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Law Commission Consultation Paper on Digital Assets

Response of the City of London Law Society

This response is on behalf of the City of London Law Society ("CLLS") Financial Law Committee ("FLC"). It addresses the questions raised in the Law Commission Consultation Paper on Digital Assets issued in July 2022. More detail on these issues is also to be found in the attached paper submitted by the CLLS to the UKJT, which was prepared by a working group of the Financial, Company and Regulatory Law Committees. Further information about the CLLS and the Financial Law Committee appears at the end of this response; we do, however, note upfront that Linklaters LLP is submitting a response to the Law Commission in which it takes a different view on a number of issues from that expressed in this FLC response. Accordingly, the member of the FLC who is a partner of Linklaters LLP and who has taken no part in the preparation of the submission, has notified the Chair of the FLC that he and his firm does not wish to be associated with this paper by reason of his being a member of the FLC.

Introductory remarks

The FLC greatly appreciates the detailed and thorough work and analysis of the Law Commission on the important topic of digital assets. We recognise the pressing need to develop a coherent, well-founded and clear legal response under English law to the substantive (and private international law) issues arising out of the growing use of blockchain and DLT-based technologies for the holding and transfer of digital assets. These issues raise some novel questions about what English law recognises as personal property and how it should do so.

As a general matter, the FLC would welcome clarification of the law on this matter. However, we consider that in identifying new categories of property, it would be better to take a more inclusive approach which would enable the law easily to recognise new forms of property as they evolve. This is preferable to a narrow definition employing somewhat arcane terminology and including core elements generative of potential interpretative uncertainty. We are also concerned to avoid cutting off the ability of common law (and equity) to define property in the evolutionary manner that has applied to date. Our response reflects that concern but builds on the excellent work of the Law Commission team and their ideas in what we hope is a constructive manner.

We also have a fundamental concern that, while the Law Commission has indicated that it is minded to avoid making digital assets in the third category amenable to possession (which we consider to be the right conclusion), much of the ensuing analysis in the Consultation Paper (for example, on "relative title" concepts, extension of the tort of

conversion and "control" as applying to relevant digital assets) derives from treatises, case-law and reasoning firmly founded in the law on possession, tangible personal property and related matters. The very term, "data *object*" - which suggests something that can be seen or touched in contrast to the more neutral term, "asset" - as a descriptive label for the proposed new third category of personal property, points to the analytical influences resulting in a number of the Law Commission's provisional proposals (based on a physical reification of the new class of personal property).

Specifically, we are not in favour of the provisional proposals made in the Consultation Paper that, first, "control" of a digital asset in the third category might properly found some form of relative legal title to the asset short of (i.e. lesser than) legal ownership; second, that a person who is vested with any such relative legal title may, in law, enforce or vindicate any rights constituted by or attached to the digital asset; or that, third, the tort of conversion should be extended to third party interference with the right, title or interest of a person in or in relation to a digital asset in the third category. In this context, we firmly agree with those academic writers who state that any such proposals are *"alien, illogical and contrary to authority"*[1]. In fact, we would go further and maintain that any such reform of English law, as applying to any digital assets as intangible personal property, would materially undermine legal certainty and the attraction of English as a law under which to constitute digital assets in the third category and/or to govern a blockchain or DLT-based system for the holding and transfer of such digital assets.

We consider the existing rules of common law and equity as currently applicable to intangible personal property can be appropriately and adequately extended to the proposed "third category" of personal (intangible) property held and transferred through blockchain or DLT-based systems (and not constituted as choses in possession or choses in action). They already provide well-founded and well-understood principles to support proprietary rights, title and interests in or in relation to a digital asset in the third category (including the resolution of priority disputes and the proper characterisation of a person's legal or equitable relationship with the digital asset); and can do this in a way that provides required flexibility sufficiently responsive to the evolving nature of the markets in digital assets and the desired commercial objectives of the participants in those markets. The inevitable strictures of the laws relating to possession (or similar concepts) as proposed by the Law Commission (based, as they are, on the oldest form of title known to the common law) are not, in our view, suitable for a modern legal system governing the holding and transfer of digital assets in the third category.

We also observe that the regulation of successful and widely used blockchain and DLT-based systems is likely to result in greater clarity on choice of law and jurisdiction as well as the identification of the jurisdiction with which any particular system may have its closest connection. This in itself will remove a number of difficult issues by increasing transparency so that many more claims relating to these systems will fit within the traditional definition of a chose in action (which may, particularly, be the case in relation to private, permissioned systems).

In relation to "stapled", "tethered" or "linked" assets, where a crypto-token is used to constitute or evidence legal or equitable, or (potentially) possessory, title to an exogenous asset (e.g. a share or credit balance in a bank account), we also strongly advocate (contrary to the position taken in the Consultation Paper) that the crypto-token should <u>*not*</u> be considered or treated as a separate or independent asset from the linked share, credit

[1] See paragraph 19.131 and footnote 1178 of the Consultation Paper in reference to M.Bridge, L.Gullifer, K.Low and G. McMeel in *The Law of Personal Property* (3rd Edition, 2021) at para. 15-127.

balance or other exogenous asset itself. In such cases, the crypto-token is better considered as a mere mechanic for the holding and transfer of the relevant title to the linked asset; and, as such, is simply an adjunct or incident of the linked asset itself. To avoid legal uncertainty or conflict between competing priority or other rules in such cases (i.e. those rules otherwise applicable to a native, endogenous crypto-token and those rules applicable to the linked asset), our preferred "one asset" analysis means that the law governing or constituting the linked asset alone should determine issues such as: how to take a security interest over the asset (and only one security interest should be required); how to perfect such a security interest; the rules of priority where there is a competing third party claim or claims to the asset; and the statutory or other laws on "financial collateral" applicable to such security interest.

We consider that the most difficult issue arising from the architecture of blockchain or DLT-based systems is the question whether English conflict of laws rules will require parties to look to some other legal system in circumstances, for example, where the location of a digital asset held in such a system is not clearly England or Wales. The multinational parallel operation nature of these systems and, in a number of cases, lack of a responsible administrator makes this a particularly acute issue affecting the question of validity and third party effectiveness of security taken over digital assets held in such systems – e.g. if English law were to require formalities in that jurisdiction to be complied with at the date of creation of a charge, the inability to determine which is the relevant jurisdiction undermines confidence in the use of an English law charge. We would very much welcome the Law Commission bringing forward their planned work in this area, so as to provide clear, well-founded and enforceable English private international law solutions to these issues.

Consultation Question 1.
20.1 We provisionally propose that the law of England and Wales should recognise a third category of personal property. Do you agree?
Paragraph 4.101

We agree that it is desirable to clarify that the classification of property in English law is not limited to real property, choses in possession and choses in action.

While early legal interest in cryptoassets has focused on the question whether they are choses in action or some other form of personal property, we note that as regulation enters this sphere it becomes more likely that the counterparty to transactions settled in a blockchain or DLT-based system will be identified or readily identifiable as a person using and participating in the system on and subject to contractual and/or statutory rules and other protocols of the system. In that event, and with particular regard to private, permissioned systems, the claimant is likely to have some form of chose in action in the traditional sense in relation to the digital asset held and transferred through the system; and, to that extent, the subject-matter of that claim will be recognised under traditional English law concepts as a form of incorporeal property.

We also note that in *AA v Persons Unknown* [2019] EWHC 3556, Mr Justice Bryan found that the seminal cryptoasset, Bitcoin, was property within the four criteria set out in Lord Wilberforce's classic definition of property in *National Provincial Bank v Ainsworth* [1965] 1 AC 1175 as being definable, identifiable by third parties, capable in their nature of assumption by third parties, and having some degree of permanence. He noted that this was also the conclusion of the Singapore International Commercial Court *in B2C2 Limited v Quoine PTC Limited* [2019] SGHC(I) 3 at [142].

We recognise that, to the extent it is determined (for public policy or other reasons) that "special" proprietary or other rules of law should be applicable to digital assets in the third category (or a sub-category of digital assets), it would be necessary to define a third category of personal property that is clearly and with legal certainty distinguishable from shares, other securities, claims (including debts and credit balances in an account) and other choses in action. For example, if different proprietary rules (inlcuding as to priority, perfection, financial collateral or title) were to be developed for digital assets in the third category (or a sub-category of digital assets), that are distinct from and inconsistent with those applicable to relevant classes of choses in action, we would need a transparent and practically applicable set of criteria to determine a bright dividing line between an asset that falls within the new third category (subject to its specific proprietary rules) and an asset that is properly characterisable as a chose in action (subject to the proprietary rules applicable to choses in action or the relevant sub-category of choses in action). If this clarity were not provided in these circumstances, parties dealing with a digital asset constituted or otherwise governed by English law would not have the requisite degree of legal certainty that they are following the correct proprietary rules when taking collateral or otherwise acquiring a proprietary interest in or in relation to the specific digital asset. This would undermine domestic and international market confidence in the use of English law to constitute or otherwise in relation to digital assets in the third category (or the relevant sub-category of such assets) – and indeed, potentially, have wider adverse ramifications for traditional markets in shares, securities or other choses in action due to the potential contagion effect of any resulting legal uncertainty.

Consultation Question 2.
20.2 We provisionally propose that, to fall within our proposed third category of personal property, the thing in question must be composed of data represented in an electronic medium, including in the form of computer code, electronic, digital or analogue signals. Do you agree?
Paragraph 5.21

We think that this potentially risks being too narrow a definition in some respects, leading to fourth and subsequent categories of personal property. For example, voluntary carbon credits in a scheme which does not have statutory backing are dealt with as personal property and are not "composed of data" in the sense that the Law Commission describes. In order to avoid an ever-growing list of personal property categories, we would favour a more general and inclusive definition building on the language of Lord Wilberforce along the following lines:

> *"English law also recognises as property assets corporeal or incorporeal which are definable, identifiable by third parties, capable in their nature of assumption by third parties and having a degree of permanence, regardless of whether the requirements for physical existence or for a chose in action are met".*

Guidance by the Law Commission to the effect they consider this to be the law could be particularly valuable (cf the Law Commission's 2019 paper on Electronic Signatures[2]).

This definition would have the advantage of covering both property types derived from statute (e.g. shares, intellectual property rights) and those derived from the behaviour of those creating a novel form of property without a statutory basis. This approach also recognises that property is very much what those who deal in it treat as property. If there

[2] Law Commission, *Electronic execution of documents* (HC 2624), Law Com. No. 386.

were a concern that this could make pure information into a form of property, this could be addressed by a form of appropriate exclusion.

We should also like to see it made abundantly clear that the concept of possession (and any related concepts derived from the law of possession e.g. as to "relative" legal title, the tort of conversion or negotiability) are limited to things which have a physical manifestation, save where expressly provided by statute (e.g. to the extent relevant, in relation to electronic trade documents under the Electronic Trade Documents Bill introduced into Parliament on 12 October 2022). Generally, incorporeal property has been dealt with over many centuries (and for sound policy reasons) on the basis that it cannot be possessed. To introduce concepts of or derived from possession (whether expressly or through the proposed application of the "control" concept as set out in the Consultation Paper) into incorporeal property is, in our view, highly undesirable. It is likely to cause confusion, unnecessary litigation and a rejection of English law as the legal basis to constitute affected digital assets in the third category (or to govern blockchain or DLT-based systems for the issue, holding and transfer of affected digital assets). This is especially the case for long-existing forms of incorporeal property, such as securities, that are dealt with in systems that have rejected concepts based on the law of possession – even where the securities held in such systems replicate securities that, when held outside of the system, take tangible form subject to the laws on possession (e.g. eligible debt securities issued, held and transferred in the CREST relevant system under the Uncertificated Securities Regulations 2001 (the "USRs") as registered securities).

In essence, the public policy considerations behind the development of the laws on possession (and related concepts, including "relative" legal title) are apposite for tangible assets, but have no rational or juridical place in application to intangible assets – including, digital assets (in the third category). The person in possession of a tangible asset is best placed to assess, manage and mitigate risks relating to its physical protection, value and insurance. As such, it is reasonable for English law, first, to impose obligations on the person in possession of a tangible object to protect the asset (e.g. through the laws on bailment); and, second, to give rights and powers to enforce or vindicate claims in relation to the tangible object (e.g. through an action in conversion).

In contrast, English and wider common law jurisdictions have always taken the policy position that the only person who should have the right to enforce or vindicate claims in relation to an intangible asset is the person with legal (ownership) title to the asset – whether as absolute owner or as (bare or other) trustee holding the legal title: see *CGU Insurance v One Tel* [2010] HCA 26 at para. [36]. The common law has never developed a form of legal title, short of ownership, as a means of giving rights or powers of enforcement or vindication in relation to an intangible asset (or any concomitant obligations to protect the asset): see Goode and McKendrick, *Commercial Law* at paras. 2.25 – 2.27 and Professor David Fox, *"Relativity of Title at Law and in Equity"* (2006) 65 CLJ 330. Further, the English law of trusts creates an "ownership-management" relationship with an intangible asset, and not a "control-management" relationship (appropriate for agency or bailment): see Underhill and Hayton, *Law of Trusts and Trustees,* at para. [1.4].

In relation to intangible assets, our common law has only ever created and allowed to subsist legal (ownership) title and equitable title (equitable title, but not legal title, being capable of relative interests). We see no reason in principle, policy or authority to change this fundamental juristic position under English law in application to digital assets (in the third category) as forms of incorporeal property. To do so (through the Consultation

Paper's proposed treatment of "control" of a digital object) will introduce proprietary rules (founded in principles under the law of possession) which will be novel and unclear in their application to digital assets (in the third category) as intangible property. Such a development, aside from creating legal uncertainty, is unnecessary as English law already has well-developed common law and equitable principles for intangible assets (e.g. to determine priority disputes) that can be readily applied to digital assets (in the third category of personal property).

Another reason for rejecting the concept of possession (or possession-like concepts through "control") for incorporeal assets of any type is that English law requires compliance in relation to physical objects capable of possession with the law of the place where the object is located (see *Blue Sky One Limited & Others v. Mahan Air & Another* [2010] EWHC 631 (Comm)).

This is a rule which is already impractical for equipment that frequently moves between different jurisdictions (e.g. planes, rolling stock, construction equipment), to the extent that it has been disapplied in relation to registrations of UK mortgages over aircraft in the international register established by the Cape Town Convention. This rule has always been recognised as impractical for traditional incorporeal assets and different methods have been adopted of identifying whether and which other system of law should be taken into account by English law (for the determination of the law to govern proprietary issues affecting the assets).

This rule is self-evidently wholly unworkable for incorporeal assets, such as crypto-tokens, held in a blockchain or DLT-based system which, by its very nature, involves parallel holdings of data in computers (or "nodes") in numerous jurisdictions participating in the system and, often, the absence of other features giving a clear answer to the question "where is the asset located".

We note that the possessory approach adopted for electronic trade documents will make their acceptability for security problematic, until it is made clear that where a corporate habitually resident in England or Wales creates a charge over an electronic trade document it is not necessary to comply with the formalities on creation of that charge under any law other than English law, regardless of any other possible deemed location of that electronic trade document. This will require to be addressed by legislation, ideally by amendment of the Electronic Trade Documents Bill already before Parliament.

Consultation Question 3.
20.3 We provisionally propose that, to fall within our proposed third category of personal property, the thing in question must exist independently of persons and independently of the legal system. Do you agree?
Paragraph 5.41

We find some difficulties with this language and we consider it is likely to create material legal uncertainty (especially in its application to digital assets held and transferred through private, permissioned blockchain or DLT-based systems).

As regards the requirement to be "independent of persons", a blockchain or DLT-based system which is permissionless and has no administrator is on one view a creature of the persons who participate, just like a club or other unincorporated organisation: it would be unfortunate to find the assets held in such systems excluded. We think the language

"*identifiable by third parties and capable of assumption by third parties*" would be more effective, as well as having sound judicial authority.

As regards the requirement to be "independent of the legal system", we note things within the proposed definition of data object (namely Bitcoin) have already been held by the English courts to be personal property (see *AA v Persons unknown, supra*). At that level, there would be a material concern that they cannot, therefore, be something that exists independently of the legal system as English law currently stands. We think the intention is to define an incorporeal asset which is not a chose in action. If the inclusive approach outlined above were adopted this would not be necessary, but if a narrower definition is used we think it would be better to specify that this category was for incorporeal assets which are not choses in action (as interpreted as limited to claims and other rights enforceable and justiciable by way of action before a court of law) and not limit it to items "comprised of data".

We also have a specific concern as to the application of the "independent of the legal system" criterion in relation to digital assets recorded in a private, permissioned blockchain or DLT-based system. Such systems will be operated, managed and administered under contractual and/or statutory rules and protocols. They will or are likely to create private law rights and obligations as between participants and the operator/administrator in relation to the maintenance of the distributed ledger/structured record and settlement processes (for the holding and transfer of title to the digital assets recorded in the systems). The existence of such private rights and obligations is likely to obfuscate the analysis as to whether the digital assets themselves (issued, held and transferred by means of such a system) can properly be considered as existing "independently of the legal system". It may, for example, be extremely difficult in practice to distinguish between the distributed ledger/structured record functions performed by the operator/administrator and/or the participants in the relevant consensus mechanism, under contract, from the registrar functions performed by a domain name registrar (which, in accordance with the analysis contained in paras. 8.13 to 8.25 of the Consultation Paper, are inconsistent with the qualification of a domain name as a "digital object").

This raises the real concern that there could be material confusion as to the proper characterisation of a digital asset recorded in a private, permissioned blockchain or DLT-based system – is it a chose in action (subject to those proprietary rules applicable to a chose in action or the relevant class of chose in action) or is it a "digital object" (subject, on the basis of the Law Commission's proposals for priority and other proprietary rules in its Consultation Paper, to different proprietary rules)? This is an issue of legal uncertainty created by the proposed "independent of the legal system" criterion.

Consultation Question 4.
20.4 We provisionally propose that, to fall within our proposed third category of personal property, the thing in question must be rivalrous. Do you agree?
Paragraph 5.73

We are not sure what this adds substantively to a definition of a category of personal property. It is possible that a requirement that the asset must be one capable of being the subject of competition will be confusing in a more specific definition and, if it is thought necessary to include this element (or something comparable) in the definition at all (which we are not convinced about), it may be better to say it is capable of being traded. This also raises for debate whether unique data objects, such as a verified electronic signature which is personal to the individual it has been linked to and not intended to be tradeable,

would fall within the class - although the verifier may charge for its creation. This would probably not be property within the general definition suggested above since it could not be assumed lawfully by a third party.

In any event, we consider that the word "rivalrous" should not be used, as it is an arcane word not in common usage. Any new definitional terms should aim to be in plain English. We recognise that the use of some arcane terms with a wealth of well-developed existing legal meaning, such as "chose in action", does seem inevitable in this area.

Consultation Question 5.
20.5 We provisionally propose that a data object, in general, must be capable of being divested on transfer. Do you agree? Please give examples, if any, of when this will not be the case.
20.6 We provisionally propose that divestibility should be regarded as an indicator, or general characteristic of data objects, rather than as a gateway criterion. Do you agree?
Paragraph 5.105

We agree with the principle, but think that divestibility would be included in the concept of "assumption by a third party" from Lord Wilberforce's definition and/or the concept of "tradability" discussed above.

Consultation Question 6.
20.7 We provisionally propose that:
(1) the law of England and Wales should explicitly recognise a distinct third category of personal property; and
(2) a thing should be recognised as falling within our proposed third category of personal property if:
(a) it is composed of data represented in an electronic medium, including in the form of computer code, electronic, digital or analogue signals;
(b) it exists independently of persons and exists independently of the legal system; and
(c) it is rivalrous.
Do you consider that the most authentic and appropriate way of implementing these proposals would be through common law development or statutory reform?
Paragraph 5.142

We think that it is unlikely that we will have a clear and authoritative statement of the law in this area in the reasonably near future - outside statutory reform. This cannot be left to the chance of a suitable case reaching the Supreme Court, so, unless there is a mechanism for a declarative opinion from that body, then legislation would be necessary. As regards to substance of what should be included in that legislation, please see our answers to Questions 1 – 5 above: in particular, our suggestion on an inclusive approach in answer to Question 2 and our comments on the content of a more specific definition in our responses to Questions 2 - 5. We would see that as confirmation of personal property as comprising any definable incorporeal asset (whether or not comprised of data) which is recognised as property by third parties and tradable. We also think that it needs to be made abundantly clear that possessory attributes (and related English laws, principles and rules) only apply to physical/tangible objects, and not to intangible assets such as digital assets (in the third category).

It is also essential in our view to be clear whether and in what circumstances English law will have regard to other systems of law in relation to incorporeal assets, for which there are currently no specific conflict of laws rules. For example, in relation to registrable securities, English law will look to the location of the register (e.g. for a foreign company quoted and traded on the London Stock Exchange) and the law under which the security is constituted; for uncertificated units of a security, it will look to the location of the records of the authorised record-holder for such units (e.g. the Operator registers maintained by Euroclear UK & International Limited as operator of the CREST relevant system) and the law under which the units are constituted; and, in the case of intermediated securities (equitable interests in or in relation to securities), to the place which is the habitual residence of the immediate intermediary holding the relevant record of the interests (and any other elements relevant to the application of the "PRIMA" test for the place where the relevant account is considered located or maintained).

Given the international nature of blockchain or DLT-based systems, it is necessary as a matter of some urgency to either determine that there is no need to look to any other legal system than English law for an issue before an English court relating to digital assets (in the third category) held in the system - unless a different law is specifically chosen by the participants of the system to govern the relevant issue - or tackle the difficult questions of trying to define what system of law should be applied by an English court to determine proprietary or other issues affecting the relevant assets held in the system. In this latter case, the law should specifically provide for parties to be able to exclude (by contract or otherwise) any rule of English private international law which would otherwise require regard to be had to another legal system in deciding the validity or effectiveness of any action relevant to the system. This seems essential given the uncertainty whether such a rule would apply (it clearly would if concepts of possession are used) and the difficulties that the architecture of blockchain and DLT-based systems raise in determining what other system of law might then be applicable.

Consultation Question 7.
20.8 We provisionally conclude that media files do not satisfy our proposed criteria of data objects, and therefore that they fall outside of our proposed third category of personal property. Do you agree?
20.9 Regardless of your answer to the above question, do you think that media files should be capable of attracting personal property rights?
Paragraph 6.52

We consider media files and computer code etc. should probably only be capable of being treated as personal property to the extent that intellectual property rights attach to them, but as practice evolves and the holding of files becomes separate from the ownership of those intellectual property rights, this may require revisiting. We believe that the law in this area would not recognise pure information as property, but may recognise a representation or encoding of information as giving the creator of that representation or encodement copyright, design right or similar rights in respect of that particular manifestation of the information. We note that the relevant code may be stored both linked to a physical object (e.g. a hard disk) or in dematerialised form (e.g. in the Cloud) and that this may lead to recognition of separate ownership of code and intellectual property rights in it.

There may also be confidential know-how which the holder is entitled to maintain confidence in and which can be traded – e.g. under a licence/information sharing agreement in which the right to use the confidential information imparted is granted.

Consultation Question 8.
20.10 We provisionally conclude that program files do not satisfy our proposed criteria of data objects, and therefore that they fall outside of our proposed third category of personal property. Do you agree?
20.11 Regardless of your answer to the above question, do you think that program files should be capable of attracting personal property rights?
Paragraph 6.62

Please see our answer to Question 7.

Consultation Question 9.
20.12 We provisionally conclude that digital records do not satisfy our proposed criteria of data objects, and therefore that they fall outside of our proposed third category of personal property. Do you agree?
20.13 Regardless of your answer to the above question, do you think that digital records should be capable of attracting personal property rights?
Paragraph 6.68

Please see our answer to Question 7.

Consultation Question 10.
20.14 We provisionally conclude that email accounts do not satisfy our proposed criteria of data objects and therefore that they fall outside of our proposed third category of personal property. Do you agree?
20.15 Regardless of your answer to the above question, do you think that email accounts should be capable of attracting personal property rights?
Paragraph 7.31

Please see our answer to Question 7. Emails are treated in law as forms of written communication and there is plenty of legal precedent on relevant copyright issues. We note that letters, emails etc. and related copyright are tradeable, so we would expect the case for data comprising emails to have the character of incorporeal property separate from copyright to be worthy of consideration, just as a physical letter would have the character of physical property separate from copyright. What appears different is that a digital copy cannot really be traded separately from the copyright: it can, however, be stored digitally, e.g. in the Cloud, so that the data is held by a person who is not the copyright holder. This requires very careful consideration, but this is perhaps the sort of issue that could be left to judicial development.

Consultation Question 11.
20.16 We provisionally conclude that in-game digital assets do not satisfy our proposed criteria of data objects and therefore that they fall outside of our proposed third category of personal property. Do you agree?
20.17 Regardless of your answer to the above question, do you think that in-game digital assets should be capable of attracting personal property rights?
Paragraph 7.59

Please see our answer to Question 7. This subject-matter is not within our expertise, but we do note that in-game digital assets appear to be tradeable in some cases.

Consultation Question 12.
20.18 We provisionally conclude that (DNS) domain names do not satisfy our proposed criteria of data objects and therefore that they fall outside of our proposed third category of personal property. Do you agree?
20.19 Regardless of your answer to the above question, do you think that (DNS) domain names should be capable of attracting personal property rights?
Paragraph 8.26

Please see our answer to Question 7. Domain names are traded and can be transferred: this may occur independently of trading in the trademark or copyright in the name used. Again we would be inclined to think further careful consideration should be given as to whether this is a form of personal property.

Further, as we have noted in our response to Question 3, the Law Commission's analysis with respect to domain names does raise issues for the holding and transfer of digital assets in private, permissioned blockchain or DLT-based systems. The contractual framework that is likely to be put in place to govern the operation of the distributed ledger/structured record for relevant native or endogenous digital assets, and entries made to the ledger/record, in such a system has clear parallels with the registrar functions performed in relation to domain names. This raises a material issue as to whether what is essentially the same type of native digital asset would be treated as a "data object" (when held and transferred in a public, permissionless system), but as failing to be "independent from the legal system" (and, therefore, not a "data object") when held and transferred through a private, permissioned blockchain or DLT-based system. This is likely to be a counter-intuitive and confusing result for market participants (and the courts) where the economic value and design features of the relevant digital asset itself are viewed as being the same (e.g. they are not constituted as a claim on an issuer) – irrespective of the type of blockchain or DLT-based system in which they are held (which might be fairly viewed as no more than a mere mechanism for the issue, holding and transfer of the type of digital asset concerned). This is an issue created by the uncertain scope and content of the "independent from the legal system" criterion in the definition of "data object".

Consultation Question 13.
20.20 We provisionally conclude that Carbon Emissions Allowances do not satisfy our proposed criteria of data objects and therefore that they fall outside of our proposed third category of personal property. Do you agree?
Paragraph 9.22

While these assets fall outside the Law Commission's definition of "data object", we consider that it would be highly desirable, if any doubt about whether these and similar tradeable assets constitute personal property, that any such doubt should be resolved in favour of treating them as such form of property. Of course, any statutory scheme may give CEAs the character of property. Both our inclusive definition and the more specific definition we propose would, we think, include them.

Consultation Question 14.
20.21 We provisionally conclude that most VCCs do not satisfy our proposed criteria of data objects and therefore that they fall outside of our proposed third category of personal property. Do you agree?
20.22 Regardless of your answer to the above question, do you think that VCCs should be capable of attracting personal property rights?
Paragraph 9.45

Please see our answer to Question 13.

Consultation Question 15.
20.23 We provisionally conclude that crypto-tokens satisfy our proposed criteria of data objects and therefore that they fall within our proposed third category of personal property. Do you agree?
Paragraph 10.139

We agree with the Law Commission's conclusion on this point, at least where the crypto-token is independent of other (exogenous) property forms and is not "constitutively" linked to that other asset (i.e. the crypto-token is endogenous and its holding does not constitute or evidence legal or equitable (proprietary), or possessory, title to the linked asset). Such endogenous crypto-tokens would also fall within the alternative definitions we propose for the third category of personal property.

However, we think the key question in relation to crypto-tokens arises where they represent or appear to represent title to other forms of incorporeal property. For example, in the event that a blockchain or DLT-based system were being used as a share or other securities register, any token would not be (and should not be treated as being) independent of the security to which it relates. It would be merely some form of evidence of ownership of a number of a finite quantity of shares, stock or bonds in issue. The same would apply where such a system holds interests in intermediated securities, where any token would evidence the nature and quantum of the interest in or in relation to the underlying asset.

In any such case, we see no reason (and potential legal uncertainty and inefficiencies) in viewing the crypto-token itself as subsisting as a separate item of personal property – there is only one asset, the linked exogenous asset, in or in relation to which the holding and transfer of the crypto-token is the agreed means to hold and transfer relevant title. The advantages of this "single asset" analysis, as opposed to the "two asset" analysis suggested by the Law Commission (see e.g. paras. 5.42 – 5.47 of the Consultation Paper) are:

1. we think it more accurately reflects the true nature of the asset that the relevant investor/participant believes it is holding, can transfer and in which the economic value is stored (i.e. the financial instrument, cash or credit claim title to which is constituted or evidenced by the holding of the crypto-token);

2. in relation to any collateral arrangement, it avoids any concern that it might be necessary to create, perfect and potentially enforce two separate security interests – one over the crypto-token itself and one over the linked asset;

3. as any question relating to title to the linked asset should be governed exclusively by the terms of issue of the linked asset, and the law under which the linked asset is constituted, it explains why the relevant proprietary rules to be applied (e.g. as to priority or perfection of an interest in or in relation to such a linked asset) should be exclusively those applicable to the type of linked asset concerned (and not those applicable to the crypto-token were it otherwise constituted as a native, endogenous data object – which proprietary rules could, conceivably, conflict with those applicable to the linked asset so as to give rise to material legal uncertainty in the event of a title dispute); and

4. it provides a coherent and rational solution as to why, in relation to a financial collateral arrangement over any such crypto-token, it is the financial collateral regime applicable to the financial instrument, cash or credit claim constituted as the linked asset (and not the separate financial collateral regime applicable to data objects) that should apply and govern the relevant financial collateral arrangement.

In contrast, where a blockchain or DLT-based system is a shadow or tracker, not backed by actual securities or interests in a security, the crypto-token would in itself be a native, endogenous tradeable asset and fall within the definition. It would, however, never be capable of giving any rights outside the system: e.g. as against the issuer of the shares shadowed. We believe that the increased application of regulation and attention to legal terms will tend to result in the rules of the system being clear as to the legal and regulatory status of any "token". However, an independent application of the definitions we have considered seems less likely to produce confusion than concentration on the data aspects as representative of an item of personal property.

Consultation Question 16.
20.24 We provisionally propose that the concept of control is more appropriate for data objects than the concept of possession. Do you agree?
Paragraph 11.111

We agree that the concept of possession is wholly unsuitable for this category of personal property. It is incorporeal property and should not be saddled with rules only appropriate for a physical object – please see on this the points we make above in our response to Question 2.

However, we remain very concerned that the Consultation Paper develops a concept of "control" that has many of the features of possession – it is a possessory wolf in control's clothing! Specifically, we have the following substantive concerns with the concept of control as set out by the Law Commission.

1. The Law Commission provisionally proposes that "control" over a digital asset (in the third category) should, in a similar way to possession, found some form of relative *legal* title to the asset (short of legal ownership). We think this is an unhelpful and retrograde step for intangible assets, such as digital assets within the third category. As we have set out in our response to Question 2, English law has never recognised such a form of lesser legal title to intangible personal property. It has reached that position for sound policy reasons based upon the fundamental distinction between the characteristics associated with tangible property in contrast to those associated with intangible property. In essence, the specific physical features and physical presence of tangible assets make it appropriate to recognise "possessory" title to found both rights and obligations in relation to the relevant asset. However, these features are not present for intangible assets and, as a result, English and other common law jurisdictions have placed the fundamental power to enforce or vindicate the rights constituted by or appurtenant to an intangible asset (and any concomitant obligations) solely in the holder of legal (*ownership*) title to the asset – whether as absolute owner or as (bare or other) trustee: see the case-law and academic authorities referred to in our response to Question 2. There is no clear policy reason to support or justify the recognition of legal title to digital assets (in the third category) other than legal

ownership – either a person is the legal owner of the asset or they have no legal title to the asset (although their title may be equitable).

2. The imposition of a form of relative legal title in a person who has control of a digital asset (in the third category), but who is not the legal owner, will in fact limit and restrict the flexibility for participants in the relevant markets for digital assets to structure their relationship with respect to the asset in the way they wish.

   For example, in relation to a cash balance, it is possible for an investor to give mandate control over a bank account held in the name of the investor to a third party (e.g. a custodian) *without creating any form of proprietary title in or in relation to the account in favour of the third party.* Under such a mandate relationship, the third party is a mere agent of the investor (as principal). The investor retains the exclusive legal relationship with the account-provider and exclusively controls the enforcement of its rights, and the account-provider's contractual or other legal obligations, with respect to the account.

   Similarly, the owner of a digital asset (in the third category) might wish to appoint a person as its agent with respect to the asset and, for that purpose, give control over the private key to the asset – but without in any way wishing to cede any proprietary or other title (so as to give proprietary or other similar rights and remedies) to the person acting as agent and who has such control. This is a far more nuanced, and flexible, solution (under which the proprietary or other relationship to be constituted or evidenced by control with respect to the relevant digital asset must be determined by reference to the objective intention of the principal), than is permitted by the blanket equation that control invariably equals some form of relative legal title – where such legal title might potentially give rise to independent and direct rights and powers, separate from and not "in right of" the principal's own legal title, contrary to the intention of the principal. We see no reason why English law should be reformed, through the development of such a concept of control for digital assets (in the third category), so as to prevent the kind of agency (mandate) arrangement that is common for other types of intangible asset. Such a development is likely to make English law unattractive to participants seeking the autonomy and range of structuring options for their digital assets, as presently available to them for cash or other intangible assets.

3. The relevant proprietary analysis as relating to control over a digital asset (in the third category) needs to be reflective of existing English law principles (to support legal certainty); and responsive to the business requirements of market participants determining the law under which to constitute such assets or the law to govern the blockchain or DLT-based system through which such assets are held and transferred. The proper proprietary analysis as to the effect of control over relevant digital assets should, in our view, be as follows.

   (a) While we agree that control of the private key for a digital asset (in the third category) is a necessary, but not sufficient, element in the asset's legal ownership, this is not by reason of any relative legal title analysis. Rather, it is an aspect of the fact that whether or not a person has legal (ownership) title to the asset must be determined by reference to the factual matrix in which the control vests and the objective intention of the parties to the arrangement as to whether such control vests so as to confer or transfer legal (ownership) title or not.

(b) Where the distributed ledger or structured record recording a digital asset is not constituted as the primary record of entitlement to the digital asset, the best evidence of legal title to the asset is determined by reference to the person who (in accordance with the rules and protocols of the blockchain or DLT-based system) can in fact exercise (as against the other participants in the system and other third parties) the incidents of ownership e.g. the power of disposal and the privileges, benefits or rewards attached to or arising from the relevant digital asset. This is the person who has factual control of the private key associated with the public address under which the relevant asset is recorded.

(c) However, the person who has such factual control may or may not have legal title to the asset. The issue must and can only be determined by an objective assessment of the circumstances in which such control has vested in that person and the objective intention of that person (and any transferor of the control to that person). Subject to such analysis in each case where control is exercised or exercisable over the asset, such control may either: (i) vest legal title in a person as absolute beneficial owner, as a trustee or as a legal mortgagee; or (ii) vest no legal title. No legal title may vest in the person with factual control in a case where the legal owner of the digital asset has transferred control to another person as agent only. In such a case, the factual exercise of control by the agent is solely in right of, for and on behalf of the principal who, as against the agent, has the *de jure* right to determine how control is to be exercised over the asset by the agent under the authority of the principal.

(d) It follows from the analysis in (a) to (c) above that, in our view, it is possible to transfer legal (ownership) title to a crypto-token to a person through a transfer of factual control of the relevant private key to that person (supported by the requisite objective intention for such a transfer of legal title) – and to do so, *even without a related status change to the ledger or structured record*. This can only occur where the controlled token remains under the public address of the person vesting control in the new legal owner. This device might be used, for example, to transfer legal title to a relevant endogenous digital asset (in the third category) to a custodian or to a legal mortgagee. Our analysis in relation to the corresponding operational procedure for an exogenous asset (that is "constitutively" linked to another asset) is set out in (g) below.

(e) A transfer of legal title can also, of course, be effected by a status change to the distributed ledger or structured record to record the relevant digital asset under the public address (and factual control) of the transferee – whether as absolute beneficial owner, (bare or other) trustee or legal mortgagee. We also consider that an equitable interest (whether by way of security or otherwise) can be created over a digital asset (in the third category) by a declaration of trust or other irrevocable appropriation of the asset by the legal owner for the benefit of the beneficiary or chargee under such terms as may be determined by the legal owner.

(f) A person may have "inchoate" control of a digital asset (in the third category), so as to vest an equitable proprietary interest (but not a legal

proprietary interest) in that person. This situation might arise in the circumstances described in para. [46] of the UKJT *Legal statement on crypto-assets and smart contracts* (November 2018). Where a transferor has broadcast a transaction to the consensus mechanism in a blockchain or DLT-based system for validation, the transferor has done everything in their power (prior to the relevant status change on the ledger or structured record) to divest themselves of the asset and (subject to validation) to give factual control to the asset under the private key of the transferee. In such a case, and on the basis of the principle in *Re Rose* [1952] Ch 499 (see the discussion on this principle in Underhill and Hayton at paras. [11.31] – [11.44]), the transferee under the relevant transaction will be vested with an *equitable* proprietary interest in the asset pending the entry of the asset under their public address in the ledger/record (after validation under the consensus mechanism). Pending such entry, the transferee's equitable title to the digital asset remains vulnerable to being defeated by a third party who (without relevant notice of the original transferee's equitable title) is able to get in the legal title to the asset (as "equity's darling") before the first transferee – e.g. where the original transferor fraudulently or negligently "double-spends" the asset before the relevant status change to the ledger/record can be effected in favour of the first transferee.

(g) We also consider that, for exogenous crypto-tokens "constitutively" linked to a share or other security, transfer of control of the token itself could be used to effect a transfer of equitable title (e.g. by way of equitable mortgage or fixed equitable charge) to the controlling party. If the relevant distributed ledger or structured record is the register of securities for the linked security (i.e. the ledger/record is constituted as the primary record of entitlement to the linked security as against the issuer of the security), then a transfer of control of the related crypto-token (without a state change to the ledger/record) will not (it cannot) effect a transfer of legal (ownership) title to the new controlling party. However, as legal title to the linked share or other security cannot be transferred by the legal holder without the consent and co-operation of the person vested with factual control of the related token, and if the arrangements between the parties evidence an intention to transfer equitable ownership to the linked asset by way of security, we consider that such an operation would be effective to create an equitable mortgage over the linked shares or other security in favour of the party who is given control over the token. An analogy might be made in such circumstances with equitable mortgages created in the certificated environment by giving possession by way of security of the share certificate (or other certificate of title) coupled with a blank proper instrument of transfer (and related security power of attorney); or the use of the "escrow" facility by way of security in relation to uncertificated units of a security in CREST.

4. We strongly oppose the extension of the tort of conversion to interference with a person's immediate right to control a digital asset (in the third category). First, we consider that such an extension is unnecessary to protect the rights of the legal owner of the relevant digital asset – who will have recourse to existing causes of action and related remedies (e.g. under a proprietary restitutionary claim at common law and/or in unjust enrichment). Second, we consider the jurisprudential justification for such an extension, namely the existence of some form of relative

legal title in the controller of the digital asset, to be highly problematic for the reasons we have outlined in 1 to 3 above. Third, we suspect that the uncertain scope of what actions might constitute actionable interference with a person's immediate right of control will give rise to legal uncertainty and, potentially, unexpected liability exposures for operators or administrators of blockchain or DLT-based systems for the issue, holding and transfer of affected digital assets – especially in the case of private, permissioned systems. This last point will be of particular concern to CSDs and other intermediaries who operate settlement and/or custody systems for shares and other securities where no risk of conversion claims arise under current English law. If such entities come to operate blockchain or DLT-based systems for digital assets (in the third category), subject to potential claims under an extended tort of conversion, their risk management processes may require them to take "defensive" actions (to minimise the risk of strict liability under a conversion action) which would reduce the efficiency and effectiveness of their systems (contrary to the wider interests of the relevant market in the digital assets concerned and its participants). This would make English law an unattractive option for the constitution of affected digital assets and/or to govern a blockchain or DLT-based system for the issue, holding and transfer of such assets.

We would also make the point that, while the concept of control is prima facie attractive, unfortunately English law precedent in the context of the Financial Collateral Arrangements (No 2) Regulations ("FCAR") 2003, has declared that the concept of control (for the purpose of perfecting a financial collateral arrangement) has the same characteristics as when the term is used in English law to distinguish a fixed charge from a floating charge. Lesser measures of factual or legal control, which are almost inevitable in the context of the practical operation of control arrangements in a blockchain or DLT-based system, would run the risk of not being recognised by the English courts as constituting sufficient control to found a legal or equitable proprietary title to a relevant digital asset (in the third category); and this area would remain unsatisfactory with regard to taking security over this category of property, as well as over other forms of financial collateral (i.e. financial instruments, cash and credit claims).

We attach a paper which the CLLS Financial Law Committee has prepared with the intention of seeking changes to the FCAR to deal with this and certain other uncertainties in the context of financial instruments and cash. The broad structural solutions proposed would work equally well in the context of other forms of incorporeal property where it is necessary to determine which parties have a right to deal with the property and in what circumstances. We believe this could be used to develop a code related to these issues for digital assets held in blockchain or DLT-based systems. This can be done independently of changes to the FCAR and we should be happy to work with the Law Commission to develop this aspect.

Consultation Question 17.

20.25 We provisionally propose that, broadly speaking, the person in control of a data object at a particular moment in time should be taken to be the person who is able sufficiently:
(1) to exclude others from the data object;
(2) to put the data object to the uses of which it is capable (including, if applicable, to effect a passing of, or transfer of, that control to another person, or a divestiture of control); and
(3) to identify themselves as the person with the abilities specified in (1) to (2)

above.
Do you agree?
Paragraph 11.112

Please see our response to Question 16.

We suspect that the range of operational arrangements, both present and in the future, in which parties will seek to acquire legal or equitable title (whether by way of security or otherwise) in or in relation to a digital asset (in the third category), and the paramount need for legal certainty as to whether any such arrangement is in any given case effective to vest such title, will require a more flexible and nuanced approach to this issue of control. This includes a well-founded and clear legal basis for the criteria to achieve effective control (which we think will include operational and policy considerations over and above those described in Question 17) and an expert assessment of whether those criteria are satisfied with respect to any individual type of operational arrangement that becomes prevalent in the market for the digital asset concerned.

In this context, it is necessary to have a more extensive regard to the sharing of actions as between relevant parties (e.g. the chargor and chargee) and we would support the development of a statutory scheme that: first, sets out the key indicators for a determination of when control effectively vests over a relevant digital asset; second, recognises the power of a suitably competent panel, body or authority to give guidance on the application of those indicators to market practices that aim to effect control for a party or parties over a digital asset (in the third category) in support of the creation of a valid and effective legal or equitable right, title or interest; and, third, requires an English court to have regard to such guidance when making any relevant determination as to whether control has effectively vested in a party or parties in any operational arrangement assessed by such guidance so as to support the grant of a legal or equitable right, title or interest in or in relation to the asset concerned. We also contemplate that any relevant competent panel, body or authority should be vested with the power to propose changes to the statutory scheme to address evolving market practices or issues that are not adequately addressed by the legislative framework underpinning the "control" concept.

Consultation Question 18.
20.26 We provisionally conclude that the concept of control as it applies to data objects should be developed through the common law, rather than being codified in statute. Do you agree?
Paragraph 11.128

We believe that an appropriate statutory scheme (designed along the lines we have outlined in our response to Question 17) is the only way to achieve legal certainty in relation to the use of the "control" concept for digital assets (in the third category) as a key element in the creation of a proprietary interest over them (whether for the purpose of taking security or otherwise) in relatively short order. As mentioned during the meeting on 11th October 2022 on aspects of the Consultation relating to collateral, the market currently uses New York law to avoid the known difficulties related to English law with respect to the concept of "control".

Consultation Question 19.
20.27 We provisionally conclude that it would be beneficial for a panel of industry, legal and technical experts to provide non-binding guidance on the complex and evolving issues relating to control and other issues involving data objects more

broadly. Do you agree?
Paragraph 11.133

Please see our preferred (but closely related) proposal in this area, as set out in our response to Question 17. We believe that such a panel would be beneficial, but it would also need to have the power to propose changes to legislation if uncertainties in this area are to be addressed in reasonably short order. It would be extremely beneficial to English law for these issues to be resolved, so as to allow the markets to operate smoothly using English law for collateral, security and other arrangements based upon the "control" concept relating to any form of incorporeal property, including those relating to data objects and other digital assets in the third category.

Consultation Question 20.
20.28 We provisionally conclude that a transfer operation that effects a state change within a crypto-token system will typically involve the replacing, modifying, destroying, cancelling, or eliminating of a pre-transfer crypto-token and the resulting and corresponding causal creation of a new, modified or causally-related crypto-token. Do you agree?
20.29 We provisionally conclude that this analysis applies in respect of UTXO based, Account based and token-standard based (both "fungible" and "non-fungible" crypto-token implementations). Do you agree?
Paragraph 12.61

Yes, we agree with both propositions set out here (but see footnote 3). We believe that technically in the blockchain and DLT-based systems we have examined the process is materially equivalent to a novation of contractual or other rights (in much the same way as shares or other securities are "transferred" across a register, or equitable entitlements in or in relation to securities are "transferred" by debit and credit book-entries to securities accounts maintained by a custodian, broker or other relevant intermediary). However, while we think that this is the correct legal analysis governing the legal mechanism by which a *state change transfer* of crypto-tokens is effected in a blockchain or DLT-based system, we do not think that in practice there is merit in overly focusing on this - rather, it should be simply recognised that the law should support the fact that functionally these transactions are regarded by participants as equivalent to (and effect) a transfer of (title to) property.[3]

This pragmatic observation is particularly pertinent where, for example, (in the circumstances we have outlined in our response to Question 15 above) legal title to a digital asset (in the third category) is transferred otherwise than by a state change to the ledger/record. A novation or equivalent legal analysis to explain how legal title is transferred in such circumstances does not adequately reflect the operational process (as the data set the subject of the change of control does not change and is not replaced, so there does not appear to be a "new" crypto-token upon transfer). However, the new controller will be able (as owner and principal, if that is consistent with the objective intention of the arrangement) to exercise the incidents of ownership over the token after such transfer of the related private key and, in our view, should be considered legal owner (in accordance with the rules and protocols of the system). This position should not affect

[3] We would note that at least one law firm represented on the FLC does not agree with the "state change" analysis under which a crypto-token is taken to be destroyed and created as a new asset under a novation or other similar process upon transfer. Their view is that this analysis could create adverse implications for the taking of security, tracing property, priority disputes and other relevant legal matters. As such, and if that is correct, there may be benefits in not accepting the "state change" as novation or similar process analysis.

the same and equal application of the rules of derivative transfer of title (including an innocent acquisition rule) to a transfer of legal title to a crypto-token by way of state change and such a transfer by way of change of control under the same public address in the blockchain or DLT-based system (please see on this our response to Question 21 below).

Consultation Question 21.
20.30 We provisionally conclude that the rules of derivative transfer of title apply to crypto-tokens, notwithstanding that a transfer of a crypto-token by a transfer operation that effects a state change involves the creation of a new, causally related thing. Do you agree?
Paragraph 13.90

Yes, we agree with the Law Commission's conclusion on this point. Just as is the case for registered shares or other securities, and for intermediated securities, we see no inconsistency as a matter of law between an application of rules for the derivative transfer of title (including an innocent acquisition rule) and a legal analysis supporting the transfer of title to a digital asset (in the third category) by way of a novation or similar legal mechanism.

However, we consider that the relevant rules should be founded not on the relative legal title approach provisionally adopted by the Law Commission in its Consultation Paper (in which control is *per se* viewed as supporting some form of legal title short of legal ownership), but upon the traditional proprietary rules (including as to priority) based on the concept of legal (ownership) title and equitable title to intangible assets. We would avoid reference for this purpose to title or priority concepts based in the law of possession of a tangible, physical object.

This means that a transferee of legal (ownership) title to a digital asset (in the third category), who acquires that title through control in the circumstances we have outlined in our response to Question 16, should acquire that title free from any defect in title of its transferor (or an equitable or other right, title, interest or other claim of a third party) only if at the relevant time the transferee did not have notice (we would favour actual notice over constructive notice) of the relevant defect in title or adverse third party claim. The "conscience" of such a transferee is, under English law, affected by the defect or adverse claim where they have relevant notice, so as to prevent their acquisition of legal title free and clear of the relevant defect or adverse third party claim – and this is true, irrespective of whether they acquire that legal title to the derivative (causally related) asset through a novation or similar legal process.

Consultation Question 22.
20.31 We provisionally propose that:
(1) A special defence of good faith purchaser for value without notice (an innocent acquisition rule) should apply to a transfer of a crypto-token by a transfer operation that effects a state change. Do you agree?
(2) An innocent acquisition rule should apply to both "fungible and "non-fungible" technical implementations of crypto-tokens. Do you agree?
(3) An innocent acquisition rule cannot and should not apply automatically to things that are linked to that crypto-token. Do you agree?
Paragraph 13.91

We agree that a special defence for a good faith purchaser for value without (actual as opposed to constructive) notice should apply upon the transfer of legal (ownership) title to the crypto-token (in the third category) to a transferee. However, we would make the following observations in relation to the proposed defence.

1. For the reasons we have set out in our response to Question 16 above, it is our view that legal (ownership) title to a crypto-token (in the third category) ***is*** capable of being vested in the person given factual control of the token without a state change being effected to the distributed ledger or structured record. This will be the case, for example, where the legal owner gives control over the crypto-token recorded under its public address in the blockchain or DLT-based system to a transferee with the intention of transferring their legal title to the transferee (e.g. as a trustee or legal mortgagee).

2. We consider that our rejection of the relative legal title approach for the proprietary rules applicable to digital assets (in the third category), which would otherwise make a person with control an "acquirer" for the purpose of the innocent acquisition rule even if that person's title falls short of legal ownership, also makes for a more coherent and well-founded basis for the rule consistent with other international initiatives in this area. The person whose "conscience" should be determinative of whether or not there is relevant notice of a defect in title or an adverse third party claim should only be the person who is otherwise to acquire legal (proprietary) title to the digital asset – and no other person. For example, if on the basis of our analysis in our response to Question 16 above, a person acquires control as a mere agent for a principal who is intended to be the legal owner, any notice of the agent of a defect in title or third party claim should not prevent the acquisition of legal title by the principal (free and clear of the transferor's defect in title or an adverse third party claim), unless the relevant circumstances of the acquisition require the notice of the agent to be imputed to the principal: see Bowstead & Reynolds *On Agency* (22nd Edition) at paras. 8-208 to 8-216. Any notice of such an agent should not automatically affect the vesting of legal title in the principal – which it would otherwise do if, in accordance with the Law Commission's preliminary proposals for some form of (lesser) legal title in a controller who is not intended to be the legal owner, the agent were considered to be a *de facto* "acquirer" of the crypto-token.

3. This is consistent with the corresponding innocent acquisition rule proposed, for example, by the UNIDROIT Working Group which makes clear that for the rule to be triggered there must be a "change of a proprietary right from one person to another person" (see Principle 8(1)(a) and the use of the term "transferee" as a component of an "innocent acquirer" under Principle 9(1)(a)). In our view, this requires a transfer of legal ownership to the acquirer, and not some form of legal title (based on mere control) short of ownership.

4. Where a crypto-token is "constitutively" linked to an exogenous asset (so that the holding of the token vests legal or equitable (proprietary), or possessory, title to the linked asset), we have outlined in our response to Question 15 (and elsewhere in this response paper) that we would prefer to view the token as a mere mechanism for the holding and transfer of title to the linked asset itself – and not as a separate and independent asset subject to its own (separate) proprietary rules. In such a case, the proprietary rules applicable to the linked asset (including any relevant innocent acquisition rule) should alone govern whether a transferee acquires title

to the linked asset (through a change of control over the linked token) free of any prior defect in title of the transferor or adverse third party claim. This would avoid any potential conflict between the scope and content of the innocent acquisition rule applicable to the token (as a separate, independent item of personal property) and the corresponding rule applicable to the linked asset – which would lead to considerable legal uncertainty in the event of a title dispute to the linked asset acquired through a change of control in the linked token.

Consultation Question 23.
20.32 We provisionally propose that an innocent acquisition rule in respect of transfers of crypto-tokens by a transfer operation that effects a state change should be implemented by way of legislation, as opposed to common law development. Do you agree?
Paragraph 13.94

We do not agree, for the reasons we set out in our response to Question 22 above, that the proposed innocent acquisition rule should only be triggered by a transfer operation that effects a state change to the distributed ledger or structured record. It should apply wherever there is a transfer of legal (proprietary) title to a crypto-token in the third category – this would occur upon such a state change, but also (where this is consistent with the objective intention of the parties to the arrangement) upon a change of control of the private key for the token under the same public address in the blockchain or DLT-based system.

However, subject to that point (and the other observations we make in our response to Question 22 above), we would support implementation of an appropriate innocent acquisition rule for crypto-tokens (in the third category) by way of legislation.

Consultation Question 24.
20.33 We provisionally conclude that the rules of derivative transfer of title apply to crypto-tokens and that it is possible to separate (superior) legal title from the recorded state of the distributed ledger or structured record and/or factual control over a crypto-token. Do you agree?
20.34 We provisionally conclude that, over time, the common law is capable of developing rules to assist with the legal analysis as to title and/or priority where disputes arise between multiple persons that have factual control of a crypto-token, and that statutory reform would not be appropriate for this purpose. We consider that those rules will need to be specific to the technical means by which such factual circumstances can arise within crypto-token systems or with respect to crypto-tokens. Do you agree?
Paragraph 13.112

As to the statement in 20.33, for the reasons we have set out in our response to Question 16 above, we would not support the development of proprietary rules (including rules of derivative transfer of title and innocent acquisition) for crypto-tokens (in the third category) on the basis of relative title concepts – and so we would not refer to "separate (superior) legal title". In our view, consistent with existing principles applicable to intangible property under English law, there should only be one type of legal title applicable to tokens – that is, legal ownership. A person may have legal ownership of a token or be vested with an equitable title, right or interest in or in relation to the token. There is no place for a second type of legal interest (short of ownership) by analogy with possessory-type concepts applicable to tangible objects. Our preferred approach for the application of the rules of

derivative transfer of title (including the innocent acquisition rule), and the relationship between factual control over and proprietary title to a crypto-token (in the third category), are set out in our responses to Questions 15 to 22 above.

As to the statement in 20.34, we have set out in our response to Questions 17 and 18, our proposed solution for the difficult issues that arise out of the practical application of the concept of "control" to operational arrangements (present and in the future) underpinning the holding and transfer of digital assets (in the third category) – whether under collateral arrangements or otherwise. This is a combined statutory and practical guidance solution (with practical guidance being formalised and prepared by a suitably competent panel, body or authority of experts to which an English court would be required to have regard in making any relevant determination).

It is clear that there may be a marked difference in market opinion between how proprietary rules for digital assets (in the third category) should be developed – for example, as we have explained above, we would not support the Law Commission's provisional relative legal title solution for relevant digital assets (derived from laws applicable to tangible, physical objects) and would prefer the application of traditional rules of common law and equity for intangible assets to such digital assets. As a result, and bearing in mind we would recommend a combined statutory/formal guidance solution to govern relevant legal issues relating to the concept of "control", we think that it will be necessary (in the interests of legal certainty under English law) either to develop a wider statutory framework for the proprietary rules (e.g. as to title, perfection, priority and financial collateral) that should apply to digital assets in the third category, or to provide authoritative guidance as to how it is contemplated English law proprietary rules will so apply. Certainly, as regards collateral, it seems to us the need for legislation on the "control" concept is urgent.

Consultation Question 25.
20.35 We provisionally conclude that it is not appropriate to treat crypto-tokens as analogous to "goods", as currently defined in the Sale of Goods Act 1979 and other related statutes, including the Supply of Goods and Services Act 1982 and the Consumer Rights Act 2015. Do you agree?
Paragraph 13.144

We agree. They are not goods, nor do they have analogous characteristics. We see them as a form of incorporeal property.

Consultation Question 26.
20.36 We provisionally propose that the law should be clarified to confirm that a transfer operation that effects a state change is a necessary (but not sufficient) condition for a legal transfer of a crypto-token. We consider that this state change condition is more appropriate than the potentially wider condition of "a change of control". Do you agree? Do you agree that such a clarification would be best achieved by common law development rather than statutory reform?
20.37 Accordingly, we provisionally conclude that allowing title to a crypto-token to transfer at the time a contract of sale is formed, but where no corresponding state change has occurred, would be inappropriate. Do you agree?
Paragraph 13.145

We have set out in our responses to Questions 15 to 22 above how we envisage title issues relating to crypto-tokens (in the third category) should be addressed. Without affecting the wider analysis set out in those responses, we believe that:

1. factual control should be a necessary element in acquiring legal ownership;

2. such control must be over the private key associated with the public address under which the token is recorded in the blockchain or DLT-based system;

3. English law should not be reformed so as to recognise some form of legal title short of legal ownership – a person either legally owns the token through their control of it or they have no form of legal title (although they may have an equitable interest in or in relation to the token);

4. whether or not factual control vests legal (proprietary) title to the token will need to be determined by reference to the factual matrix pertaining to the control arrangement and an analysis as to whether the objective intention of the relevant parties to the arrangement was that legal title should vest in the person given factual control;

5. legal title could (subject to these points) vest in a person with control otherwise than through a state change to the ledger/record;

6. title priority disputes in relation to crypto-tokens (in the third category) should be determined by reference to the traditional rules of common law and equity applicable to corresponding disputes affecting intangible assets (subject to the development of an appropriate innocent acquisition rule based on actual notice); and

7. while we do not think that legal title to a crypto-token should be capable of being transferred otherwise than through a change of control in or through the system (subject to considerations of objective intention), it should be possible for an equitable interest in or in relation to the crypto-token to vest off-chain (including at the time of a contract of sale) if the relevant requirements in equity (e.g. as to specific performance) for the appropriation of the token to the relevant transaction are otherwise satisfied. We consider there is no reason to suppose that the law would not recognise the interests in equity of a purchaser pending completion of a transfer. What steps are involved to achieve that completion will be factually specific to the particular system under consideration and we do not think it is appropriate to legislate in an area where these circumstances are likely to change and to differ as between systems and/or the relevant factual scenarios.

Our wider views on the need for legislation and/or formal guidance on the issues of "control" and the proprietary rules applicable to crypto-tokens (in the third category) are set out in our responses to Questions 17, 18 and 24.

Consultation Question 27.

20.38 Are there any other types of link between a crypto-token and a thing external to a crypto-token system that you commonly encounter or use in practice?
20.39 We provisionally conclude that market participants should have the flexibility to develop their own legal mechanisms to establish a link between a crypto-token and something else — normally a thing external to the crypto-token system. As

such, we provisionally conclude that no law reform is necessary or desirable further to clarify or specify the method of constituting a link between a crypto-token and a linked thing or the legal effects of such a link at this time. Do you agree?
Paragraph 14.114

The main links we encounter (or conceive that we could encounter) in practice between a crypto-token and another asset are:

1. the distributed ledger or structured record for the token could, under the terms of issue for a share or other security, be constituted as the primary record of entitlement to the share or a unit of the security as against the issuer (and so the holder of the token will be vested with legal title to the share or unit);

2. the ledger or record may be a record of the token-holder's equitable entitlement in or in relation to the linked asset(s) (e.g. an omnibus account held in the name of the trustee or its nominee at the central bank or a pool of securities/securities entitlements held by or for the trustee) under the terms of a trust declared by the trustee; and

3. the ledger or record may be a record of the person(s) to whom a bailee "attorns" individual, non-fungible and specifically identified or identifiable tangible assets held by or for it so as to create a possessory title for such persons in the linked assets.

We think this is a factual, commercial matter best left to autonomous, structural choices made by participants in the markets for digital (and other) assets that use blockchain or DLT-based systems. As such, legislation is not needed and might in fact unduly constrain flexibility in our markets.

Consultation Question 28.
20.40 Do you consider that there are any specific legal issues relating to non-fungible tokens ("NFTs") that would require different treatment from other crypto-tokens under the law of England and Wales?
Paragraph 15.74

We have not identified any specific additional legal issues relating to NFTs that would require different treatment from other crypto-tokens under English law. However, much would depend on the individual circumstances governing the arrangements for a particular NFT (or the terms of its constitution) as to whether new or additional legal risk issues could arise that have not been identified in the Consultation Paper. We have suggested in our response to Question 17 that we would support the statutory recognition of a suitably competent panel, body or authority with the power to raise issues of legal uncertainty for legal reform – e.g. where they have arisen as a result of market developments (including those that might affect NFTs).

Consultation Question 29.
20.41 We provisionally conclude that it is appropriate to draw a distinction between direct custody services (that is, holding crypto-tokens on behalf of or for the account of other persons and having capacity to exercise or to coordinate or direct the exercise of factual control in terms of both its positive and negative aspects) and custodial or other technology-based services that do not involve a direct custody relationship. Do you agree?

Paragraph 16.41

We believe this is primarily an issue for regulators, who would wish to build on their regulatory work in relation to holdings of securities in e.g. intermediated settings. There are settled rules applicable e.g. in insolvency.

Consultation Question 30.

20.42 We provisionally conclude that, under the law of England and Wales, crypto-token custody arrangements could be characterised and structured as trusts, even where the underlying entitlements are (i) held on a consolidated unallocated basis for the benefit of multiple users, and (ii) potentially even commingled with unallocated entitlements held for the benefit of the custodian itself. Do you agree?

20.43 We provisionally conclude that the best way of understanding the interests of beneficiaries under such trusts are as rights of co-ownership in an equitable tenancy in common. Do you agree?

20.44 Do you consider that providers and users of crypto-token custody services would benefit from any statutory intervention or other law reform initiative clarifying the subject matter certainty requirements for creating a valid trust over commingled, unallocated holdings of crypto-tokens? If yes, please explain what clarifications you think would assist.

Paragraph 16.75

We agree that the trust analyses set out in 20.42 and 20.43 are correct. However, we would emphasise the point that we have made in our responses to Questions 2 and 16 above. A trust creates an "ownership-management" relationship for the trustee in relation to the trust asset – a mere "control-management" relationship is insufficient to found a trust (control without ownership might support an agency or bailment relationship). A custodian will only have a trust relationship in relation to the relevant digital assets, as custody asset(s), if its control vests it with (as a matter of objective intention under the custody arrangement) legal (ownership/proprietary) title in the relevant digital assets. It is possible, much in the same way as a custodian (as agent) is given "mandate" powers over a client's bank account, that the custodian's control over a relevant digital asset is conferred by the client solely under a principal-agent relationship (under which no legal or other proprietary title is intended to pass to the custodian). This is an important point because, for insolvency, regulatory or other reasons, it will be necessary to consider carefully the factual matrix relating to the custodian's control to determine the true nature of its title, as well as its substantive rights and obligations with respect to the custody asset(s).

We do not consider the proposition supported by the decision in *Armstrong v Winnington Networks Ltd.* [2013] Ch 156 that English law recognises a trust of a legal title in intangible personal property short of ownership (i.e. a relative legal title) to be correct. If the control of the custodian is not objectively intended to confer or transfer legal (ownership) title on/to the custodian in relation to relevant digital asset(s), then the custodian will not be acting as a trustee in relation to that asset. It may be acting as an agent or have some other form of mere contractual relationship with the asset.

We think the question of whether intervention is desirable for e.g. consumer protection or to protect the stability of financial markets is a matter for regulators. We do not, however, consider that there is any material substantive legal uncertainty as to whether it is possible under English law to create a valid and effective trust over commingled and unallocated

holdings of crypto-tokens (in the third category). On this basis, we agree that no statutory intervention or further law reform initiative is necessary in this area.

Consultation Question 31.
20.45 We provisionally conclude that a presumption of trust does not currently apply to crypto-token custody facilities and should not be introduced as a new interpretive principle. Do you agree?
Paragraph 16.107

We think this is a matter which will be settled on the basis of established legal principles, and this should become clear as the law develops for the reasons and in the way stated in our responses to Questions 15 to 22, 26 and 30 above. The regulatory system is also likely to develop appropriate responses to the public policy issues created by a custodian's control over its client's crypto-tokens (in the third category). We agree, therefore, that there should not be a presumption of trust as a matter of law – such a presumption may indeed, for the reason we outlined in our response to Question 30, be contrary to the commercial intentions of the parties to the custody arrangement (subject to any overriding regulatory prohibitions or restrictions that are, or might come to be put, in place to protect investors).

Consultation Question 32.
20.46 We provisionally propose that clarification of the scope and application of section 53(1)(c) LPA 1925 would be beneficial for custodians and would help facilitate the broader adoption of trust law in structuring custody facilities, in relation to crypto-tokens specifically and/or to other asset classes and holding structures, including intermediated investment securities. Do you agree?
20.47 If you think that clarification of the scope and application of section 53(1)(c) LPA 1925 would be beneficial, what do you think would be the best way of achieving this? Please indicate which (if any) of the models suggested in the consultation paper would be appropriate, or otherwise outline any further alternatives that you think would be more practically effective and/or workable.
Paragraph 17.58

We agree with the Law Commission's provisional proposal in 20.46. However, in addition to a disapplication of section 53(1)(c) LPA 1925, we also think (in a similar way to regulation 38(5) of the Uncertificated Securities Regulations 2001) that it should be clarified that section 136 LPA will not apply to a transfer of: (a) an interest in or in relation to such crypto-tokens (in the third category); (b) crypto-tokens "constitutively" linked to a share, other security or other legal or equitable chose in action; or (c) (to the extent not falling within (b)) intermediated securities. Section 136 LPA 1925 may impose formality requirements on the transfer of both legal and equitable choses in action: see Chitty *On Contracts* at para. 22-012. As such, it might have an adverse effect on, for example, the validity of a transfer through a blockchain or a DLT-based system of a crypto-token that is constituted as a (legal) claim on an issuer of a debt security or other debtor, or as an equitable entitlement (under a trust i.e. an equitable chose in action) in or in relation to a linked asset.

As far as 20.47 is concerned, our preference would on balance be for Option 2(b). This clearly and with the required high degree of legal certainty (favoured by the financial markets) removes any formality requirement under English law that might otherwise affect the validity or effectiveness of a transfer of any of the asset categories outlined in (a) to (c) above through a blockchain or DLT-based system. It would pick up the section 136 LPA

1925 issue that we have identified above (which is not addressed by Option 2(a) as set out in para. 17.55 of the Consultation Paper). It would also allow for the adoption of an internationally-recognised solution for this formality issue (i.e. with reference to the like solution adopted in the Geneva Convention on Substantive Rules for Intermediated Securities) uniformly across all affected asset classes.

We also consider that the relevant disapplication of any potential invalidating formality requirements should apply to the asset classes outlined above, *irrespective of whether they are held and transferred through a system operated or managed by a professional custodian.* First, an issuer of a debt security or other claim that is represented by the entry of a crypto-token on a distributed ledger or structured record may not use relevant systems or services operated or managed by a professional custodian. Second, relevant formality issues could affect crypto-tokens constituted as equitable entitlements in relation to a cash account (e.g. an omnibus account held at the central bank). A (bare) trustee under such a pure cash arrangement (outside of the safeguarding and administration of securities or other types of investment-like digital assets in the third category) may not readily be viewed by the market as acting as a "custodian" (even if it may be providing "professional" services as a trustee). Third, we think the failure to extend relevant protections to the relevant asset classes held and transferred by means of blockchain or DLT-based system that are not operated or managed by a professional custodian would make English law an unattractive choice of law to govern such a system (or England and Wales - an unattractive jurisdiction for the "location" or "close connection" of the system or the determination of proprietary issues affecting the holding and transfer of relevant digital assets through the system). We see no evident compelling public policy reason to make the distinction between professional custodian and non-professional custodian blockchain or DLT-based systems in the manner provisionally proposed by the Law Commission. It unduly narrows the protections proposed to be afforded to the relevant asset classes held and transferred by means of blockchain or DLT-based (crypto-token) systems.

Consultation Question 33.
20.48 We provisionally propose that legislation should provide for a general pro rata shortfall allocation rule in respect of commingled unallocated holdings of crypto-tokens or crypto-token entitlements in a custodian insolvency. Do you agree?
Paragraph 17.81

Yes, we agree. We believe that rules consistent with those for interests in or in relation to intermediated securities should be adopted (e.g. as under the IBSAR).

We would, however, make two specific observations that the Law Commission should take into account in this area.

1. If there is law reform to develop a shortfall allocation rule in relation to crypto-tokens in the event of a custodian insolvency which sits alongside (but is separate from the corresponding regime under the IBSAR), it will need to be readily and transparently determinable as to which regime is to apply to the various asset classes that may be held by the insolvent custodian – shares and other securities under the IBSAR regime, and crypto-tokens (in the third category) in the new regime. This underscores the desirability, in our view, (as outlined in our introductory remarks at the start of this response paper and in our response to Question 15) of viewing a token that is "constitutively" linked to a share or other security as being an incident only of (and so not a separate and independent asset distinct from) that share or other security – what we have described as the "one

asset" or "single asset" analysis. Where a business provides custody services in relation to shares or other securities recorded both in legacy and blockchain or DLT-based systems, this "one asset" approach would point clearly to one single shortfall allocation rule under the IBSAR (assuming the entity otherwise qualifies as an "investment bank"). This avoids any legal uncertainty as to the proper shortfall allocation rule (and under which insolvency regime) to be applied to crypto-tokens that are "constitutively" linked to shares or other securities in such a case.

2. As we have explained in our response to Question 30 above, it may not always be the case that a custodian's control over a crypto-token (or pool of crypto-tokens) constitutes the custodian as a trustee of the tokens. The relevant custody arrangement may evidence an objective intention that such control is to be exercised as an agent of, and not as a trustee for, the client. In such a case, the custodian will not have any legal title to the tokens that it holds on trust for a client or clients; and the proposed shortfall allocation rule will have no application to any tokens that are the subject of the principal-agency arrangements.

Consultation Question 34.
20.49 We provisionally conclude that extending bailment to crypto-tokens, or the creation of an analogous concept based on control, is not necessary at this time. Do you agree?
If not, please provide specific examples of market structures or platforms that would benefit from being arranged as bailments, that could not be effectively structured using the trust and/or contract frameworks currently available.
Paragraph 17.103

For the reasons we have explained in some detail in our introductory remarks to this response paper, and in our responses to Questions 2 and 16 above, we do not favour the adoption of possession (or possession-like) concepts (including through "control") to digital assets (in the third category), as forms of intangible property. We do not think bailment is generally a relevant concept for incorporeal assets, although analogous security effects are achieved through the creation of security over incorporeal assets in the form of equitable charges/mortgages and legal mortgages.

Consultation Question 35.
20.50 We provisionally conclude that crypto-tokens, as objects of personal property rights, can be the subject of title transfer collateral arrangements without the need for specific law reform to provide for this. Do you agree?
Paragraph 18.17

Yes, we agree with this proposition as a general principle. However, English law currently has some key uncertainties in this area – please see our answers to Questions 16 to 19 with regard to the concept of "control". These need to be addressed for these assets, as well as for other forms of incorporeal property. The only method which would produce improvement in a reasonable timescale would be legislation, supported by appropriate formal guidance given by a suitably competent panel, body or authority (to which an English court would be required to have regard when making a determination on any relevant issue the subject of such guidance).

Consultation Question 36.
20.51 We provisionally conclude that non-possessory securities can be satisfactorily

granted in respect of crypto-tokens without the need for law reform. Do you agree?
Paragraph 18.26

Yes, we agree with this as a general principle, but please see our answer to Question 35 above: without appropriate law reform on the concept of "control" (or "provision") as relating to financial collateral, while non-possessory security can be created, it will be limited in form and lack market responsiveness, leading to the choice of other systems of law where this is possible.

Consultation Question 37.
20.52 We provisionally conclude that it is not desirable to make provision for data objects to be the subject of possessory securities such as the pledge, or to develop analogous security arrangements based on a transfer of control. Do you agree? If not, please provide specific examples of market structures or platforms that would benefit from the availability of possessory security arrangements, that could not be effectively structured using the non-possessory security frameworks currently available.
Paragraph 18.44

Yes, we agree – please see our introductory remarks to this response paper, and our responses to Questions 2 and 16 above. A pledge in English law involves the transfer of possession to a physical thing with a known location by the pledgor to the pledgee and under English law this location has significant consequences for the validity of any security created. It is not a suitable form of security for an incorporeal asset, such as a digital asset (within the third category).

Consultation Question 38.
20.53 We provisionally conclude that the Financial Collateral Arrangements (No 2) Regulations 2003, SI 2003 No 3226 (the "FCARs") should not be extended to more formally and comprehensively encompass crypto-token collateral arrangements. Do you agree?
Paragraph 18.47

We consider this is an issue of form rather than substance. The FCARs require revision, in any event, as to the issue of "control" as indicated in our responses to Questions 16 to 19 above. The same types of clarification will be needed for financial collateral in the form of crypto-tokens. As we have indicated in our separate paper attached to this response, on a statutory and related guidance solution for the concept of "control" as relating to financial instruments and cash (see our response to Question 16), we would favour (as also proposed by the Law Commission) the development of the more flexible concept of "provision" (in the context of financial collateral) both for financial instruments and crypto-tokens (in the third category). This concept is likely to be more responsive to financial market demands for efficient, effective and practical means to take security over financial instruments and relevant crypto-tokens.

For the reasons explained in our analysis relating to the "single asset" solution for crypto-tokens that are "constitutively" linked to a share, other security or cash (see our response to Question 15), we envisage that if a separate financial collateral regime is developed for crypto-tokens (in the third category) such "linked" tokens will in fact remain subject to the existing FCARs regime. Such tokens are properly to be regarded as an incident of the financial instrument or cash for which they act as a mere mechanism for holding and

transferring title. They are not a separate, independent asset to be made subject to the separate financial collateral regime.

We also anticipate that regulated blockchain or DLT-based systems connected with the financial markets will wish to be free of the registration (perfection) requirements under the Companies Act 2006 (and to have the other protections from insolvency law provided for by the FCARs in relation to assets held by or through their systems). This will require legislation analogous to the FCARs. It may be easier to make these changes within a single piece of legislation replacing the FCARs, which, as a form of retained EU law, may in any event require replacement, in the event that legislation currently before Parliament goes ahead.

We would have a concern as to the potential distortions to market activity that might result if the respective statutory financial collateral regimes for financial instruments/cash and crypto-tokens were to become materially mis-aligned. If the same material policy considerations behind the protections afforded to financial collateral arrangements over financial instruments/cash are considered (broadly) equally to apply to the grant or extension of the same or similar protections for crypto-tokens (in the third category), there would appear little reason to have any such mis-alignment. For the reasons explored in our responses to Questions 17 to 19 above, we favour responsive, practical and flexible financial collateral regimes for both financial instruments/cash and relevant tokens. This is an urgent requirement, as we consider the current position under the FCARs may already be adversely affecting the attraction of English law to govern financial collateral arrangements (whether over financial instruments/cash or relevant crypto-tokens).

Consultation Question 39.
20.54 We provisionally conclude that it would be beneficial to implement law reform to establish a legal framework that better facilitates the entering into, operation, rapid, priority enforcement and/or resolution of crypto-token collateral arrangements. Do you agree?
If so, do you have a view on whether it would be more appropriate for any such law reform to aim to create: (i) a unified, comprehensive and undifferentiated regime for financial collateral arrangements involving both traditional types of financial collateral and crypto-tokens; or (ii) a bespoke regime for financial collateral arrangements in respect of crypto-tokens?
Paragraph 18.113

Yes, we agree - please see our answer to Question 38 above.

Consultation Question 40.
20.55 We provisionally conclude that an action to enforce an obligation to "pay" nonmonetary units such as crypto-tokens would (and should) be characterised as a claim for unliquidated damages, unless and until crypto-tokens are generally considered to be money (or analogous thereto). Do you agree?
Paragraph 19.26

We agree. We think it doubtful that any, but a very limited category of, crypto-tokens will ever be considered to be money. Clearly non-fungible tokens are not suitable for this treatment in any event, nor would tokens representing interests in shares and other securities be suitable for this treatment as they represent interests in a finite resource. Money supply can have a different quantum at different levels in the market.

Consultation Question 41.
20.56 We provisionally conclude that tracing (rather than following) provides the correct analysis of the process that should be applied to locate and identify the claimant's property after transfers of crypto-tokens by a transfer operation that effects a state change, and that the existing rules on tracing (at equity and common law) can be applied to crypto-tokens. Do you agree?
20.57 Do you consider that the common law on tracing into a mixture requires further development or law reform (whether generally or specifically with respect to crypto-tokens)?
Paragraph 19.52

As to the statement in 20.56, we agree as this appears to follow from the analysis (with which we agree) that a state change to the distributed ledger or structured record creates a new, modified or causally-related crypto-token to the transferor's asset.[4]

Tracing is essentially an equitable remedy or process which we believe would be available in the context of cryptoassets, but we are uncertain as to whether there is any advantage in seeking to develop the common law outside the field of equity.

Consultation Question 42.
20.58 We provisionally conclude that the following existing legal frameworks can be applied to data objects, without the need for statutory law reform (although the common law may need to develop on an iterative basis):
(1) breach of contract;
(2) vitiating factors;
(3) following and tracing;
(4) equitable wrongs;
(5) proprietary restitutionary claims at law; and
(6) unjust enrichment.
Do you agree?
Paragraph 19.88

Yes, we agree (subject to our view on following v tracing as expressed in our response to Question 41 above).

Consultation Question 43.
20.59 We provisionally conclude that, in relation to the tort of conversion, there are arguments in favour of extending conversion (or a conversion-type cause of action grounded in control rather than possession) to data objects. Do you agree?
20.60 We provisionally conclude that the introduction of a special defence of (or analogous to) good faith purchaser for value without notice (at law) would limit the impact of the application of strict liability for conversion in the context of data objects. Do you agree?
Paragraph 19.123

[4] As we have indicated in our response to Question 20, at least one law firm represented on the FLC is not in favour of the "stage change" analysis under which a crypto-token should be taken as destroyed and a new token created upon transfer. They prefer to characterise the process as under one under which the token continues to subsist through a chain of transfers. If that view prevails, then following rather than tracing is likely to provide the correct analysis of the process that should be applied to locate and identify the claimant's property.

No, we do not agree that it would be sensible to introduce law reform to extend the tort of conversion to digital assets (in the third category) – please see our analysis on this in our introductory remarks to this response, and our answers to Questions 2 and 16 above.

In essence, we consider that such an extension is unnecessary to protect the interests of the true owner of the digital asset (i.e. the legal owner), who have adequate causes of action in restitution and unjust enrichment; it would be contrary to principle and existing legal authority; it would create legal uncertainty (because its juridical justification is a form of relative legal title equivalent to possession, and based on control, which we consider would introduce a form of legal title that is not recognised in English law for sound policy reasons); and would create unacceptable legal risk (as a strict liability tort) for operators/administrators of private, permissioned blockchain or DLT-based systems for the holding and transfer of such digital assets (who, in order to mitigate against the new risk of strict liability associated with their processing of such assets – which might constitute a type of "interference" with the immediate right of control - may take "defensive" measures that adversely affect the efficient and effective operation of their systems in support of the relevant financial market).

All of these considerations would make English law less attractive as the law under which to constitute an affected digital asset and/or the choice of English law to govern a blockchain or DLT-based system for the holding and transfer of title to such assets.

We do not consider that our concerns would be adequately addressed by the proposed "good faith purchaser" defence to the conversion tort as set out in 20.60. For example, it would provide no protection to third parties (such as operators/administrators of blockchain or DLT-based systems), that might innocently interfere with an immediate right of control, but who do not themselves acquire any title to the affected digital asset.

Consultation Question 44
20.61 We provisionally conclude that existing principles in relation to injunctive relief can apply to data objects, without the need for law reform. Do you agree?
Paragraph 19.148

Yes, we agree with the Law Commission's provisional conclusion here as to the availability of injunctive relief under existing equitable principles.

Consultation Question 45.
20.62 Are there any other causes of action or remedies you think may be highly or specifically relevant to data objects but which require law reform?
Paragraph 19.149

No.

Consultation Question 46.
20.63 We provisionally conclude that the existing methods of enforcement of judgments (and ancillary mechanisms) in the context of crypto-tokens are satisfactory. Do you agree?
Paragraph 19.158

Yes, we agree.

Consultation Question 47.

20.64 We provisionally conclude that there is an arguable case for law reform to provide courts in England and Wales with the discretion to award a remedy (where traditionally denominated in money) denominated in certain crypto-tokens in appropriate cases. Do you agree?
20.65 If so, what factors should be relevant to the exercise of this discretion?

Paragraph 19.168

We note that some such awards would be possible under the discretion to award specific performance remedies. We find it rather odd to have a specific remedy of this sort other than for crypto-tokens in any class regarded as equivalent to money, where we agree that this reform would add flexibility and potentially allow for a fairer remedy in some circumstances. As regards any crypto-token treated as equivalent to money, the provision would be in line with the right of the courts to make awards in foreign currencies.

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