection.[53]

With this brief background, we return again to Article 12 and the CER. What is control in this new context?[54] The answer to this question is found in § 12-105. That section conditions control on the acquisition of the three powers specified in paragraph (a)(1).[55] These are: "the power to enjoy 'substantially all the benefit' of the CER, the exclusive power to prevent others from enjoying 'substantially all the benefit' of the CER, *and* the exclusive power to transfer control of the CER."[56]

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default rule requires the filing of a financing statement to perfect all security interests. *See* U.C.C. § 9-310(a). But filing a financing statement is not analogous to possession.

45. Jeanne L. Schroeder, *Is Article 8 Finally Ready This Time? The Radical Reform of Secured Lending on Wall Street*, 1994 COLUM. BUS. L. REV. 291, 297–98 ("To a large part the drafters justify their choice on traditional commercial law and conveyancing principles re-articulated through a new concept called 'control.'").

46. *See* U.C.C. § 8-303 ("Protected Purchaser"); *id.* § 8-503 ("Property Interest of Entitlement Holder in Financial Asset Held by Securities Intermediary"); *id.* § 8-510 ("Rights of Purchaser of Security Entitlement from Entitlement Holder").

47. *See* Schroeder, *supra* note 45, at 376, 389.

48. Beth A. Diebold, *The Expanding Concept of Security Interests: An Introduction to Revised UCC Article 9*, 12 LOY. CONSUMER L. REV. 151, 154–55 (2000).

49. *See* U.C.C. §§ 9-312(b)(1), 9-104.

50. *See id.* §§ 9-312(b)(2), 9-107.

51. *See id.* §§ 9-314(a), 9-106.

52. *See id.* §§ 9-314(a), 9-105.

53. Drew L. Kershen, *Article 7: Documents of Title—2003 Developments*, 59 BUS. LAW. 1629, 1630 (2004); *see* U.C.C. §§ 7-106, 9-314(a).

54. Control in other contexts is defined in § 7-106 (Control of Electronic Document of Title), § 9-104 (Control of Deposit Accounts), § 9-105 (Control of Electronic Chattel Paper), and § 9-107 (Control of Letter-of-Credit Right). For investment property, § 9-106 defines control for purposes of a commodity contract but directs one to § 8-106 for other types of investment property. U.C.C. § 9-106.

55. *Id.* § 12-105; U.C.C. § 12-105 Reporter's Note 2 (AM. L. INST. & UNIF. L. COMM'N, Draft Jan. 17, 2022) ("A person would have a power described in this paragraph if the controllable electronic record, a record attached to or logically associated with the controllable electronic record, or any system in which it is recorded gives the purchaser that power.").

56. Edwin E. Smith & Steven O. Weise, *The Proposed 2022 Amendments to the Uniform Commercial Code: Digital Assets*, AM. BAR ASS'N (Mar. 25, 2022), https://www.americanbar.org/groups/business_law/resources/business-law-today/2022-april/the--proposed-2022-amendments/ [https://perma.cc/GMT6-4MPB].

Moreover, the person must be able to demonstrate to others that the person has the power to use the electronic record.[57]

Interestingly, the Article 12 requirements for control mimic, in large measure, the liberal conception of ownership of property embraced by all mature legal systems.[58] This conception is grounded in the observation that property is best understood in a relational context, that is, "to denote legal relations between persons with respect to a thing."[59] For this reason, the *Restatement of Property* defines the term "property" nowhere but, rather, defines the more appropriate terms "right,"[60] "privilege,"[61] "power,"[62] and "immunity."[63] This approach attempts to promote "[c]larity of thought and exactness of expression . . . ."[64] It is worth noting that in 1913, Wesley N. Hohfeld published the first of a series of influential articles in which he claimed to have identified what he described as the eight "lowest common denominators of the law."[65] These consist of four primary entitlements (rights, privilege, power, and immunity) and their opposites and correlatives (no-rights, duty, disability, and liability).[66] His purpose was to demonstrate that only by utilizing these fundamental conceptions was it possible to "think straight" about everyday legal problems.[67] In this connection, he exposed legal ideas like "title," "due process," privity," and "ownership" as meaningless expressions and, hence, unsuitable guides to the understanding and correct solution of cases.[68]

If one is to think in terms of Hohfeld's power-liability and immunity-disability vocabulary when considering Article 12's conception of control, it would certainly be helpful to conjoin it with the analysis of ownership suggested by A.M. Honoré.[69] For Honoré, the liberal concept of ownership consists of 11 incidents or relations of ownership that can be spread in a variety of ways among two or more persons.[70] These incidents were inspired by Hohfeld and include some rights that are quite similar to the powers required for control of an Article 12

57. *See* U.C.C. § 12-105(a)(2) (Am. L. Inst. & Unif. L. Comm'n 2022).

58. *See* A.M. Honoré, *Ownership* ("There is indeed, a substantial similarity in the position of one who 'owns' an umbrella in England, France, Russia, China, and any other modern country one may care to mention."), *in* Oxford Essays in Jurisprudence 107, 108 (A. G. Guest ed., 1961).

59. Restatement of Prop. ch. 1, Introductory Note (Am. L. Inst. 1936).

60. *Id.* § 1.

61. *Id.* § 2.

62. *Id.* § 3.

63. *Id.* § 4.

64. *Id.* at ch. 1, Introductory Note.

65. Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 Yale L.J. 16, 58 (1913).

66. *Id.* at 30.

67. *Id.* at 18.

68. *See* Edwin W. Patterson, Jurisprudence: Men and Ideas of the Law 139 (Harry W. Jones ed., 1953).

69. *See generally* Honoré, *supra* note 58.

70. *Id.* at 113.

electronic record. These are the right to use,[71] the right to the capital,[72] and the right to security.[73]

The primary contention of this Article is that the drafters of Article 12 erred in one important respect in establishing conditions for an electronic record transferee to receive good title to the electronic record. Therefore, although interesting, this brief digression into the theoretical underpinnings of ownership and its relationship to the definition of control is ultimately of minimal relevance to the claim made here. Accordingly, the remainder of this Article will assume that the person claiming title to the record has acquired control.

B. *The Rights of a (Qualifying) Purchaser*

The derivation principle and its exception, the good faith purchase doctrine, are at the core of Article 12. The principle is codified in § 12-104(d), which provides that a purchaser of a CER acquires all rights that its transferor had or had the power to transfer.[74] Thus, in the absence of a statutory or common law exception, Article 12 follows the general conveyancing principle of *nemo dat* and the shelter rule.[75] So far, so good. Let us now consider Article 12's formulation of the good faith purchase doctrine in the context of CERs. We begin with Article 12's definition of "qualifying purchaser." Section 12-102(a)(2) provides:

> "Qualifying purchaser" means a purchaser of a controllable electronic record or an interest in a controllable electronic record that obtains control of the controllable electronic record for value, in good faith, and without notice of a claim of a property right in the controllable electronic record.[76]

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71. This means the right to "personal use and enjoyment" only. Honoré, *supra* note 58, at 116. In Hohfeld's terms, the person has a privilege to use and a right that his privilege not be interfered with. *See* Hohfeld, *supra* note 65, at 35.

72. This is the power to alienate a thing, and the privilege to consume, waste, or destroy it. Honoré, *supra* note 58, at 118.

73. This right assumes—apart from bankruptcy and debt collection remedies—that the thing cannot be expropriated by someone without first obtaining permission from the right-holder to do so. *See id.* at 119.

74. U.C.C. § 12-104(d) (Am. L. Inst. & Unif. L. Comm'n 2022).

75. An important aspect of the derivation principle is a corollary rule colloquially named the "shelter rule." This rule is reflected in *id.* §§ 2-403(1), 3-203(b), 7-504(a), 8-302(a). While *nemo dat* states the idea that a transferee of property obtains no greater rights than its transferor had; the shelter rule reflects the idea that a transfer of property will vest the transferee with no fewer rights than those held by its transferor. Lary Lawrence, An Introduction to Payment Systems 134 (1997). In other words, the transferee steps into the shoes of its transferor. These twin aspects of the derivation principle are expressed in § 12-104(d). Section 12-104(c) suggests that the section works in tandem with other law. It reads: "Except as provided in this section, law other than this article determines whether a person acquires a right in a controllable electronic record and the right the person acquires." U.C.C. § 12-104(c). We are told in the Reporter's Note to this section that other law might include, for example, UCC Article 9. *See id.* § 12-104 cmt. 3.

76. U.C.C. § 12-102(a)(2).

Not surprisingly, we are told by the drafters that the criteria for qualifying purchaser replicates, in important respects, the criteria for holder in due course status under Article 3.[77] For example, § 3-302 provides that a holder in due course must (1) take the instrument for value,[78] (2) in good faith,[79] and (3) "without notice of any claim to the instrument described in Section 3-306."[80]

The hallmark of qualifying purchaser status is the freedom from a competing claim of a property or possessory right in the CER that is enjoyed by the purchaser. This can work to cut off the rights of third parties who are not parties to the CER transaction. Even in situations to which this aspect of the Article 12 good faith purchase doctrine applies, the effect of this benefit may be less than is initially appreciated. The reason lies not in the utility of this "take-free" rule[81] but in its scope. There are two important limitations to the rule.

First, the application of the take-free rule does not encompass a benefit of holder in due course status that historically has had significant commercial importance. We refer, of course, to the freedom from personal defenses and claims in recoupment accorded to such holders under § 3-305(b).[82] Certainly, the obligation to pay, which is tethered to, or made part of, the CER (a controllable account or controllable payment intangible) would have greater value to the purchaser if it were assured of taking the payment right-free from virtually any ground of nonpayment, including virtually all defenses and claims in recoupment. Notwithstanding the absence of this consequence of holder in due course status from Article 12, its functional equivalent can, nevertheless, be achieved by contract. Both § 9-403(b)[83] and the

77. *See id.* § 12-102 cmt. 3. This is not surprising because many of those same policy considerations that entitle the holder in due course to good faith purchase treatment will also justify the special treatment of qualifying purchasers. *See infra* Part IV.

78. U.C.C. § 3-302(a)(2)(i). The relevant definition of value is found in § 3-303(a). *Id.* §§ 3-303(a), 12-102(a)(4).

79. U.C.C. § 3-302(a)(2)(ii).

80. *Id.* § 3-302(a)(2)(v).

81. This descriptive phrase is used by the drafters of Article 12 in their discussions of the consequences of qualifying purchaser status. *See* Smith & Weise, *supra* note 56 ("[I]f the purchaser is a 'qualifying purchaser,' the purchaser benefits from the 'take-free' rule, *i.e.*, the purchaser acquires the CER free from competing property claims to the CER.").

82. U.C.C. § 3-305(b).

83. Section 9-403(b) provides:

> (b) [Agreement not to assert claim or defense.] Except as otherwise provided in this section, an agreement between an account debtor and an assignor not to assert against an assignee any claim or defense that the account debtor may have against the assignor is enforceable by an assignee that takes an assignment:
>
> (1) for value;
>
> (2) in good faith;
>
> (3) without notice of a claim of a property or possessory right to the property assigned; and

common law[84] sanction the use of contractual free-from-defenses clauses that can be used to create undertakings that bring about the advantages of those obligations that are reified in a negotiable instrument.

The second limitation to the Article 12 take-free rule is that, with the exception of the right to payment evidenced by a controllable account or controllable payment intangible,[85] it adds nothing to the qualifying purchaser's interest in property that is tethered to a CER (we have in mind metaphorical Box 2[86]).[87] Consider, for example, an article in the *New York Times* discussing recent events surrounding the website OpenSea, which bills itself as the world's largest web marketplace for NFTs and crypto collectibles.[88] According to the *Times*, there is a widespread problem of hackers using phishing scams to steal NFTs to which digital art is tethered.[89] The hackers then use this same website to traffic the stolen NFTs.[90]

Suppose now that the purloined NFT is sold. Assessing the rights of a purchaser of the stolen NFT requires first that one ascertain whether the purchaser is a qualifying purchaser under Article 12. But the relevance of that inquiry pertains only to the electronic record or NFT, not to the tethered object. Even assuming that the qualifying purchaser acquires good title to the record, this tells us nothing about the interest

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(4) without notice of a defense or claim in recoupment of the type that may be asserted against a person entitled to enforce a negotiable instrument under Section 3-305(a).

Id. § 9-403(b).

84. Illustration 10 to Restatement (Second) Contracts § 336 provides:

> A sells and delivers goods to B, and B agrees that in the event of an assignment to C, B will pay the price to C without asserting any defense or claim based on breach of warranty by A. A assigns his rights under the contract to C, who takes in good faith and without notice of any defense or claim. In the absence of statute or administrative rule, B is barred from asserting against C a defense or claim based on breach of warranty by A.

RESTATEMENT (SECOND) OF CONTS. § 336 cmt. f, illus. 10 (AM. L. INST. 1981).

85. Section 12-104(a) tells us that this section applies to controllable accounts and controllable payment intangibles in the same way that it applies to CERs. This means that all the benefits of the shelter principle and the take-free rule for qualifying purchasers of CERs apply with equal force to the interest acquired by a qualifying purchaser in the account or payment intangible. Smith & Weise, *supra* note 56. In other words, "the controllable account or controllable payment intangible travels with the CER, and the transferee may benefit from the same 'take-free' rule that applies to the CER. The effect is to create what is functionally an electronic instrument." *Id.*

86. *See supra* Section II.A.

87. U.C.C. § 12-104(f) ("Except as provided in subsections (a) and (e) . . . a qualifying purchaser takes a right to payment, right to performance, or other interest in property evidenced by the controllable electronic record subject to a claim of a property right in the right to payment, right to performance, or other interest in property.").

88. David Yaffe-Bellany, *Thefts, Fraud and Lawsuits at the World's Biggest NFT Marketplace*, N.Y. TIMES (June 6, 2022), https://www.nytimes.com/2022/06/06/technology/nft-opensea-theft-fraud.html [https://perma.cc/H64M-XYVS].

89. *See id.*

90. *Id.*

acquired in the tethered object. More to the point, the Reporter's Note to § 12-104 explains that the section:

> [L]imits the application of the take-free rule in subsection (e) to controllable electronic records and, through the application of subsection (a), controllable accounts and controllable payment intangibles evidenced by a controllable electronic record. Under subsection (f), except as provided in subsections (a) and (e), a qualifying purchaser takes rights to payment (other than controllable accounts and controllable payment intangibles), rights to performance, and interests in property that are evidenced by a controllable electronic record subject to third-party property claims, unless law other than Article 12 provides to the contrary.[91]

What that "other law" might be in the case of tethered digital art is anyone's guess. What is clear is that whatever interest the purchaser has in the NFT by virtue of Article 12[92] tells us nothing about her intellectual property rights in the art.[93] On the other hand, in some situations, the law that governs ownership of the tethered object will be clear. The following simple example may aid the discussion:

> Sam Smith operates "Smith's Watches" where he sells and repairs watches. In an effort to expand sales, Sam decided to take advantage of the crypto token craze by using an NFT platform to mint and sell tokens that are linked to his watches. Purchasers are led to believe that when they purchase a token, they obtain title to, with the corresponding right, to receive, the linked watch from Sam.[94] One day, Sally Jones brings her treasured heirloom watch to Sam so that he can make some needed repairs. Later that same day, one of Sam's employees mistakenly tokenizes the watch and the resulting NFT is purchased by Isaac Innocent, who subsequently takes possession of the watch from Sam.

What are the respective rights of Sally and Isaac to the watch? Or perhaps the more relevant question to ask at this juncture is what source(s) of law will be used to determine those rights? First, there is the NFT to consider. For this aspect of the transaction, the relevant source of law would be Article 12, specifically § 12-104(d). Notice that because there are no competing claims to the NFT, Isaac will get good title without needing to rely on Article 12's take-free rule, and his status as a qualifying purchaser would be irrelevant. But what about the watch itself? After all, acquiring good title to the watch is the essential purpose of the transaction. Here, since we have a common example of goods (i.e., the watch) being entrusted to a merchant who deals in

91. U.C.C. § 12-104 cmt. 9.

92. We argue later in this Article that despite Article 12's take-free rule, the so-called purchaser would acquire zero interest in the NFT. *See infra* Part IV.

93. *See* Smith & Weise, *supra* note 56 ("[T]he proposed amendments do not affect copyright law as it relates to someone in control of a non-fungible token . . . .").

94. *See generally* Moringiello & Odinet, *supra* note 32 (discussing NFT's as a token and their connection, if any, with the underlying assets they represent).

goods of that kind, we look to subsections (2) and (3) of § 2-403, which are designed to protect persons who buy in ordinary course out of inventory.[95] The overall result in our example, therefore, is that Isaac gets good title to the NFT under Article 12 and good title to the watch under Article 2.

The foregoing discussion of Article 12 is intended to provide no more than a basic understanding of its scope and operation. It is fair to assume that the principal goal of its drafters was to clear up a good part of the confusion and imprecision surrounding the relationship between "security of property" and "security of ownership" in the context of electronic records, thereby facilitating exchange between parties in a free and open market. In other words, the goal was to provide a statutory framework for an area of the law that has never before been codified. That sounds simple enough. What, then, is the problem? We must first look at how the UCC generally deals with the introduction of a thief into the chain of title so that we can then understand the problem that arises from using the term "purchaser."

IV. Introducing a Thief into the Chain of Title

As discussed above,[96] the most significant contribution of Article 12 is to provide a set of rational rules to govern the allocation of competing claims to property in a CER. If a CER is purchased, the purchaser acquires all rights that the transferor had in the CER (i.e., the "shelter" rule).[97] In addition, if the purchaser is a "qualifying purchaser," she acquires the CER free from competing property claims (the "take-free" rule). With this scheme in mind, consider the following scenario drawn from the Reporter's Prefatory Note to Article 12:

> [A]ssume that *O* is the owner of [a] bitcoin and that *S* is a hacker, who acquire[s] control of the bitcoin illegally from *O*.
>
> - Just as a buyer of goods can obtain possession from a seller that has no rights in the goods, *B* can obtain control of the bitcoin, even if *S* "stole" it from *O*.
> - If *B* obtains control of the bitcoin for value, in good faith, and without notice of any claim of a property interest, *B* would be a qualifying purchaser.
> - Even if *B* would not have acquired any rights in the bitcoin under non-Article 12 law . . . as an Article 12 qualifying purchaser, *B* would acquire the bitcoin free of all claims of a property interest in the bitcoin. . . . [In the unlikely event that *O*] could locate *B*,

95. U.C.C. § 2-403(2) ("Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business."); *id.* § 2-403 cmt. 2.

96. *See supra* notes 13, 17–18 and accompanying text.

97. U.C.C. § 12-104(d).

> *B* would defeat *O*'s claim of ownership and own the bitcoin free and clear. The same result would obtain if *B* bought a negotiable instrument from a thief under circumstances where *B* became a holder in due course.[98]

The foregoing scenario clearly evinces the drafters' intention to codify what can only be described as a significant and far-reaching exception to the time-honored security of property principle that even a good faith purchaser who takes property from a thief will not defeat the true owner's title.[99] But, as with most time-honored rules, there are likely to be existing exceptions. In fact, the drafters direct our attention to one such exception in favor of a holder in due course of a negotiable instrument under Article 3. Consider the following example:

> Harry writes a check "to the order of Mary" and gives it to her. Mary signs just her name on the back of the check. The check is then stolen by the thief, who negotiates the check to Sam, who, giving value for the check in good faith and without notice of the theft, qualifies as a holder in due course.

What result? Sam has good title to the check, and poor Mary is left with a presumably worthless conversion claim against the thief. Under Article 3, when Mary indorses the check by signing her name,[100] she converts the check into a check payable to the bearer.[101] Because the check is now in bearer form, the taking by the thief constitutes a negotiation,[102] with the thief qualifying as its new holder.[103] At this point, the check remains the property of Mary, but not for long. As a holder in due course, Sam takes the check free of all claims to the instrument.[104] Essentially, then, Article 3 establishes a token-based system where ownership of property is established by possession—the only thing that needs to be verified by the taker is the instrument's authenticity—much like the recipients of Federal Reserve Notes or other forms of money.[105] When one takes a $20 bill, for example, one need only be concerned with its authenticity. If it is fake, the recipient is simply out of luck. Moreover, there is little recourse for people who have their money lost or stolen.

The Article 3 tokenization exception to the rule that a thief cannot pass good title is reflected in other areas of commercial law as well. Compare, for example, the approach taken with respect to negotiable

98. *See id.* Prefatory Note to Article 12, cmt. 3.
99. *See, e.g.*, Wheelwright v. Depeyster, 1 Johns. 471, 471, 482 (N.Y. Sup. Ct. 1806) (holding that the purchasers of coffee stolen by privateers acquired no title to it).
100. *See* U.C.C. § 3-204 ("Indorsement").
101. *See id.* §§ 3-109(c), 3-205(b).
102. *See id.* § 3-201. ("Negotiation").
103. *See id.* § 1-201(21) (defining "holder").
104. *See id.* § 3-306 ("Claims to an Instrument").
105. *See, e.g.*, Miller v. Race (1758) 97 Eng. Rep. 398, 401; 1 Burr. 452, 457.

documents of title under Article 7. There, we are told that a holder[106] to whom a negotiable document of title has been "duly negotiated" acquires title to the document and the goods it represents.[107] Thus, what matters for title purposes are the form and validity of the document and the nature of the transaction. In other words, even a thief can pass good title to a document under the right circumstances.[108]

The historical tension between security of property principles and security of purchase principles has always played out differently in the context of goods. Although we can identify instances where Article 2 provides a wrongdoer with the power to pass a better title than she has, the wrongdoer is only in that position because of a contributory action taken by the true owner. Consider the rules of § 2-403. That section begins with the introduction of the title classification known as "voidable title" and the concomitant rule that a person who has voidable title has the power to transfer good title to a good faith purchaser for value.[109] Persons who have voidable title are those who have somehow tricked or conned the true owner into voluntarily transferring possession of the goods to them.[110] They might have done so by impersonating a third party or purchasing the goods with a check that later bounced.[111] Regardless of how voidable title was obtained, the important point here is that the wrongdoer is not a true thief in the pickpocket sense of the term because the owner was not deprived of her goods by a physical taking of which she was unaware.

Next, § 2-403 follows with the previously discussed entrustment rule.[112] Although there are clearly differences between the voidable title

106. Holder status is defined in terms similar to that of a holder of a negotiable instrument. *See* U.C.C. § 1-201(21). When the tangible document of title is in bearer form, one only need be in possession of the document to qualify as its holder. *Id.*

107. U.C.C. § 7-501(b)(3) (providing that "[a] document is duly negotiated if it is negotiated . . . to a holder that purchases it in good faith, without notice of any defense against or claim to it on the part of any person, and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves taking delivery of the document in settlement or payment of a monetary obligation"). Although not relevant for purposes of this Article, we note that the foregoing requirements for a document to be duly negotiated differ from the "in due course" requirements under Article 3. For one thing, Article 3 has no requirement that the negotiation occur in the regular course of business or financing. *See id.* § 3-303(a) For another thing, the transferee of an instrument may take the instrument as payment of a monetary obligation without sacrificing the due course aspect of the transaction. *See id.* § 3-303(a)(3).

108. This tokenization to property is also the approach attempted in Article 8 with regard to securities in bearer form. *See* U.C.C. § 8-303. For a further discussion of this attempt, *see infra* notes 139–40 and accompanying text.

109. U.C.C. § 2-403(1).

110. *See id.*

111. *See id*. for a non-exhaustive listing of voidable title generating transactions.

112. U.C.C. § 2-403(2) ("Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business."); *id.* § 2-403 cmt. 2.

doctrine and the doctrine of entrustment,[113] it cannot be overemphasized that they both center around situations where the original owner of goods has, through some voluntary act, clothed the wrongdoer with the appearance of ownership or authority to sell. This being so, these UCC doctrines offer no protection to good faith purchasers when a true thief appears in the chain of title. Following the appearance of such an unworthy individual, no one other than the true owner can have good title. Certainly, this conclusion is not explicitly stated by the Code's drafters, but without a statutory exception to the more traditional property law framework protecting security of ownership, the conclusion is inevitable.[114] The thief, of course, receives void title, and so do all subsequent takers. Thus, "void title" joins with "good title" and "voidable title" to make up our lexicon of concepts used to resolve various title problems involving goods.

It is in this overall commercial law setting of the good faith purchase doctrine that Article 12 was drafted. As pointed out previously, the qualifying purchaser of a CER enjoys an especially privileged position in the scheme of Article 12, akin to, for example, the holder in due course of a negotiable instrument under Article 3. Even if the transferor of a CER has void title (a thief or hacker), the drafters intend to provide her with the power to pass a good title to a qualifying purchaser,[115] which, as explained above, is not something that can happen with goods. Nevertheless, in this area, Article 12 does not represent as fully or as directly an appreciation of Code definitions as might have been hoped.

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113. One difference is that the beneficiary of the voidable title rule is a good faith purchaser for value whereas the entrustment rule narrows the class of beneficiaries to buyers in ordinary course of business. *See* U.C.C. § 1-201(9) (defining "Buyer in ordinary course of business"). The second difference between the two doctrines is that the entrustment rule requires that the goods be entrusted to a merchant who deals in goods of that kind. *See id.* § 2-403(2). By contrast, any wrongdoer, whether or not a merchant, can acquire voidable title. *See id.* § 2-403(1).

114. The conclusion's inevitability follows from the statement in § 2-403(1) that "[a] purchaser of goods acquires all title which his transferor had . . . ." U.C.C. § 2-403(1). For a case that gives effect to this expression of *nemo dat*, see Erisoty v. Rizik, No. CIV.A.93-6215, 1995 WL 91406, at *9 (E.D. Pa. Feb. 23, 1995) (quoting Underhill Coal Mining Co. v. Hixon, 652 A.2d 343, 346 (Pa. Super. Ct. 1994) (recognizing that a "bona fide purchaser [of goods] from a thief gets nothing"). Historically, the English principle of "market overt" was developed and used in some transactions and locales to somewhat alleviate the plight of the good faith purchaser in this context. *See* 2 William Blackstone, Commentaries *449; Daniel E. Murray, *Sale in Market Overt*, 9 Int'l & Comp. L.Q. 24, 25–26 (1960). The underlying principle was that persons who purchased goods from businesses dealing with such goods at the market should take free of the claims of others. Murray, *supra*, at 25–26. It appears that the market overt concept was confined to certain locales and did not prevail throughout England. *See* Sale of Goods Act 1979 § 22(1) (UK), https://www.legislation.gov.uk/ukpga/1979/54/enacted [https://perma.cc/89A7-UX8Y] (The good faith purchase of stolen goods is protected where the goods "are sold in market overt, according to the usage of the market . . . .").

115. *See* Wheelwright v. Depeyster, 1 Johns. 471 (N.Y. Sup. Ct. 1806).

V. The Fundamental Problem with Article 12

A. *The Definition of Purchaser and a Comparison with Holder in Due Course*

The basic problem is with the definition of "purchaser" as defined in §§ 1-201(b)(29) and 1-201(b)(30). To be a "qualifying purchaser" under Article 12, one must first show that she is a "purchaser" of the CER. A "purchaser" is "a person who takes by purchase."[116] A purchase "includes taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction *creating an interest in property*."[117] Because a thief or hacker of a CER obtains no property interest in the record (a void title), and Article 12 leaves to other law the question of whether any interest in property rights is initially acquired by the transferee of a record,[118] how would it be possible for the hacker to transfer any interest at all? Since we know of no other law that would provide an exception to the general notion that a thief cannot pass any sort of property interest, it naturally follows that a person who takes a CER from a hacker would not be participating in a transaction that creates an interest in property. Thus, this person could not be a purchaser and so would not be eligible to be a "qualifying purchaser" who would benefit from Article 12's generous take-free rule.[119] The point is that what the drafters are saying about this particular aspect of Article 12 and what is being touted as good policy are not what one gets in reality. Once a hacker or thief enters into the picture, all titles that follow evermore are void.

But what about the good title outcome that can follow from the analogous holder in due course doctrine that the drafters explicitly mention in the Prefatory Note to Article 12?[120] Is this also misleading?

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116. U.C.C. § 1-201(b)(30).

117. *Id.* § 1-201(29) (emphasis added).

118. The Official Comment to § 12-104 provides the following example:

> *A* creates a controllable electronic record. . . . [O]ther law would determine what rights *A* has in the controllable electronic record. . . . *A* and *B* agree to the sale of the controllable electronic record to *B*. Other law would determine what steps need to be taken for *B* to acquire rights in the controllable electronic record. Once *B* acquires those rights under other law, *B* would be a purchaser (as defined in Section 1-201), whose rights also would be determined by [either subsection (d) or by subsections (e) and (g), depending on whether *B* was a qualifying purchaser].

Id. § 12-104 cmt. 3.

119. A somewhat analogous situation was presented in *First National Bank of Amarillo v. Southwestern Livestock, Inc.*, 616 F. Supp. 1515 (D. Kan. 1985), *aff'd*, 859 F.2d 847 (10th Cir. 1988). There, an auction house sought to avoid conversion liability for selling cattle subject to an existing unperfected security interest by arguing that it was a purchaser. *Id.* at 1516. This argument was rejected on the ground that that the auctioneer did not show that it had acquired any interest in the cattle. *Id.* at 1518. Mere possession of the cattle was not enough in the absence of any property interest of the auctioneer. *Id.*

120. *See supra* notes 98–105 and accompanying text.

The answer is "no." As explained above,[121] it is indeed possible for a thief to pass good title to a stolen instrument if the taker qualifies as a holder in due course. The reason for the different Article 3 result is quite simple. By requiring "holder" status instead of "purchaser" status, Article 3 eliminates the property interest predicate that is a critical part of the definition of "purchase."[122] A person can be a holder by possession alone without the need to identify some sort of property interest obtained under non-Article 3 law.[123] And under the right circumstances, that holder (with only possession) can pass or receive good title under § 3-306.[124]

Interestingly, when Article 3 was originally drafted, there was a misfit between the definition of "holder" and the intentions of its drafters expressed in some of its provisions.[125] One example can be found in former § 3-406, which provided that "'[a]ny person who by his negligence substantially contributes to a material alteration of the instrument or to the making of an unauthorized signature is precluded from asserting the alteration or lack of authority against a holder in due course or against a drawee or other payor . . . .'"[126]

Despite the clear intent of the drafters to include holders in due course within the class of persons to whom a duty of care is owed by the maker or drawer of the instrument, a literal application of the definition of holder would frustrate this intent where there is an unauthorized indorsement.[127] In such cases, the person who takes the instrument would fail to qualify as a holder, let alone a holder in due course.[128] To cure this drafting problem, the wording of § 3-406 was changed in 1990 to read as follows:

> A person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature . . . is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.[129]

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121. *See supra* notes 100–07 and accompanying text.
122. U.C.C. §§ 3-302, 1-201(21), 1-201(30).
123. *See id.* § 1-201(21).
124. *See id.* § 3-306.
125. *See generally* Lary Lawrence, *Misconceptions About Article 3 of the Uniform Commercial Code: A Suggested Methodology and Proposed Revisions*, 62 N.C. L. REV. 115, 126–31 (1983) (discussing the limitations of Article 3 and contrasting the likely intentions of the drafter).
126. *See id.* at 126.
127. Former § 3-406 worked as intended where there has been an alteration since a person who takes an altered instrument may be a holder in due course if the instrument contains all necessary indorsements and the "in due course" requirements have been met. *See* U.C.C. Notes and Cmts. to Article III, pt. IV (AM. L. INST. & UNIF. L. COMM'N, Proposed Final Draft No. 1, 1948); Lawrence, *supra* note 125, at 128 (noting that the drafters of Article III intended to impose a duty of care upon the drawer of an instrument).
128. *See* U.C.C. §§ 1-201(21), 3-302(a) (AM. L. INST. & UNIF. L. COMM'N 2022).
129. *See* U.C.C. § 3-406(a).

Eliminated from the section is any reference to holder status and, therefore, any need for a court to achieve the correct result by adverse construction of language.[130]

A second example of a problem caused by the definition of the term "holder" arose with regard to the beneficiaries of the transfer warranties.[131] Former § 3-417(2) read as follows: "[a]ny person who transfers an instrument and receives consideration warrants to his transferee and if the transfer is by indorsement to any subsequent *holder* who takes the instrument in good faith that (a) he has good title to the instrument . . . ."[132] Once again, where there had been a forged indorsement in the chain of transfers, no subsequent taker of the instrument could possibly be a holder who would benefit from the warranty of title. This, unfortunately, would be the literal outcome, notwithstanding the fact that the taker may have reasonably relied upon the indorsement made by an earlier party in the chain of transfers and historical evidence that the drafters intended a different result.[133] And once again, the problem was cured by the 1990 revisions to Article 3. Instead of defining the class of warranty beneficiaries in terms of holder status, the relevant class was changed to define it in terms of "any subsequent transferee."[134]

It is fair to suggest that the inconsistency of the definition of the term "purchaser" in Article 12 and the clearly stated goal of the drafters to provide CERs with a heightened form of negotiability that would allow even a thief to pass good title will eventually be cured by an appropriate change to the statute at some future date, much like the wrinkles that were ironed out of Article 3. But before that happens, there will be the inevitable litigation by interested parties (similar to that which occurred under former Article 3) seeking to persuade courts that the clear, literal interpretation of statutory language should or should not be followed. Obviously, this will negatively affect our commercial law system by increasing the uncertainty of legal outcomes.

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130. *See id.* This might include the erroneous opinion that the purchaser is included within the category of "other payor" under the section or by ignoring the section entirely and deciding the case under former § 3-404. *See, e.g.*, Trust Co. of Ga. Bank of Savannah v. Port Terminal & Warehousing Co., 266 S.E.2d 254 (Ga. Ct. App. 1980); Mott Grain Co. v. First Nat'l Bank & Trust Co., 259 N.W.2d 667 (N.D. 1977); *see also* Lawrence, *supra* note 125, at 128–29 ("Virtually every court deciding this issue under Article 3 has permitted a purchaser of an instrument bearing a forged indorsement to preclude the negligent party from asserting the forgery.").

131. For those readers who seek an additional example, see Lawrence, *supra* note 125, at 130–31 (discussing the problem caused by the definition of "holder" in situations where there has been no delivery of a note).

132. *Id.* at 129.

133. *See id.* at 130 ("[T]he drafters intended to extend the class of persons entitled to the benefits of the warranties of indorsers and not to limit them.").

134. The relevant section providing for transfer warranties now reads, in part as follows: "(a) A person who transfers an instrument for consideration warrants to the transferee and, if the transfer is by indorsement, to any subsequent transferee that: (1) the warrantor is a person entitled to enforce the instrument . . . ." U.C.C. § 3-416(a)(1).

B. *Legal Uncertainty*

As we explained earlier in this Article, legal certainty and predictability serve the instrumentalist goal of promoting market transactions—in a capitalistic society, the primary means of allocating resources from less to more valuable users.[135] For these market transactions to take place, it is essential that the parties have a basic understanding of the law applicable to the contract. Consider, for example, a simple contract for the purchase and sale of a lawn mower for $200. Presumably, for this voluntary exchange to occur, it must benefit both parties—the seller must value $200 more than the lawn mower, and the buyer must value the lawn mower more than $200. Further, all such exchanges involve a number of risks. There is the risk that either the buyer or the seller might be dishonest or otherwise fail to perform. If the buyer wrongfully refuses to pay for the lawn mower or the seller wrongfully refuses to deliver it, the aggrieved party may have to face the vagaries, uncertainties, and delays of the judicial system in order to obtain relief. There is also the risk that the lawn mower will be damaged or lost before delivery to the buyer. Then, there is the risk that the lawn mower will not perform as expected. Finally, and most relevant to the focus of this Article, there is the risk that a third party will assert a claim to the lawn mower of one sort or another. Given these and other risks, it is crucial to the protection of rational expectations and the promotion of fair and efficient exchanges that the parties be able to anticipate judicial outcomes. The inability to know ownership priority undermines the market for selling CERs and increases costs when sales do occur. Moreover, lawyers will be unable to advise clients while deals are in the process of being shaped.

We concede that, to some extent, the notion that reliance on existing rules plays a significant role in governing the day-to-day behavior of commercial transactors may be problematic. This skepticism is the result of recognizing that a significant degree of indeterminacy remains in the law and that unexpected outcomes due to unanticipated contingencies cannot be altogether eliminated, even by the most careful statutory drafting.[136]

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135. *See supra* notes 13–15 and accompanying text.

136. *See* Anthony D'Amato, *Counterintuitive Consequences of "Plain Meaning,"* 33 ARIZ. L. REV. 529, 530–34 (1991); *see also* H. L. A. HART, THE CONCEPT OF LAW 128–29 (2d ed. 1994). Professor Hart makes the point that inherent in any piece of legislation is what he has called an "indeterminacy of aim." HART, *supra*, at 128. He goes on to posit an ordinance which bars vehicles from a public park. *Id.* at 127. Although it may be clear that, if the purpose of the law is to maintain peace and quiet, the legislature intended to banish cars, buses, and motorcycles; it is unclear whether any other "vehicles" were intended to be excluded:

> We have initially settled the question that peace and quiet in the park is to be maintained at the cost, at any rate, of the exclusion of these things. On the other hand, until we have put the general aim of peace in the park into conjunction with those cases which we did not, or perhaps could not, initially envisage

However, most of the uncertainty of the result could have been avoided had the drafters chosen a term other than "purchaser" to describe the beneficiary of Article 12's liberal take-free rule and defined it in a manner that would effectuate the drafters' statutory aim. Recognizing that some degree of legal indeterminacy is a necessary byproduct of the healthy evolution of the law, the costs associated with indeterminacy still dictate that steps should be taken to minimize the degree of uncertainty to the greatest extent possible. If inartful statutory drafting is a source of uncertainty that can easily be reduced without offsetting social costs, efforts should be made to do so.

The drafters were initially made cognizant of our concern by an email that was sent by one of the authors of this Article to the Drafting Committee members and Professor Charles Mooney, the Reporter, on April 25, 2022.[137] Professor Mooney's quick and courteous response on behalf of the Committee read, in significant part, as follows:

> Thanks [so] much for your comment. We don't think that the term "purchaser" should be read so narrowly as you suggest. If it were, for example, a thief would appear to make no warranty under 8-108(a) and [e]xample 3 in Comment 2 to 8-116 would be wrong. Moreover, it would also contradict the accepted understanding that a transferee of a bearer certificated security (these days, one indorsed in blank) from a thief could be a protected purchaser. While we might provide in 12-104 that one in control has the power to transfer rights in a CER to a QP, that is implicit (as it is in 8-303) and would create an unfortunate implication for Article 8.
>
> For this reason we are [n]ot planning to make any change to address this issue.[138]

Plainly, the Drafting Committee attempts to rationalize its drafting error in Article 12 by pointing to a similar error that was made in the drafting of Article 8. But instead of doubling down on the Article 8 error, why not take the opportunity provided by the current drafting project to coordinate the necessary changes to Article 8? As mentioned above, a similar move was made in 1990 to provide added clarity and certainty to the application of Article 3.[139] Why rely on courts to tweak sections of the Code if ambiguities are recognized and can be eliminated by careful

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> (perhaps a toy motor-car electrically propelled) our aim is, in this direction, indeterminate. We have not settled, because we have not anticipated, the question which will be raised by the unenvisaged case when it occurs: whether some degree of peace in the park is to be sacrificed to, or defended against, those children whose pleasure or interest it is to use these things.

Id. at 129.

137. Email from David Frisch, Professor of L., U. Richmond Sch. of L., to UCC Drafting Comm. and Charles Mooney, Jr., Professor of L., U. Penn. Carey L. Sch. (Apr. 25, 2022, 2:56 PM) (on file with authors).

138. Email from Charles Mooney, Jr., Professor of L., U. Penn. Carey L. Sch., to David Frisch, Professor of Law, U. Richmond Sch. of L. (Apr. 26, 2022, 4:34 PM) (on file with authors).

139. *See supra* note 133 and accompanying text.

drafting? Why invite the inevitable litigation and wait until a court gets it "wrong" before making the necessary adjustments to the Code to get it "right"? Why provide judges, who unfortunately make a mess of the policy decisions made by the drafters, with the excuse that the law left them no alternative? The problem the definition of "purchaser" raises is real, and the response of the Drafting Committee is unfortunate. It simply does not exhibit the analysis and considered judgment that we would expect from a UCC drafting committee.

VI. Conclusion

Article 12 has the ability to provide needed but currently lacking commercial law rules for "digital assets," which could result in a high degree of certainty and uniformity for purchasers in transactions involving current and emerging technologies.[140] However, the drafters' failure to clear up a glaring misstep resulting from their use of the term "purchaser" threatens that certainty and invites unnecessary litigation. Because of the drafters' lack of action, it may fall upon state legislatures to take steps to remedy this problem before the enactment of Article 12. Action must be taken to prevent the inevitable confusion and uncertainty that will otherwise prevail upon the adoption of the new article.

140. *See* U.C.C. Prefatory Note to Article 12 cmt. 1 (Am. L. Inst. & Unif. L. Comm'n 2022).