Open Learning Forum

Code Is Not Law: The Legal Background for Trade Finance Using Blockchain

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Executive Summary written by GBBC

Introduction

Blockchain has enormous potential to streamline trade finance. Unfortunately, the legal status of electronic negotiable instruments (digitized versions of traditional negotiable instruments like checks, bills of exchange, promissory notes, etc.) in the U.S. is impeding progress. Laws differ across jurisdictions and some state and federal legislators have attempted to provide clarity on blockchain-based legal documents. In the U.S., there are currently no laws or regulations that grant electronic blockchain-based negotiable instruments the same legal status as traditional paper instruments.

The Uniform Commercial Code (UCC) was first published in 1952; it is a group of laws that applies to all commercial transactions in the U.S. Article 3 of the UCC, which governs negotiable instruments, has not been amended since 2002 and "has its roots in the Negotiable Instrument Law first approved by the National Conference of Commissioners on Uniform State Laws in 1896." Clearly, this is not a modern document. In 1999, the UCC proposed, and almost all states enacted, the Uniform Electronic Transactions Act (UETA), which grants electronic signatures and records the same validity as paper signatures and records.

The three major impediments to the adoption of blockchain-based electronic negotiable instruments are: (1) the requirement that negotiable instruments be signed; (2) laws that govern electronic promissory notes but not drafts or bills of exchange; and (3) a dearth of case law interpretations on electronic negotiable instruments. This paper specifically addresses electronic promissory notes and bills of exchange.

Solution 1

The preferred solution to these issues is to alter and clarify definitions in Article 3 of the UCC to make it clear that electronic negotiable instruments have the same legal backing as traditional instruments. However, this is a burdensome and time-consuming process, as the American Law Institute and National Conference of Commissioners on Uniform State Laws would have to propose changes; states would then have to enact the changes.

Solution 2

The second proposed solution would involve extending UETA to cover electronic negotiable instruments. The concern with this solution is that it would work around the edges of the problem, rather than addressing the core issue: UCC Article 3. It would also take a similar amount of time and effort as the first proposed solution.

Solution 3

The third proposed solution is a temporary fix that would address issues associated with the legal standing of electronic negotiable instruments. The solution is a "rulebook" that would involve an agreement between all parties on a blockchain. All parties would have to confirm that any electronic negotiable instruments on a permissioned blockchain are compliant with the rulebook. The rulebook would be drawn from UCC Article 3, but with appropriate updates to ensure electronic instruments have appropriate legal standing.

Conclusion

Stakeholders should work together with regulators and legislators to update UCC Article 3. As this is a time-consuming process, a rulebook could be created that provides temporary legal certainty to companies using blockchain for electronic negotiable instruments.