

Legal challenges in relation to digital assets

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What is a DA?

Principles 2(1), 2(2), 6

An electronic record which is capable of being subject to control

eg Bitcoin, Ether

Plan of my presentation

- Linked assets
- Private International Law
- Custody

Linked assets

Principle 4

Digital
asset

Other
asset

If the digital asset is transferred to
A, the other asset is also
transferred to A

A

A

Possible 'other' assets

Intangibles

- Shares
- Debt securities
- Receivable(s)
- Right to possession of goods
- (Contractual) right eg to money, goods or services
- Another digital asset
- Intellectual property

Tangibles

- Land
- Goods

Nothing

- NFTs
- Information

How to achieve a link: securities

Statute provides for the link:

- Legislation in France, Luxembourg, Germany

‘Stapling’ : the UK

- Debt securities: can be 'stapled' to a digital asset so that transfer of the digital asset transfers the security, but equity securities cannot be transferred without an entry in the company's register.

How to achieve a link: goods



Statute provides for the link

- Legislation in Liechtenstein

UK: who controls the digital asset is only evidence of who owns the goods

- Property passes when the parties intend it to pass. The owner of the digital asset/goods could sell the goods to A and the digital asset to B.

Private International Law

Proprietary issues: applicable law

A controls a digital asset. B claims that he is the true owner of the digital asset. A claims that she is.

A is in country X. B is in country Y.

Tangibles : Lex situs would normally apply . But where is the digital asset?

Parties should be able to discover in advance what law applies to proprietary issues

One law for an entire issue of securities.

Choice of applicable law clearly stated in the asset

Law of the place of the issuer

What is the position if neither of these apply?

How are digital assets held?

Self-custody

- A controls the DA eg through a non-custodial wallet
- A continues to own the asset

A transfers control of the DA to B who holds it on A's behalf

- Custody
- A continues to have a proprietary right in the asset
- A is not at risk in B's insolvency
- Common law: the DA is held on trust (*Ruscoe v Cryptopia* [2020] NZHC 728)

A transfers control AND ownership of the DA to B

- Eg B lends out the DAs it owns and earns interest some of which is passed on to clients
- B owns the asset.
- B owes A an obligation to deliver an equivalent asset
- A is at risk in B's insolvency.

Example: Celsius UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK Case No.- 22-10964, 4th January 2023)

- Celsius in financial difficulties: filed for Ch 11 and accounts frozen
- 2 types of account : custody and 'earn' accounts
- US bankruptcy court confirmed that custody customers could withdraw all assets from their accounts but that 'earn' account customers only had personal claims against Celsius
- Celsius: restructuring plan whereby 'earn' account customers obtained c.67% recovery
- Easy case: contracts were clear as to legal consequences
- The customers who had 'earn' accounts still argued that they had a proprietary claim to the digital assets because the word 'lend' was used, which they said meant that they had a right to get the same assets back: this was rejected by the judge.

Example: Gatecoin Ltd. [2023] HKCFI 914

- Gatecoin was a crypto exchange that went into liquidation
- In 2016 it had agreements with its customers that (arguably) created a trust relationship between Gatecoin and the customers.
- In 2018 Gatecoin changed its terms and conditions so that the provision creating the trust was taken out
- The court directed that the liquidator had to decide, in relation to each customer, whether they had accepted the change of terms and conditions by accessing Gatecoin's website : the court directed the liquidator to ask customers to provide evidence if they claim that they did not accept the terms and conditions.

Conclusion

- There are many interesting legal issues that are likely to arise in relation to digital assets in the next few years.
- This talk:
 - Linked assets
 - Private international law
 - Custody
- The need for legal certainty will have to be fulfilled by a combination of targeted legislation and informed decisions by national courts.
- The UNIDROIT Principles on digital assets and private law can help with both.