UNIDROIT Digital Assets and Private Law - Online Consultation

General Comments, Structure of the Principles, and Introduction.

Please use this section to provide any general comments, comments on the structure of the Principles, and comments on the section labelled Introduction.

General Comments

We are, in principle, supportive of the UNIDROIT Principles on Digital Assets and Private Law. This is a novel area in which states are increasingly looking to adapt their domestic laws to the global paradigm shift represented by the possibilities of digital assets. We, therefore, welcome the purpose of the Principles and think that this is a useful tool which, depending on the level of adoption, can provide a degree of standardisation and uniformity among legal systems.

We also welcome the flexibility and neutrality and the practical and functional approach that the Principles take, and think that this may be helpful for the adoption of the Principles as widely as possible.

As we will further elaborate in our comments on Principles 1 and 3 below, the scope of the instrument is rather narrow. Therefore, other applicable rules (ie, in the Principles terminology, 'other law') will find a wide scope of application in relation to proprietary issues arising from digital assets. Therefore, states which consider adopting the Principles should undertake a careful exercise to identify whether and how the Principles would fit in with their existing regime, such as regarding insolvency. In terms of legal drafting technique, we wonder why the Principles state which issues other law applies to, instead of stating that the Principles do not apply to those issues. Although both approaches would have the same result, the latter might be preferable from a legal drafting technique.

We, generally, find that some Principles and parts of the Commentary are rather technical (in particular in Section V) and may not be very accessible to non-subject specific readers. The Principles include various cross-references to other Principles and this means that the reader needs to bring all these internal references together to be able to understand and apply the Principles. In addition, this would probably lead to a result that states, which consider adopting the Principles, would need to adopt the Principles as a whole, not partially.

We find that the Commentary is helpful as an explanatory or guiding tool. However, some Principles cannot be understood accurately on their own, without the Commentary. This may pose issues given that the Commentary does not have the same legal value (or force) as the Principles.

Structure of the Principles

We think that the structure of the Principles is overall logical, but may benefit from some refinements regarding Principles 1 and 3 which we will elaborate on in our comments to those Principles.

Introduction

The introduction is reasonable overall.

We do, however, see value in having further explanation on the need for such a private law framework on digital assets at the international level.

We infer, from para 4, that the Principles have been designed to apply in both domestic and cross-border situations. However, there is no clear indication of what counts as a cross-border situation. This (ie internationality) becomes particularly important for the application of Principle 5 on conflict of laws as it is that cross-border (or international) element that requires the conflict of law analysis.

Para 19 addresses transition rules. We are not sure why this is included in the Introduction rather than under the Principles, as the legal value of the former and latter seem to differ.

Section I: Scope and Definitions

Please use this section to provide comments on Section I of the Principles relating to Scope and Definitions. This section comprises of 4 Principles. When providing comments on the Commentary, please provide the paragraph number where possible.

Principle 1: Scope

Principle 1 sets out the material scope of application as 'the private law relating to digital assets'. When this is read along with the Commentary, it becomes clear that the scope is actually limited to only certain aspects of the private law, which mostly centre on property law and insolvency law. We, therefore, suggest an amendment to the provision to indicate that the Principles deal with 'aspects of' the private law relating to digital assets.

Principle 3(3) deals with the matters excluded from the scope and we think that it may be better placed under Principle 1 dealing with the scope.

The territorial scope of the Principles is not defined, although it is inferred, as we noted in our comment above regarding the Introduction, that both domestic and cross-border situations are included in the scope.

Principle 2: Definitions

We note that the definition of control is not provided in Principle 2, but in Principle 6 instead. It would be useful to establish a link between Principles 2

and 6 in this regard, for example by adding to the end of Principle 2 'as defined by Principle 6'.

Regarding Principle 2(2) concerning the term 'principles law', para 17 of the Commentary is not clear to us.

Regarding Principle 2(5)(d) concerning the term 'transfer', further explanation in the Commentary would be helpful as to why the term transfer is used to include the creation of security rights as, in this context, there is technically not a transfer but a creation of a new right. One suggestion for the wording of the first part of the provision here could be that 'the term 'transfer' includes the grant of a security right in favour of a secured creditor, except where the context requires otherwise'. Please also see below for our comment on Principle 3(3)(d) and (e) which relates to the definition of the term transfer.

Regarding Principle 2(8) concerning the term 'insolvency proceedings', it is not clear enough to us if the intention is that this applies to individuals as well as non-natural persons. If this is the intention, we suggest that UNIDROIT should consider whether to specify that the use of 'liquidation' in the provision covers both personal insolvency and corporate insolvency, or alternatively this aspect ought to be clarified in the Commentary. In a number of systems, 'liquidation' is a technical term relating to corporate insolvency specifically, whereas here it is presumably being used in a wider sense to include non-corporate insolvency proceedings. Also, as a minor suggestion, there seems to be a missing word of 'the' in the provision, which should read as '…at least one of ***the*** following…'.

Principle 3: General Principles

Regarding Principle 3(1), it states that a digital asset can be the 'subject' of proprietary rights. We wonder whether this should instead refer to the 'object' of proprietary rights. We do recognise that the term 'subject' is used in the principle in a broader non-technical sense, yet it would be advisable to at least explain the position more extensively in the Commentary and note that it might be preferable to formulate the provision with reference to 'object' instead of 'subject' in some systems. See also our comments at Principle 14 below.

Regarding Principle 3(3) concerning excluded matters, it is helpful to have such an indicative itemised list. However, this list may be better placed under Principle 1 dealing with the scope, as we noted above.

Regarding Principle 3(3)(e), we in principle agree to having such a provision for security rights. However, as the definition of the term transfer in Principle 2(5)(d) covers the creation of security rights (see above for our comments on the corresponding question on this), it seems that this makes, in the current draft, Principle 3(3)(e) superfluous given Principle 3(3)(d) serves that purpose. Furthermore, there is potential overlap between Principle 3(3)(b) and (c) given the current wording of Principle 2(5)(d). We, therefore, think that the re-consideration of the wording of Principle 2(5)(d) would be helpful from these perspectives as well.

Principle 4: Linked Assets

This Principle seems sensible to us.

Section II: Private International Law

Please use this section to provide comments on Section II of the Principles relating to Private International Law. This section comprises of 1 Principle. When providing comments on the Commentary, please provide the paragraph number where possible.

Principle 5: Conflict of laws

We understand, from para 2, that the scope of the conflict of laws principle is not limited to the issues covered by the Principles. It is an unusual approach to us that the scope of a provision has a wider scope of application than the instrument it is included in. This point also relates to the relationship between the application of the conflict of laws principle and the whole Principles as an instrument. If a proprietary issue in respect of a digital asset is brought before a court of a state which has adopted the UNIDROIT Principles, would the court first apply the conflict of laws rules in Principle 5 and determine the applicable law (which may or may not be a law that has the Principles as a part of it) or would the court first apply the substantive law rules in the Principles and refer to Principle 5 for only the matters not resolved by the substantive law rules?

As we noted above, it is not clear when this provision should apply since there is no clear indication of what counts as a cross-border situation and the test for internationality. Are all situations relating to proprietary issues in respect of a digital asset deemed cross-border under the UNIDROIT Principles and require the conflict of law analysis?

Characterisation seems to be left to national law (see paragraph 1 of the Commentary) and there may be divergent application and/or interpretation of what is proprietary among adopting states. In addition, as the transfer of title to a digital asset does not usually involve physical objects, this blurs the boundaries between proprietary and obligatory rights (see B Yüksel Ripley and F Heindler, 'The Law Applicable to Crypto Assets: What Policy Choices Are Ahead of Us?' in A Bonomi, M Lehmann and S Lalani (eds) *Blockchain and Private International Law* (Brill, forthcoming)).

We, in principle, see value in a waterfall of factors for the determination of the applicable law in this context. At the top of this waterfall, Principle 5(1)(a) and (b) accepts party autonomy. Although we agree that party autonomy should have a place in relation to digital assets as we will elaborate further below, we think that it will probably have no or very little application in public permissionless systems and they currently represent the majority of the systems available. We are not entirely convinced by the explanation in the Commentary regarding the reasons for the acceptance of party autonomy, which is that the usual connecting factors have no useful role to play in the context of the law applicable to proprietary issues relating to digital assets. The *lex situs* is predominant in international property law issues and we agree that there are difficulties around determining the situs of the digital assets. However, these

difficulties are not peculiar to digital assets and they arise also in relation to other types of intangibles with no physical location, such as money debts, shares, rights of action, and intellectual property. Conflict of laws solutions have been developed for them by ascribing them to an artificial or fictional legal situs where they can be pursued or enforced. Therefore, solutions can be developed for digital assets (or types of digital assets) as well. Indeed, there is a growing body of cases from the court of England and Wales suggesting that the situs of digital assets (in given cases Bitcoin) is the place where the person or company who owns the assets is domiciled (see eg *Ion Science Ltd v Persons Unknown* Unreported, 21.12.2020, *Fetch.AI Ltd v Persons Unknown* [2021] EWHC 2254 (Comm), para 14). More recently, in *Tulip Trading Ltd v Bitcoin Association For BSV & Ors* ([2022] EWHC 667 (Ch), the English court suggested that the situs is the place of residence or business of the owner, not their domicile. Their analysis is based on Professor Andrew Dickinson's proposal (see A Dickinson, 'Cryptocurrencies and the Conflict of Laws' in D Fox and S Green (eds) Cryptocurrencies in Public and Private Law (OUP, 2019) 118-137; C Proctor, 'Cryptocurrencies in International and Public Law Conceptions of Money' in D Fox and S Green (eds) Cryptocurrencies in Public and Private Law (OUP, 2019)). The 'owner' can be interpreted in the context of Principles 6 and 7 as the person who has control of the digital asset.

In addition, traditionally there is no or limited place for party autonomy in international property law and we therefore think that acceptance of freedom of choice would benefit from further justification in the Commentary. We also wonder about all sorts of other issues relating to freedom of choice and whether these have been considered by the UNIDROIT. This includes weaker party (eg consumer) protection and the effect of choice of law on third parties (eg in good faith acquisition). In support of party autonomy, the explanatory text to the Principles refers to the 2015 Hague Principles of Choice of Law in Commercial Contract. The 2015 Hague Principles, however, were tailor-made for commercial contracts, excluding consumer contracts and proprietary questions. We wonder whether these issues have been left to other law (including its private international rules).

Further explanation would also be helpful as to why the law specified in the asset prevails over the law specified in the system and whether considerations have been given to a scenario where these two laws are in conflict.

We also think that the bottom of the waterfall would benefit from further consideration. In Option A (i), is the reference to the substantive law rules of the forum and if so what is the justification for skipping the conflicts stage here and directly applying substantive rules? Would this give scope to forum shopping, which will continue to exist unless the Principles are adopted globally? In Option A (iii) and Option B (ii), the last resort is to the private international law of the forum. As the applicable law in public permissionless systems will probably almost always be determined according to objective choice of law rules due to the absence of choice of law, we think that, under the current proposal, uniformity may not be achieved to the extent that is desired compared to substantive law provision of the Principles.

Given that systems or platforms are self-contained and the distinction between contractual and proprietary issues are blurred in the systems, we think that all issues (contractual and proprietary) can be subject to the law that governs the system (for an analysis on the determination of this law, see Yüksel Ripley, Burcu, 'Cryptocurrency Transfers in Distributed Ledger Technology-Based Systems and Their Characterisation' in Conflict of Laws (July 31, 2022). Justin Borg-Barthet, Katarina Trimmings, Burcu Yüksel Ripley and Patricia Živković (eds), From Theory to Practice in Private International Law: Gedächtnisschrift for Professor Jonathan Fitchen (Hart, Forthcoming), Available at SSRN: https://ssrn.com/abstract=4336222 or http://dx.doi.org/10.2139/ssrn.4336222).

We welcome the proposal of the Hague Conference on Private International Law for Joint Work: HCCH-UNIDROIT Project on Law Applicable to Cross-Border Holdings and Transfers of Digital Assets and Tokens and consider that conflict of laws issues would benefit from further examination in the scope of that project.

Section III: Control

Please use this section to provide comments on Section III of the Principles relating to Control. This section comprises of 4 Principles. When providing comments on the Commentary, please provide the paragraph number where possible.

Principle 6: Definition of control

We, in principle, agree with this Principle.

The title of the Principle is definition of control, however it seems that the provisions set out herein are broader than definitions. Perhaps the title could be amended given this. In addition, as we suggested above in our comments on Principle 2, it would be helpful to link these two principles.

Our understanding is that the conditions set out in Principle 6(1)(a) and (b) are cumulative in nature. It would be helpful to make this clear in the Principle, such as by adding 'and' between them.

Principle 7: Identification of a person in control of a digital asset

We, in principle, agree with this Principle. However, we are not sure about the use the word of 'reasonable' in the context of 7(2). We suggest that that word can either be deleted from the Principle, which would simply mean that a non-exhaustive list of possible means of identification is provided, or its inclusion and significance can be explained in the Commentary. If there is a desire to include a reference to "reasonable means" in the Principle itself, it would be better to include it at the end of Principle 8(2), so that a list of potential means of identification is given, followed by e.g. "or other reasonable means".

Principle 8: Innocent acquisition

We, in principle, agree with this Principle.

However, we wonder whether the flexibility provided to states in 8(1)(b) can hinder the level of uniformity on this matter among states. We also wonder whether there is a real need for 8(7) given Principles 3(3) and 9. Confusingly, Principle 9 is expressly subject to Principle 8, which includes 8(7) and its statement that if a transferee is not an innocent acquirer other law applies to determine the rights and liabilities of the transferee. Presumably Principle 9 is not subject to the application of other law in the way indicated by Principle 8(7).

Principle 9: Rights of transferee

We, in principle, agree with this Principle.

However, as we understand from para 3 of the Commentary, the party who acquires a digital asset from an innocent acquirer can get the benefit of innocent acquisition even though they are not innocent themself. We wonder about the reasoning for this and its appropriateness in policy terms. A different formulation could be helpful to address this policy concern, eg a person who acquires a digital asset from an innocent acquirer is merely presumed to be in good faith themselves.

Section IV: Custody

Please use this section to provide comments on Section IV of the Principles relating to Custody. This section comprises of 4 Principles. When providing comments on the Commentary, please provide the paragraph number where possible.

Principle 10: Custody

The term 'maintain' in this context is new to us, but we understand from the Commentary that this is a concept that the UNIDROIT aims to introduce under the Principles.

It would also be useful to have more explanation for the inclusion of the term 'in the ordinary course of the service provider's business' in Principle 10(3)(a) and detail as to what the term is intended to encompass (and some examples of what would be excluded from its scope).

Principle 11: Duties owed by a custodian to its client

Regarding Principle 11(1), para 1 of the Commentary indicates that the duties set out in there are basic duties and that States should not permit them to be excluded by the terms of the custody agreement. We understand that the aim here is to provide the client with protection that cannot be derogated from by agreement. Based on this, we wonder whether these are then intended to be mandatory rules and, if so, whether they apply in cross-border situations as mandatory rules in the private international law sense. It would be helpful if the

Commentary clarifies this or States, adopting the provision, make it clear that these rules constitute mandatory rules.

Principle 12: Innocent client

We understand that this Principle is an adaptation of the innocent acquisition rule for custody and this seems logical to us. However, we would find it helpful if further explanation is provided in the Commentary regarding the reason for the choice of the innocent client over the third party who potentially has rights, and may also be "innocent".

Principle 13: Insolvency of custodian

We are generally supportive of the policies behind Principle 13 and the wording and structure of the principle. However, we note in relation to 13(3) and the accompanying Commentary (at para 5) that there is no explanation as to what happens to the rights which a custodian has against a sub-custodian if the former enters an insolvency proceeding. The principle merely states that the rights in respect of the relevant digital asset 'do not form part of the custodian's estate' and this is essentially repeated in the Commentary. Is the intention for the rights to remain exercisable by the custodian itself, despite the insolvency proceeding? Instead, perhaps the intention is for the rights not to be exercisable by the custodian, as well as not being distributable as part of its estate. A further possibility is that the rights could be transferred to the client, so that there is a more direct relationship between the client and the sub-custodian, in the event of the custodian's insolvency. Specific provision could be made for this, or there could be a provision similar to Principle 13(2), which states that an insolvency representative 'must take reasonable steps for the control of the digital assets… to be changed to the control of [the] client or of a custodian nominated by that client' but instead applied to the rights against the sub-custodian, rather than the digital assets. At least there should be some further explanation in the Commentary as to what is the intended effect of the principle in its current form. A similar point could also be made about the commentary in relation to Principle 13(1) – see para 2.

A further, minor point about the Commentary is that in para 1, the final sentence is unclear and confusing. It states 'if the consequences set out in Principle 13 special regime would not be possible under the special regime, Principle 13 will need to be modified accordingly'. Is it simply the case that the first inclusion of 'special regime' should be omitted, or does the sentence require more substantial amendment for clarity purposes?

Section V: Secured Transactions

Please use this section to provide comments on Section V of the Principles relating to Secured Transactions. This section comprises of 4 Principles. When providing comments on the Commentary, please provide the paragraph number where possible.

Principle 14: Secured transactions: general

We agree with the overall content of the principle. However, it is worthwhile to note that in Principle 14(1) the reference to digital assets being the 'subject' of security rights may be misleading, as we stated in our comment on Principle 3 above. In technical terms, in some systems (principally Civilian systems), subjects in relation to property are persons (whether natural or legal) who may hold rights in relation to objects, which are things (including potentially digital assets). We do recognise that the term 'subject' is used in a broader sense in the current formulation, yet it would be advisable to at least explain the position more extensively in the Commentary and note that it might be preferable to formulate the provision with reference to 'object' instead of 'subject' in some systems.

We note that 14(2) and (3) respectively specify that other law applies to determine, firstly, the legal effect of creation and, secondly, the third-party effectiveness of a digital asset, in relation to linked assets. In many systems creation will correspond directly with third-party effectiveness, which means that the inclusion of (3) might not be necessary, or could even create confusion. However, we accept that there are many systems in which there is a distinction between creation and third-party effectiveness, and so, on balance, we agree with its inclusion. Perhaps though it could be noted more expressly in the commentary that in some systems there may not be such an obvious distinction.

Principle 15: Control as a method of achieving third party effectiveness

We agree that control should be a method of achieving third-party effectiveness of a security right in a digital asset. We also note and agree that there can be other methods of obtaining a security right in such an asset, depending on the system in question (e.g. through certain types of agreement, by way of registration or some other form of notification or publicity).

In para 3, it is stated that, under some laws, a transfer to a wallet held by the secured creditor or its agent would 'be sufficient to protect the security right against third-party claims, including in insolvency'. It may be worthwhile pointing out that, depending on the system and the circumstances, the digital asset may either not fall within the insolvency estate of the debtor at all (as there is deemed to have been a transfer) or that it does fall within the estate of the debtor but is encumbered by a security right.

As a point of clarity, in para 9, it is stated that if the secured creditor 'cannot exercise the abilities without the consent, or participation of the grantor, then it should not be in control for the purpose of achieving third-party effectiveness'. This may need more explanation with reference to multi-signature arrangements. Such an explanation may also assist with the illustrations at paras 11 and 12 (incorrectly labelled as 13), the first of which does refer to a multi-signature arrangement (and could be referred to in a prior explanation). The position is clarified to some extent by para 9 of the Commentary to Principle

17, but not entirely and further discussion at this earlier point would be beneficial.

Principle 16: Priority of security rights in digital assets

We note the justifications given for a security right made effective against third parties by control having priority over a security right made so effective by another method. On balance, we are minded to agree. We note that control in this context may be considered equivalent to the possession of tangible/corporeal assets, which in a number of systems can give priority to a security holder ahead of such a creditor who has obtained a security over the assets by another means.

In para 3 of the Commentary, it is stated that while, under Principle 8, a secured creditor may be an innocent acquirer only if they act without knowledge of a competing interest, the effect of Principle 16 is that the secured creditor that takes control would have priority 'over one that registers irrespective of knowledge'. While we accept that this is the direct result of principle 16, we wonder whether the contrast with Principle 8 should be more expressly and strongly justified here. Of course, the whole concept of security rights involves parties trying to obtain priority over other creditors and this competition between compatible but ranked interests differs from ownership. It could be noted that if there is a legitimate means, such as control, which enables one secured creditor to have priority over others, they should be able to use that to gain an advantage, due to the nature of security rights, even if they are not in good faith.

Principle 17: Enforcement of security rights in digital assets

We generally agree with this principle on the enforcement of security rights in digital assets; however, it may be worthwhile to further justify its inclusion in light of the existence of Principle 18, which provides that in respect of procedural matters, including enforcement, other law applies.

In addition, Principle 17(1) specifies that the relevant other law includes 'any requirement to proceed in good faith and in a commercially reasonable manner'. While we understand the desire to include this statement, the use of 'and' between the possibilities should be replaced with 'or' or 'and/or' to undeniably include other law which requires e.g. parties to proceed in good faith but where there is no specific requirement for acting in a commercially reasonable manner, or vice versa.

Section VI: Procedural Law Including Enforcement

Please use this section to provide comments on Section VI of the Principles relating to Procedural Law Including Enforcement. This section comprises of 1 Principle. When providing comments on the Commentary, please provide the paragraph number where possible.

Principle 18: Procedural law including enforcement

We note that there may be some dispute about what constitutes procedural matters and what constitutes substantive law in different systems. One potential solution might be to include a provision on the distinction between procedure and substance, similar to e.g. Article 5 of the Proposal for a Regulation of the European Parliament and of the Council on the law applicable to the third-party effects of assignments of claims, harmonising a non-exhaustive list of procedural issues. Although the Commentary provides some guidance on this, the Commentary does not have the same legal value (or force) as the Principles, as we noted above in our general comments. Further, the weight given to the Commentary might differ from one country to another. Therefore, providing such a provision under the Principles would be helpful although we recognise that it is probably not possible to entirely avoid divergent interpretations in the present context. In any event, the approach of the Principles means that anything not dealt with by them is covered by other law. As such, it could be queried whether Principle 18 is actually required. However, on balance, we think it is helpful to have an express statement on procedural law, to avoid ambiguity or uncertainty.

Section VII: Insolvency

Please use this section to provide comments on Section VII of the Principles relating to Insolvency. This section comprises of 1 Principle. When providing comments on the Commentary, please provide the paragraph number where possible.

Principle 19: Effect of insolvency on proprietary rights in digital assets

We agree with the content of this principle, but attention should be given to whether Principle 19(1) should also include the subject of the insolvency proceeding (the debtor) in the list of parties against whom a proprietary right is effective in an insolvency proceeding. We acknowledge that the debtor is not a 'third party', but the wording could easily be adjusted to include the debtor. It is noted in the Commentary at para 1 that the debtor may be the person with the proprietary right or it might be another party. Particularly if another party has the proprietary right, it is important that such a right is (or remains) effective against the debtor in an insolvency proceeding. Any doubt cast on this by the provision in its current form should be addressed. In reality, the issue may not matter so much in proceedings where the debtor no longer has control over their assets, but for debtor-in-possession proceedings, in particular, it may be of great significance. At the very least, the commentary should more clearly specify why the debtor is not included on the list and state that the proprietary rights will be effective against the debtor in an insolvency proceeding too.

Any other comments

Please use this section to insert any other comments.

This response is provided by a working group of the Centre for Commercial Law at the University of Aberdeen (Scotland, UK). The working group consists of Dr

Burcu Yüksel Ripley, Dr Alisdair MacPherson, Dr Michiel Poesen, Ms Alanoud Albargan and Mr Le Xuan Tung, with Dr Onyoja Momoh as an observer.

The CCL brings together researchers across the broad groups of corporate and commercial law, international trade law, intellectual property and technology law, and dispute resolution. The law relating to digital assets is one of the research areas of the CCL. Working groups and members of the CCL have responded to various calls for evidence and consultations in relation to digital assets and electronic trade documents (see https://www.abdn.ac.uk/law/research/centre-for-commercial-law/public-policy-stakeholder-engagement-1109.php) and published widely in the area to help raise awareness of the issues and contribute to the development of solutions.