The Takeaway
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Crypto Commerce Comes to Texas

Making Texas Commercial Law More Competitive in the Digital Asset Economy

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As crypto and blockchain-related activity continues growing in Texas, legislative efforts are underway to create a more favorable legal environment. Legal reforms, including the 2022 amendments to the Uniform Commercial Code (UCC) Article 12, enable the creation of "controllable electronic records" that we argue in a recent law review article[1] can represent claims in bankruptcy by trade creditors – typically suppliers, contractors, and customers who have little ability to sell their distressed debt claims under current legal rules. By tokenizing these claims on blockchains as "debt tokens," the claims can be freely traded with legal certainty, increasing liquidity. Adopting UCC Article 12 would therefore make Texas an attractive jurisdiction for this kind of claims trading in the digital asset economy.

WHAT'S THE TAKEAWAY?

The recent UCC amendments to UCC Article 12 enable the creation of controllable electronic records.

These controllable electronic records can be used to represent bankruptcy claims.

Tokenizing these claims would allow trading with legal certainty and increased liquidity.

Texas should adopt UCC Article 12 to make it an attractive jurisdiction for the digital asset economy.

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CRYPTO IN TEXAS

Over the past few years, Texas has become a popular jurisdiction for crypto-related activity. In fact, a portion of the Texas Business and Commerce Code is dedicated specifically to virtual currencies.[2,3] Yet, while Texas has adopted Article 9 of the Uniform Commercial Code (UCC), they have not adopted the recently finalized, new Article 12.[4, 5]

> *We anticipate a market for tokenized trade claims that is significantly more liquid, driven by lower transaction costs, improved price discovery, and narrower spreads between bid and ask prices. Moreover, these dynamics could be amplified by enhanced record visibility and data availability, as bankruptcy trade claims become digital assets traded on electronic, possibly distributed, networks.*[6]

In our recent research paper,[7] my coauthors and I explain how adoption of the new 2022 amendments to the UCC could create a more favorable environment for the trading of bankruptcy claims by certain kinds of creditors—namely, the so-called trade creditors. If Texas enacted these amendments to its commercial code, the state could achieve a competitive edge when it comes to not only crypto-related commerce but also in various kinds of commercial activities more broadly. These are especially relevant for bankruptcy cases.

CLAIMS TRADING IN BANKRUPTCY

While bankruptcy claims trading has been happening since the earliest American congress, it has undergone an evolution since the rise of the digital asset economy.[8] Claims trading allows creditors in bankruptcy cases to sell their claims (debts owed to them) on an open market, rather than waiting for the full bankruptcy process to play out. This provides creditors with quicker access to money by letting them sell their claims at current market prices to investors looking to profit. Investors buy these claims at a discounted rate, betting that when the company eventually settles its bankruptcy, the investor will get paid more than what they paid for the claim initially.[9]

Currently, bankruptcy claims trading is governed by federal bankruptcy law and rules governing commercial circulation.[10] But not all claims are created equal. Certain types of claims trade more easily than others because the commercial law rules governing these claims make them more attractive to investors. These favored claims include bank loan and corporate bonds that are usually held by financial institutions. The claims that get less favorable treatment and therefore do not readily trade are those held by so-called trade creditors. These would typically include smaller companies that the bankruptcy firm owes money to—like contractors, suppliers, skilled workers, and, in the case of defunct crypto companies, customers. The lack of beneficial legal rules for trade creditors has played out in the recent bankruptcies of crypto companies like Voyager, Celsius, and (most notoriously) FTX.[11]

In our law review article titled *Debt Tokens*, we explain how the new 2022 amendments to the UCC, combined with crypto-based technologies, can be used to create much more favorable conditions for the buying and selling of trade debts by creating "debt tokens" that could be operationalized for debt trading.

OPERATIONALIZING DEBT TOKENS

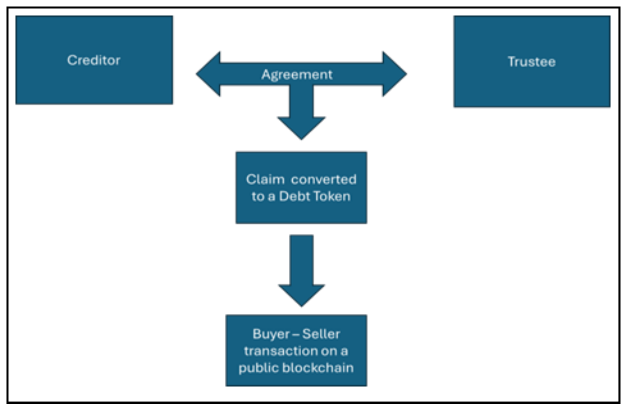
The method for turning a trade claim into a tradable crypto asset that can be bought and sold through blockchain technology involves using the new amended commercial laws to create what is known as a controllable electronic record. We explain a variety of ways this can be structured along a spectrum. For these purposes, we describe two of these methods.

Under the first method, the process starts with a trade creditor (someone owed money by the bankrupt company for having provided goods or services to the company) agreeing with the bankruptcy trustee (the person overseeing the bankruptcy) that their claim will be represented by a controllable electronic record (which will be colloquially known as a debt token). If the trustee agrees, then it will eventually pay whatever the claim is worth to whoever holds this debt token. The trade creditor then creates this debt token on a public blockchain network, such as through the popular Ethereum platform. Through the combination of this crypto technology and the new UCC Article 12 laws, this token represents and provides control over their claim in the bankruptcy.

> *It should not be overlooked that the introduction of controllable accounts is inherently positive, as it provides additional optionality and versatility. When this is coupled with the prospect of a market that offers greater liquidity, more competitive pricing, and increased transparency, we predict that bankruptcy trade debt holders will gain access to superior exit opportunities.*[12]

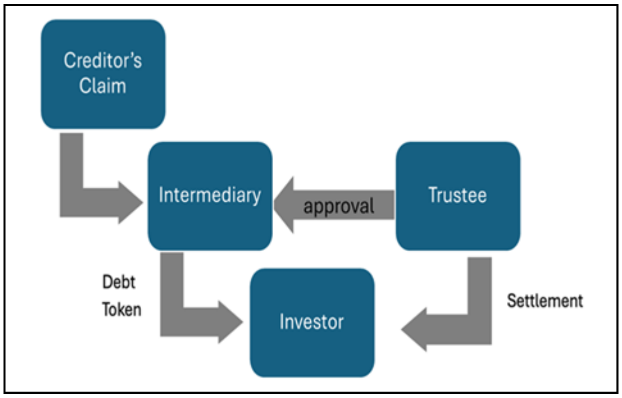
At this point, the trade creditor can sell its claim by transferring the debt token to a buyer for an agreed price. Whoever controls the token is entitled to receive payment from the trustee for the claim once the bankruptcy concludes. The buyer can then resell the claim to someone else by transferring the debt token. This allows claims to be freely traded among different parties on the blockchain. Figure 1 depicts the transaction.

Figure 1:



Alternatively, there could be a third-party company involved that helps create the debt tokens and facilitates their trading. This company would provide tech support to trade creditors for issuing the debt tokens and could hold custody of them in digital wallets. When trade creditors want to sell, the company would transfer the debt token to the buyer, basically transferring control of the claim. The company could also help manage payments back to token holders from the bankruptcy trustee. All of this can be done by the intermediary company for a fee or a percentage of the payout. Figure 2 depicts this alternative transaction setup.

Figure 2:



CONCLUSION

In sum, the debt tokens represent and transfer ownership/control of bankruptcy claims, allowing them to be traded more easily on blockchain networks with or without an intermediary company involved. By using the special legal rules governing controllable electronic records, the trade claim, which was once difficult to transfer, can be transferred with greater ease and legal certainty. In its efforts to create a more business-friendly environment for digital asset transactions and the companies that facilitate them, Texas should consider enacting the new 2022 UCC amendments.

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Notes:

[1]Andrea Tosato, Diane Lourdes Dick, & Christopher K. Odinet, *Debt Tokens*, University of Pennsylvania Law Review, (forthcoming 2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4694629

[2]Bohdan Prylepa, *Cryptocurrency companies form Texas Blockchain Task Force to promote clear rules*, Medium (Sept. 13, 2023), https://medium.com/@prylepab/cryptocurrency-companies-form-texas-blockchain-task-force-to-promote-clear-rules-b007d7cf40fc

[3]Texas Business & Commerce Code. §§ 12.001 – 12.004 (West 2021).

[4]Stuart D. Levi et al., *Amendments to Uniform Commercial Code Aim To Provide Clarity on the Transfer of Digital Assets*, Skadden, (Oct. 6, 2022), https://www.skadden.com/insights/publications/2022/10/amendments-to-uniform-commercial-code

[5]Uniform Law Commission, *UCC, 2022 Amendments*, https://www.uniformlaws.org/committees/community-home?communitykey=1457c422-ddb7-40b0-8c76-39a1991651ac (last visited Apr. 29, 2024).

[6]Andrea Tosato, Diane Lourdes Dick, & Christopher K. Odinet, *Debt Tokens*, University of Pennsylvania Law Review, (forthcoming 2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4694629

[7]Ibid.

[8]Ibid.

[9]Ibid.

[10]Ibid.

[11]Ibid.

[12]Ibid.

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