KEY POINTS

- English law currently recognises two types of personal property: (i) things in possession; and (ii) things in action.
- English law has generally been flexible in recognising that crypto-tokens could attract property rights, even though they do not fit neatly into these two categories.
- The Law Commission recommends that the law of England and Wales should explicitly recognise a third category of personal property called "data objects". This is intended to deal specifically with digital assets and their legal implications.
- The legal certainty created would make English law an attractive choice of law for crypto-token related transactions.

Feature

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English law in the 21st century: does it need an update to accommodate crypto?

The recent Law Commission Digital Assets Consultation Paper proposes the creation of a third category of personal property under English law. The article focuses on identifying some of the practical consequences of this proposal from a financial services perspective. This is achieved by summarising some of the main points made in the consultation and considering the potential impact for the use of English law.

WHAT IS THE STATUS OF THE LAW COMMISSION CONSULTATION PAPER

The Law Commission published its Consultation Paper on Digital Assets (Consultation Paper) on 28 July 2022, following its Call for Evidence in April 2021.

The Consultation Paper does not change the law, it simply recommends changes to the laws of England and Wales.[1] In this article, we will explore the key recommendation, to introduce a new third category of personal property.

WHAT IS SO SPECIAL ABOUT DIGITAL ASSETS ANYWAY?

English law has traditionally recognised two distinct types of personal property:

- **things in possession**, which are objects that the law considers capable of possession, and includes assets which are tangible, moveable and visible (eg a bag of gold); and
- **things in action**, that is personal property that can only be claimed or enforced through legal action or proceedings (eg shares in a company, debts, a right to sue for breach of contract).

There is English case law that provides that all personal things are "either in possession or action" and that the law does not recognise any third category between these two (*Colonial Bank v Whinney*). The issue with digital assets is that they do not seem to neatly fall within either of these categories.

Digital assets are not "things in possession" as they are virtual and not tangible and require some form of physical control. The courts have held that intangible things cannot be possessed (*OBG Ltd v Allan*[2]). The only way to control (or in common parlance "hold") digital assets is through the private cryptographic key that corresponds to the digital wallet in which the digital assets are recorded. However, this *practical* control is remote and not sufficient to equate to physical control or possession.

Regarding "things in action", many crypto-tokens do not themselves embody any right capable of being enforced by court litigation or action, and so would appear to fall outside of the scope of this category. For example, one Bitcoin does not grant the holder any enforcement right against an issuer.

However, English law has been flexible in recognising that digital assets including crypto-tokens can attract property rights, even though they do not fall squarely within either of these two categories. We note that in *Fetch.ai v Persons Unknown*,[3] the judge described crypto-tokens held on Binance as things in action. The judgment in *AA v Persons Unknown*[4] suggested it would be "fallacious" to proceed on the basis that the law of England and Wales recognises no form of property other than things in possession and things in action, and endorsing the UK Jurisdiction Taskforce's Legal Statement. In this respect, it was held that a crypto-token could attract property rights even if it was not a thing in action in the narrow sense of the term.

The problem generally, is that once it is determined that digital assets qualify as property, the sub-classification as things in possession or things in action will carry a number of consequences, including:

- how to establish ownership of the asset and how it is transferred;
- how security can be granted over the asset;
- whether the asset can be held on trust;
- how the asset is treated on insolvency;
- what remedies are available, eg proprietary vs contractual claims, etc.

The Consultation Paper concludes that the application of legal rules developed for these two traditional categories of property may not be appropriate for digital assets.

INTRODUCING THE NEW CATEGORY OF PROPERTY: DATA OBJECTS

The Law Commission recommends that the law of England and Wales should explicitly recognise a third category of personal property called "data objects". This is intended to deal specifically with digital assets and their legal implications.

The Consultation Paper proposes that a thing should be recognised as a data object if the following three limbs are met:

(1) **It is composed of data represented in an electronic medium**: The thing in question must be composed of data

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represented in an electronic medium, including computer code, electronic, digital or analogue signals. This enables differentiation from things in possession, which may include a network or system which has a tangible existence (notwithstanding the fact that such systems may be highly distributed). Data objects have an informational quality. The Consultation Paper provides that information is not, in and of itself, an asset. The intention is to capture data which is "uniquely instantiated within a particular network or system", as this is what allows certain digital assets to function more like objects rather than pure information.

(2) **It exists independently of persons and exists independently of the legal system**: Data objects must have an existence which is independent of any particular person, such that the object of the property right must be separate from its owner. In addition, the thing must exist independently of the legal system. This differentiates data objects from things in action, such as debt claims, which are reliant on the legal system for their existence and enforceability. By contrast, data objects exist independently of legal rules (eg crypto-tokens have an existence on a blockchain or other system, which is independent from a legal system).

(3) **It is rivalrous**: This means that it must be something whose capacity for use is not unlimited, and it cannot be capable of being used simultaneously by two people. The example provided is that if Alice uses a Game Boy, Bob cannot use the same Game Boy at the same time, and therefore Alice's use of the Game Boy prejudices Bob's ability to use it. The Consultation Paper provides that the divestibility of a thing is a useful indicator of whether it will meet the other limbs to be a data object; however, it should not be a standalone criterion. This is to ensure this new category is flexible enough to capture certain digital assets (including crypto-tokens) as data objects, even if they possess technical features which limit their transferability or their divestibility.

CRYPTO-TOKENS AS DATA OBJECTS

The Consultation Paper provisionally concludes that most crypto-tokens are capable of satisfying the three limbs above, and therefore would qualify as data objects. It discusses how a crypto-token has a form and a function. Its form is that it is constituted of data structures, which in general is the public or private key pair, in addition to distributed ledger. Its function is that data structure is instantiated within a crypto-token system. A crypto-token system is manifested by the active operation of the rules governing that data structure (eg the rules of the protocol system). That is to say, the string of characters on a particular protocol which represents a particular crypto-token does not alone amount to a crypto-token. Instead, that string of characters only has value if it is instantiated within the particular crypto-token protocol. The fact that crypto-tokens have both form and function means they do not exist purely as information (as information alone is not capable of attracting personal property rights).

This means that a private key, which is not an instantiated data structure, is not capable of attracting property rights.

HOW DOES THIS IMPACT CRYPTO-SERVICES?

With the recognition of crypto-tokens as data objects (and property) the impact for financial markets would be legal certainty. In particular, the Consultation Paper recognises that there would be different legal structures for custody arrangements of crypto-tokens. These range from a cash like arrangement where the custodian receives the assets as an outright title transfer to trust-based arrangements.

The Consultation Paper considers the introduction of a general presumption that crypto-tokens would be held on trust where there is a direct crypto-token custody relationship. The rationale would be to protect users from the custodian's insolvency unless the risk has been disclosed and was accepted. However, the Law Commission concludes that a presumption should not be introduced at this stage.

Regardless of the final position in this respect, the introduction of a new category of property would provide much needed certainty in respect of how crypto-tokens are transferred and held. Arguably, custody services are the key to enabling a wider market adoption of crypto-token trading and to the use of crypto-tokens in an analogous manner to financial instruments.

An update to English law may be needed. ■

1 The Law Commission's 2020-21 Annual Report notes that historically, almost two thirds of their reports have been implemented by the government. As such, the Consultation Paper is a good indication of how the law may evolve to accommodate the rapidly evolving world of digital assets.
2 [2007] UKHL 21.
3 [2021] EWHC 2254 (Comm), [2021] 7 WLUK 601.
4 [2019] EWHC 3556 (Comm), [2020] 4 WLR 35.

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