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How Would You Like to Pay? The Risks of Lending to Borrowers Who are Paid in Crypto

5-Minute Read

By Christopher Ross and Stephen Sepinuck

As the adoption of cryptocurrencies as a medium of exchange continues to expand within our economy, more and more companies are now accepting payment in digital currencies from their customers. Today you can use cryptocurrency to buy movie tickets, your morning latte or even a new electric vehicle.

However, lenders to borrowers that accept (or may in the future accept) crypto in exchange for goods and services must be aware of how this burgeoning form of decentralized finance is treated under applicable law. Though often used as a substitute for government-issued currencies, cryptocurrencies are not "money" under the Uniform Commercial Code ("UCC"), and are instead categorized as a "general intangible." The result of that distinction has important implications on the creation, perfection, and priority of a lender's lien on rights to receive payment in cryptocurrency.

What Are Cryptocurrencies and Rights to Payment in Cryptocurrency Under the UCC?

Generally speaking, when a company sells product or provides services to a customer in exchange for a promise to pay in dollars (or some other fiat currency), the customer's promise to pay will be one of four common types of Article 9 collateral – an account, chattel paper, an instrument, or a payment intangible (all defined as a right to payment in money or of a monetary obligation).

Because cryptocurrencies are not money, an obligation to pay in cryptocurrency is not a "monetary obligation" (a term used throughout the UCC but not defined). Consequently, a right to payment in cryptocurrency cannot be an account, chattel paper, an instrument[1] or a payment intangible. Instead, a right to payment in cryptocurrency is a general intangible (other than a payment intangible), like the cryptocurrency itself is.

Before discussing how to deal with the consequences of these distinctions in practice, it is worth considering how one key (but seemingly minor) variation would complicate things further.

[1] Such a right also cannot be a "promissory note" because that term is a subset of "instruments."

Who Gets to Decide?

Companies and their customers might blur the lines between payments due in money (i.e., a monetary obligation) and payments due in cryptocurrency. One way they might do so is by creating a right to payment that the customer (i.e., the account debtor) can discharge by payment in either money or cryptocurrency.

Although it is not entirely clear how the UCC would treat such a right to payment, one logical approach would be to look at the obligation from the perspective of the customer. If the customer can be compelled to make payment in money (i.e., the company/borrower has the option to determine whether the obligation can be discharged in dollars or in crypto), then the obligation should be regarded as a monetary obligation. In contrast, if the account debtor/customer has the option to pay in dollars or cryptocurrency, then it may be more appropriate to treat the obligation as non-monetary and the right to payment as a general intangible.

What Are the Implications of These Distinctions and How Should a Lender Address Them?

At least seven consequences follow from the classification of rights to payment that are denominated in cryptocurrency as general intangibles

	Issue	***How to Address***
Description of Collateral in the Security Agreement	Unlike rights to payment of a monetary obligation, a security agreement will not encumber rights to payment in cryptocurrency by including the terms “accounts,” “chattel paper,” “instruments,” or “payment intangibles” in the description of collateral.	If rights to payment in cryptocurrency are to be part of the collateral, the description of collateral in the security agreement should include “general intangibles, “rights to payment in cryptocurrency,” or other suitable language.
Indication of Collateral in the UCC Filing	Unlike rights to payment of a monetary obligation, a UCC financing statement will not perfect a security interest in rights to payment in cryptocurrency by including the terms “accounts,” “chattel paper,” “instruments,” or “payment intangibles” in the indication of collateral.	Indicate the collateral by using the phrase “all assets” or by including “general intangibles,” “rights to payment in cryptocurrency,” or other suitable language.
Perfection of Lender’s Lien on the Collateral	Perfection of a security interest in rights to payment in cryptocurrency by possession or control will not ordinarily be possible. Similarly, there can be no automatic perfection for a security interest arising from a sale of rights to payment in cryptocurrency.	Filing a financing statement is likely the only method to perfect a security interest in rights to payment in cryptocurrency.
Scope	Article 9 applies to the use of rights to payment in cryptocurrency as collateral	This has implications for the enforceability of any contractual

	Issue	How to Address
	for a loan, but it does not apply to an outright sale of rights to payment in cryptocurrency.	restrictions on assignment of rights to payment in cryptocurrency, discussed below.
Restrictions on Assignment	Because rights to payment in cryptocurrency are general intangibles (but are not payment intangibles), any contractual restriction on the assignment of the rights will remain partially effective. This means that any restriction on transfer will not prevent a security interest from attaching to the rights to payment in cryptocurrency, but the secured party will have no ability to enforce that right against the account debtor.	In conducting due diligence, review the debtor's contracts to determine if any require the debtor's customer to pay in cryptocurrency and, if so, determine if any contracts restrict the debtor's ability to assign the right to payment.
	Article 9 applies to the use of rights to payment in cryptocurrency as collateral for a loan, but it does not apply to an outright sale of rights to payment in cryptocurrency. Consequently, if a business is selling such rights to payment in cryptocurrency, Article 9 will not override any contractual restriction on assignment of the rights to payment. As a result, the buyer might, in fact, get nothing unless the account debtors consent.	Consider requiring the debtor to do one of the following: (i) removing from its customer contracts any restriction on assignment of the right to payment; or (ii) incorporating into its customer contracts an express consent by the customer to the debtor assigning the right to payment.
No Holder in Due Course or Take Free	There can be no holder in due course of rights to payment in cryptocurrency. Similarly, a transferee of such rights cannot "take free" under any of the rules protecting purchasers of property.	This could be a benefit to the lender but potentially increases the need for proper due diligence at the outset to ensure that the lender has a perfected, first-priority security interest.
No Discharge Rule	None of the UCC's rules regarding how the account debtor may discharge its obligation apply.	Consider requiring the debtor to include in its customer contracts terms that specify when and under what circumstances the customer must pay the secured party.

Special Concerns for Split-Collateral Deals

In many split-collateral deals, the provider of the revolving loan gets priority in the debtor's current assets, including accounts, inventory, and payment intangibles ("Current Asset Collateral") while the provider of the term loan gets priority in equipment, general intangibles, and other fixed assets ("Fixed Asset

Collateral”). Moreover, the allocation of proceeds of collateral between Current Asset Collateral and Fixed Asset Collateral usually follows the allocation of the original collateral from which the proceeds were derived.

If rights to payment in cryptocurrency arise from the sale of inventory, the loan documents likely already define such rights as Current Asset Collateral because of the proceeds rule discussed above. However, if the rights to payment in cryptocurrency are generated from the provision of services, those rights are not proceeds of anything and therefore would likely qualify as Fixed Asset Collateral (unless the documents otherwise specify). This result may not align with the parties’ expectations.

Consequently, lenders structuring a split-collateral deal should consider modifying the traditional Current Asset Collateral and Fixed Asset Collateral definitions to account for the UCC’s treatment of payment obligations in cryptocurrencies as general intangibles, rather than as accounts receivable or payment intangibles.

Alternatively, the lender of the revolving loan might simplify its underwriting by removing rights to payment in cryptocurrency from the borrowing base altogether. However, as the use of cryptocurrencies continues to gain traction across the economy, this approach may not provide the borrower with sufficient flexibility for the expansion of its business (or availability under its credit facility).

Conclusion

Many businesses already accept payment in one or more cryptocurrencies. Yet few of them—or their lenders—have adequately considered and addressed the implications of doing so under the UCC. Lawyers at Paul Hastings are prepared to assist clients in structuring transactions and drafting contracts to ensure that accepting payment in cryptocurrency will not entail unexpected risks.

If you have any questions concerning these developing issues, please do not hesitate to contact either of the following Paul Hastings New York lawyers:

Christopher G. Ross
1.212.318.6788
christopherross@paulhastings.com

Stephen Sepinuck
1.509.279-5550
stephensepinuck@paulhastings.com

Paul Hastings LLP

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