Response to the Law Commission of England and Wales Call for Evidence on Digital Assets (July 2021)

This response is provided by a working group of the Centre for Commercial Law at the University of Aberdeen. The working group consists of Dr Burcu Yüksel Ripley, Dr Alisdair MacPherson and Mrs Donna McKenzie Skene.

General Comments

We welcome this call for evidence and appreciate the opportunity provided to stakeholders to express views to assist with law reform proposals in this area. We note that the Centre for Commercial Law responded to the UK Government Consultation and Call for Evidence on UK Regulatory Approach to Cryptoassets and Stablecoins (see https://www.abdn.ac.uk/law/research/public-policy-stakeholder-engagement-1109.php#panel1114) and is responding also to the Law Commission Consultation on Digital Assets: Electronic Trade Documents.

We agree that there is a pressing need for law reform in the UK in this area to provide legal certainty and predictability regarding the legal status of digital assets and to facilitate innovation by appropriate legal frameworks in the UK, which is a leading country in the global financial sector and aspires to be amongst the most innovative economies. In this respect, we emphasise the importance of law reform across the three jurisdictions of the UK and a level of uniformity to be achieved among them. We note that this consultation and the consultation on electronic trade documents limit their scope to England and Wales. However, we consider that some of the law reform proposals in both consultations have a UK-wide impact and therefore would have a knock-on effect in the jurisdictions of the UK beyond England and Wales. Regarding Scotland, some of the acts being considered for reform in this consultation (eg the Sale of Goods Act 1979) and in the consultation on electronic trade documents (eg the Bills of Exchange Act 1882 and the Carriage of Goods by Sea Act 1992) are applicable in Scotland. In addition, some areas, notably insolvency, require consideration of Scots law implications. Furthermore, depending on where the situs of a digital asset is, there might be cases where the law of England and Wales and law of Scotland are both relevant and therefore give rise to intra-UK conflict of laws situations. Based on these considerations, we think that it would be very useful for the Law Commission for England and Wales to engage with the Scottish Law Commission and promote close cooperation in the scope of work under both consultations.

Question 1. What would be the legal or practical implications for you if digital assets were possessable under the law of England and Wales? Please explain your answer and provide examples.

We think that some of these implications would relate to the link between possession and ownership while others would mainly relate to the notion of possession itself.

In terms of the implications relating to the link between possession and ownership, there is currently legal uncertainty whether persons, who have digital assets, own these assets. If digital assets were to be possessable, it should also be recognised by law that they could be owned and provided with protection via legal remedies. Legal certainty and protection might otherwise not be achieved in all cases if digital assets were deemed to be not possessable but rather could only be claimed by action, particularly in the absence of a central point of authority to which such a claim could be made. For example, a person who holds money in a bank account has only a thing in action and therefore has a right to claim against the bank over the amount in his

bank account. However, for example in the case of Bitcoin, underpinned by a permissionless blockchain, there is no central point of authority against which the person has a right to claim over Bitcoins in his digital wallet as it is a pseudonymous peer-to-peer system. Therefore, the law should remedy that, at least to some extent.

In terms of the implications relating to the notion of possession itself, there are legal provisions or legal concepts which specifically use or refer to the notion of possession. One example of this is the Insolvency Act 1986, s 236, which makes provision for the examination of a person *inter alia* "known or suspected to have *in his possession* any property of the company…" (emphasis added). Possession is relevant to the creation of certain types of security. In addition, the appropriate method of debt enforcement action (in Scotland, referred to as diligence) is linked to possession and specific remedies (eg possessory remedies) are other examples. Therefore, if digital assets were possessable, it would have certain legal and practical implications regarding these provisions and concepts.

The call for evidence paper seems to consider options for digital assets under the traditional division of "choses in possession" and "choses in action". However, they do not easily fit into this division since they share several characteristics of chose in possession (such as transferability and storage) whilst being intangible (on this point, see eg Financial Markets Law Committee Paper on Fintech: Issues of Legal Complexity, June 2018, http://fmlc.org/wp-content/uploads/2018/06/FinTech_bound.pdf, pp.21-22; Joanna Perkins and Jennifer Enwezor, "The Legal Aspects of Virtual Currencies" (2016) 10 *Journal of International Banking and Financial Law* 569, p.570). We note that this makes a case for an argument for traditional categories of English common law to be extended to recognise "virtual choses in possession" as a new form of property referring to intangible property with the essential characteristic of choses in possession (on this point, see Financial Markets Law Committee Paper and Perkins and Enwezor cited above; see also the speech on 'Financial Technology: Opportunities and Challenges to Law and Regulation'of Lord Hodge, Justice of the UK Supreme Court, 26 October 2018, https://www.supremecourt.uk/docs/speech-181026.pdf, p.15). We therefore raise for consideration, as part of this law reform, the option of creating a third category with a more specialised regime for digital assets. This could draw on existing rules and concepts as appropriate but create bespoke rules where necessary to recognise the specific characteristics of (different types of) digital assets. Such an approach would help to integrate digital assets with broader property law while also creating a regime that accommodates the particular issues pertinent to digital assets.

Question 2. Do you consider a transfer of a digital asset to be more analogous to a transfer of a thing in possession, such as cash, or a transfer of a thing in action, such as bank money? Does a different analysis apply for different types of digital assets (including different sub-sets of cryptoassets) or different methods of transfer? Please explain your answer and provide examples.

Bitcoin, as the first cryptoasset, was introduced as a purely peer-to-peer version of electronic cash that would allow online payments to be sent directly from one party to another without going through a financial institution. In that respect, we think that a transfer of a digital asset involving those characteristics would be more analogous to a transfer of a thing in possession. Yet the intangible nature of digital assets is more akin to a thing in action than a thing in possession. In any event, we note that the current digital asset landscape is continuously being evolved and diversified and therefore there might be digital assets for which both of these analogies could be potentially applicable. The answer to this question would likely depend on the type of the asset in question and the technology underpinning it.

Question 3. Are there practical circumstances in which it would be useful to distinguish, or to separate, the ownership and the possession of a digital asset, particularly in relation to transfers? If so: (1) For cryptoassets, could these circumstances arise both on-chain (reflected by modifying a ledger or blockchain) or only off-chain (where value moves or a transaction occurs without modification to the relevant ledger or blockchain)? (2) Do other technical or practical solutions (for example smart contracts, multisignature, escrow arrangements, Layer 2 applications or "mixing") or market practice make these distinctions less important? Please explain your answer and provide examples.

The distinction between ownership and possession is a well-recognised distinction for other types of property and certain rights arise based on this distinction. We therefore think that this distinction should also be applied for digital assets. This distinction would be needed particularly in the following circumstances: where third party intermediaries (eg digital asset wallet providers) are used by asset holders to access and manage their assets; where a digital asset is subject to deposit, trust, lien or other security; where digital assets are being lent to someone else; or where ownership is disputed (eg in cases where an asset is stolen).

(1) We think that it would be logical for this distinction to be applied to both on-chain and off-chain situations.

(2) We have no particular comment on this sub-question.

Question 4. How do you typically characterise an on-chain transfer of a cryptoasset? Please explain your answer and provide examples.

We think that an on-chain transfer of a cryptoasset is to be typically characterised as a transfer of (the same) cryptoasset, notwithstanding the fact that new data is being used or created in this process. We think that what is newly created in an on-chain transfer is the data facilitating the transfer, not the asset itself.

If the law would treat an on-chain transfer as creating "new" cryptoasset, that would bring unnecessary complications regarding the ownership of an asset each time it is being transferred on-chain. This would be undesirable. One example of this could be seen in the application of the provisions for recovering property disposed of by a debtor prior to insolvency or indeed for any vindicatory action to recover specific property.

Under the existing law, an on-chain transfer might be seen as creating new property if it is interpreted by a very strict analogy to the delivery of a tangible object, but we think that law reform could address that.

Question 5. In what circumstances (if any) are digital assets analogous to "goods", as currently defined under the Sale of Goods Act 1979? In what circumstances are digital assets not analogous to "goods"? What would be the practical consequences of characterising digital assets as "goods" for these purposes? Please explain your answer and provide examples. We would also be interested in respondents' views on these issues in the context of the Supply of Goods and Services Act 1982 and the Consumer Rights Act 2015.

We think that digital assets are not analogous to "goods" for the purposes of the Sale of Goods Act (SGA) 1979. They currently do not fit into the definition of goods in the Act. They cannot be considered as personal chattels as they do not satisfy the tangibility criterion for this purpose.

Regarding cryptoassets used for payment purposes and seen as an equivalent of peer-to-peer electronic cash and also almost definitely for central bank digital currencies, they are more analogous to money (rather than goods) as they are a means of payment for goods for the purposes of the SGA. The fact that they are currently not considered as legal tender should not change their character as a means of payment.

If digital assets were to be characterised as goods for the purposes of the SGA, we think that a number of aspects of the scheme for goods in the Act could not be applied to them directly as they are not physical objects.

We think that this analogy could probably be applied to the Supply of Goods and Services Act 1982 and the Consumer Rights Act 2015 in a similar way. For example, the Consumer Rights Act defines 'goods' in Article 2(8) as "any tangible moveable items, but that includes water, gas and electricity if and only if they are put up for supply in a limited volume or set quantity." Digital assets would not typically fit into this definition. However, peculiarities of these two Acts would require further consideration. For example, the Consumer Rights Act applies to contracts for the supply of digital content and defines 'digital content' in Article 2(9) as "data which are produced and supplied in digital form", which might be relevant to discussions around characterisation of tokenised assets. However, the scheme of this Act treats a contract for the supply of digital content different than a contract for the supply of goods or the supply of services.

Question 6. What practical or legal difficulties or problems (if any) do you encounter with the application of the "nemo dat" principle in respect of a transfer of a digital asset? (1) Do you encounter or anticipate the same practical or legal difficulties or problems in respect of on-chain transfers and off-chain transfers? (2) Do different digital assets or digital assets that perform different functions give rise to different practical or legal difficulties or problems? (3) Would the ability to possess a digital asset affect the application of the "nemo dat" principle? (4) What else could be done to alleviate these practical or legal difficulties or problems? Please explain your answer and provide examples.

We are not in a position to answer this question based on practical experience. However, we think that legal or practical difficulties may arise in terms of proving ownership depending on the type of digital assets, and they could be alleviated by providing specific statutory rules for digital assets. Consideration also needs to be given to a number of other issues, including the extent to which rules such as those for sellers or buyers in possession after sale, in terms of ss 24 and 25 of the Sale of Goods Act 1979, should apply to digital assets.

Question 7. How do you typically characterise the relationship between a digital asset token and the underlying tokenised asset? (1) What are the practical consequences of this characterisation for the purposes of transfers of either the digital asset token or the underlying tokenised asset which it represents? (2) Does the current legal characterisation of a transfer give rise to practical or legal difficulties or problems? (3) Would the ability to possess a digital asset token help to clarify this analysis? (4) What else could be done to alleviate these practical or legal difficulties or problems? Please explain your answer and provide examples.

We think that this is a question of what has been transferred (eg the token or the underlying asset) and the extent to which the tokenised asset is represented by the token. Legal or practical

difficulties might arise for example in the context of insolvency where there may be issues as to what exactly is included in the insolvency estate.

These problems could be alleviated by providing specific statutory rules for digital assets which would set out circumstances when the transfer of the token would lead to the transfer of the asset.

Question 8. If a digital asset were possessable, are there practical circumstances in which bailment of digital assets could arise? (1) Do you think bailment of a digital asset would be a useful or practical concept? (2) Do other technical or practical solutions or market practice make bailment of digital assets less important? Please explain your answer and provide examples.

If a digital asset were possessable, there might be practical circumstances in which bailment of digital assets arise, for example, in the context of the use of third party intermediaries (eg digital asset wallet providers) and security rights (eg pledge as a form of bailment).

(1) We think that bailment of a digital asset would be a useful and practical concept, and if possession of digital assets is allowed by law reform, bailment of these assets should exist. As already noted, the utilisation of existing concepts to digital assets is helpful to integrate such assets into the existing law of property and will help to resolve issues in future. The application of "digital bailment" is one such example of this.

(2) We have no particular comment on this sub-question.

Question 9. How is security over digital assets granted or taken in practice? (1) Do you consider mortgages and charges to be effective methods of taking security over digital assets? (2) If a digital asset were possessable, are there practical circumstances in which the creation of possessory security over a digital asset might be used? (3) Do other technical or practical solutions or market practice, including the creation of quasi-security, make the ability to take possessory security over a digital asset less important? Please explain your answer and provide examples.

We are not in a position to answer this question based on practical experience.

(1) Under the existing law of England and Wales, it seems that mortgages and charges can be used for taking security over digital assets. (Mortgages do not apply in Scotland and although at present security could be taken in the form of a floating charge, such a charge cannot be granted by all debtors.) The characterisation of a charge as fixed or floating may give rise to particular issues. Although concerns around difficulties in exercising control over a digital asset might reduce the efficacy of taking a mortgage or charge over digital assets, it could probably be addressed by technological solutions.

(2) We think that if possession of digital assets would be allowed by law reform, the creation of possessory security over a digital asset would make sense. If possessory security is to be allowed, it might be helpful to also clarify whether an "assignment" for security purposes will be permissible as an alternative (as this is a form of transaction used for intangible property). Of course, the requirements for transferring digital assets could determine this and it may be that a transaction in such terms would be characterised as eg a mortgage, assuming relevant transfer requirements were met. (From the perspective of Scots law, which as noted above does not allow mortgages, it would be useful to know if an assignation in security of such property

would be possible, but we appreciate that this is not a question for the Law Commission of England and Wales.)

(2) We have no particular comment on this sub-question.

Question 10. If a digital asset were possessable, are there practical circumstances in which conversion of a digital asset could arise? (1) Do you think conversion would provide a useful or practical claim in this context? (2) Do other technical or practical solutions or market practice mean that the applicability of conversion to digital assets is less important to stakeholders and market participants? Please explain your answer and provide examples.

If a digital asset were possessable, there might be practical circumstances in which conversion of a digital asset could arise, for example, where a digital asset is stolen.

(1) It seems logical to us for conversion to be available as a remedy for unlawful interference in this kind of cases. Again, applying rules that are relevant for other assets is advisable here.

(2) We have no particular comment on this sub-question.

Question 11. We welcome comments on the aspects of the Liechtenstein Blockchain Act and the Wyoming Blockchain Laws relevant to the questions in this call for evidence. What other jurisdictions, if any, should we consider and why?

We think that it would be useful to consider the following jurisdictions or projects (and the Law Commission should continue to monitor developments elsewhere in future):

- United States of America (USA): The work of the Joint Committee of the Uniform Commercial Code and Emerging Technologies of the American Law Institute and the Uniform Law Commission (https://www.uniformlaws.org/committees/community-home?CommunityKey=cb5f9e0b-7185-4a33-9e4c-1f79ba560c71) reflects the latest US approach and has made considerable progress in this area.
- Switzerland: The Swiss Act to Adopt Federal Law to Developments of Distributed Ledger Technology, entered into force in two phases, and provided significant amendments to different statutes across different fields. Some of the main aspects of the Act include regulating the transfer of rights on the blockchain by means of digital registers, introducing a new category of ledger-based securities to the Code of Obligations, and providing special provisions for the segregation of cryptoassets held in custody by a third party in bankruptcy proceedings.
- European Union (EU): A legal and regulatory framework for blockchain is a part of the EU's blockchain strategy, including current proposals for digital Euro and for a Regulation on Markets in Crypto-assets (MiCA) governing the issuance, trading and storing of cryptoassets falling into its scope. Although the Law Commission's current law reform proposal has a different scope and focus, it would be useful to monitor developments in the EU in this area.
- International Institute for the Unification of Private Law (UNIDROIT): The UNIDROIT is working on developing a legal instrument containing principles and legislative guidance in the area of private law and digital assets (see https://www.unidroit.org/work-in-progress/digital-assets-and-private-law). A number of key international institutions whose work is relevant to this area (including the United Nations Commission for International Trade Law (UNCITRAL) and the Hague Conference on Private International Law (HCCH)) are participating as observers in

their Working Group. A guidance document on Digital Assets and Private Law is expected to be adopted by early 2022.

- International Academy of Comparative Law (IACL): One of the topics that the IACL selected for its 2022 General Congress is "Cryptocurrencies: the impossible domestic law regime?" (see https://aidc-iacl.org/wp-content/uploads/2021/05/ASUNCION-Topics-List-As-of-Feb-6.pdf)/. For this purpose, Special National Rapporteurs have been appointed from 24 countries to prepare a national report on different aspects of cryptocurrencies, including private law aspects, for their respective jurisdiction (see https://aidc-iacl.org/snr/). This project would be useful to consider in order to have a comparative approach on the issue.
- Hague Conference on Private International Law: The HCCH is working on private international law implications of the digital economy, including DLT and its applications including digital assets). The mandate for the work is to monitor developments with a view towards identifying topics for further study (see https://assets.hcch.net/docs/f787749d-9512-4a9e-ad4a-cbc585bddd2e.pdf and https://assets.hcch.net/docs/8bdc7071-c324-4660-96bc-86efba6214f2.pdf). Digital assets, given their cross-border nature, give rise to conflict of laws/private international law issues. As a HCCH member, the UK's cooperation and coordination with the HCCH regarding conflict of laws/private international law issues in this area is important for law reform particularly given the proposal of the Law Commission to take forward a separate project on private international law and emerging technologies as part of their 14th programme of law reform.

Question 12. We welcome suggestions as to other issues which arise in practice, or other areas of law which could be affected, and which should be included in the scope of our digital assets project. For each issue, we would be grateful for the following information: (1) a summary of the problem or potential problem. (2) an explanation of and evidence of the effect of the problem or potential problem in practice. (3) suggested solutions to the problem or potential problem, and any evidence of the costs and benefits of the solution.

Issues relating to third-party intermediaries: For example, in cases where a person opens an account with a third party intermediary (eg digital asset wallet provider), would that third party have any ownership or possession rights over crypto assets registered in the wallet?

Issues relating to insolvency: These would include whether digital assets are part of the insolvent estate and how they are to be treated; the mechanics and effect of vesting, where relevant; the nature of the assets, which may in turn be relevant to the officeholder's powers to recover, manage and realise the assets and to obtain information about them; valuation; the operation of the provisions on challengeable transactions; the determination of whether a valid security exists over the asset; the interpretation of specific provisions such as s 236 of the Insolvency Act 1986, referred to above; and the implications for a distribution *in specie*.

Issues relating to debt enforcement: This includes what type of debt enforcement method(s) can be used for such assets; how and against whom debt enforcement against digital assets should take place; and whether existing debt enforcement processes and rights would need to be adapted to accommodate such assets.

Issues relating to conflict of laws/private international law issues: Digital assets, given their cross-border nature, give rise to conflict of laws/private international law issues. For the nature of the problem, key issues that arise in this context, and potential solutions, see the HCCH documents cited above in our response to Question 11.