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PERSPECTIVES

DIGITAL ASSETS: NOVEL DISPUTE SOLUTIONS FOR NOVEL TECHNOLOGIES

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Markets and uses for digital assets and blockchain technology continue to expand rapidly. While cryptocurrencies, distributed ledger technology and smart contracts have been around for a while, their increasing use and value is bringing them mainstream recognition. Most recently, non-fungible tokens (NFTs) – unique digital assets recorded on a blockchain to certify authenticity – have received significant attention.

Millions have been spent on NFTs, such as NBA Top Shots, Beeple’s artwork and rare CryptoPunks, and artists, musicians, sports teams, clubs and leagues around the world are exploring NFTs as a potential revenue source.

While large sums of money are already being invested in digital assets and new applications of associated technology, the law does not currently provide certainty as to their precise legal status. This article explores: (i) how the UK Jurisdiction Taskforce (UKJT) of the LawTech Delivery Panel and the UK’s Law Commission are working to ensure that digital assets receive consistent legal recognition and protection, and to make English law and jurisdiction an attractive proposition for related transactions and dispute resolution; and (ii) the types of legal disputes which may arise in connection with digital assets.

The UKJT

In 2019, the UKJT issued a consultation paper on the status of cryptoassets, distributed ledger technology and smart contracts in English private law, noting that the flexibility of England's well-developed common law system is well-placed to adapt to deal with these new technologies and their commercial applications, albeit perceived legal uncertainties might create a lack of confidence among potential investors and participants.

The consultation paper was followed by a legal statement on cryptoassets and smart contracts, which opined that: (i) the novel and distinctive features of cryptoassets, e.g., intangibility, cryptographic authentication, use of a distributed

ledger and decentralisation, do not prevent them from being classified as 'property'; (ii) cryptoassets are not prevented from being property for being pure information, or because they might not be conventionally classifiable as 'things in possession' or 'things in action'; and accordingly (iii) cryptoassets ought to be treated in principle as property – albeit whether English law would treat an asset as property would depend on the nature of the particular asset – and cryptoassets cannot be physically possessed, since they are purely virtual.

The legal statement also concluded that: (i) a smart contract is capable of satisfying the basic requirements for formation of a contract under English law; (ii) a smart contract can be identified, interpreted and enforced using well-established

legal principles, whether it is written in computer code alone, or in a traditional agreement which is then implemented by code; (iii) English law does not struggle with the concept of anonymous or pseudonymous parties contracting; and (iv) statutory requirements for agreements or signatures to be in writing can be met by computer source code and document authentication using a private key.

English court decisions

The English courts have so far been prepared to treat cryptocurrencies as property. For example, in *Vorotyntseva v Money-4 Limited* (2018), the court granted a worldwide freezing order in respect of quantities of Bitcoin and Ethereum. In *Liam David Robertson v Persons Unknown* (2019), an asset preservation order was granted over cryptocurrencies. In *AA v Persons Unknown* (2019), the court held that cryptoassets, such as bitcoins, are a form of property capable of being the subject of a proprietary injunction, and in doing so adopted the analysis of the proprietary status of cryptocurrencies in the UKJT's Legal Statement. In *Ion Science v Persons Unknown* (2020), the court granted a proprietary injunction and worldwide freezing order in respect of bitcoins following cyber fraud, together with disclosure orders against cryptocurrency exchanges which had processed relevant transactions to help trace missing assets and identify fraudsters. And very recently in *Fetch.ai Ltd and another v Persons Unknown* (2021), the court

has granted similar interim relief in connection with fraudulent trading on a cryptocurrency exchange.

Law Commission

In April of 2021, the UK's Law Commission issued a 'call for evidence' to gather information about how digital assets are being used, treated and dealt with by market participants, to build on the conclusions of the UKJT Legal Statement, and to consider whether law reform may be necessary – in particular, to bring clarity to the concept of a novel form of property which is incapable of being physically possessed.

Under English common law, whether a thing is capable of being property is important, since proprietary rights are good against the world, whereas personal rights are rights against only a person that has assumed a relevant legal duty. English law has traditionally divided property into two categories: things in possession; and things in action. A thing in possession is any object that can be physically possessed, i.e., things which are tangible, moveable and visible. A thing in action has been described as narrowly as a right which can be asserted only by taking legal action, and more broadly as a residual class of personal property, i.e., anything else which is not a thing in possession.

While the UKJT's legal statement observed that cryptoassets are purely virtual and cannot be physically possessed, it also concluded that, if a cryptoasset does not embody a legally enforceable right or obligation, it is not necessary or useful to

classify it as a thing in action either. This raises the question whether a digital asset can in fact constitute property, if it is neither a thing in possession or a thing in action.

In the case of *AA v Persons Unknown*, the court adopted the reasoning of the UKJT legal statement and acknowledged that cryptocurrencies are neither things in possession or things in action. Nevertheless, the court held that cryptocurrencies are a form of property, though it did not go so far as to identify whether a new third category of personal property exists or how that category might be defined.

The Law Commission's ongoing digital assets project intends to focus on this issue in particular, to assess whether a third category of 'virtual' property exists and whether digital assets ought to be treated as possessable under English law. The Law Commission's aim is to put forward proposals for law reform in this area in a further consultation paper on digital assets later this year.

Digital Dispute Resolution Rules

This year has also seen the publication of the UKJT's 'Digital Dispute Resolution Rules', designed to enable fast and cost-effective resolutions to commercial disputes involving novel digital assets and technologies.

The rules define 'digital assets' as including:
(i) a cryptoasset, digital token, smart contract or other digital or coded representation of an asset or

transaction; (ii) a 'digital asset system' such as the digital environment or platform in which a digital asset exists; and (iii) an 'interested party' as a party to a contract incorporating the Rules, including a person who has digitally signed the relevant asset or who claims to own or control it through possession or knowledge of a digital key. The rules can be adopted in advance of a dispute arising (e.g., in an agreement or the rules of a digital asset system) or once it has arisen.

In common with other forms of dispute resolution provision, parties can specify the following. First, whether a particular issue or type of dispute is to be resolved by expert determination or arbitration. Second, any preferences as to the number, identity or qualifications of their decision makers. Third, any preferences as to the procedure to be adopted for the resolution of the dispute. Finally, any modifications to the application or operation of the rules.

Some digital asset systems already have peer-to-peer voting or consensus dispute resolution mechanisms, whereby a person, panel of persons or artificial intelligence agent, votes on or determines a dispute which is then implemented directly within the system – for example to modify, cancel, create or transfer a digital asset. The rules refer to this as an 'automatic dispute resolution process' and confirm that parties shall treat its outcome as legally binding.

Otherwise, the rules provide that any dispute arising out of the relevant contract or digital asset

shall be submitted to an English-seated arbitration (unless expert determination has been specified).

The process is designed to be fast and flexible. For example: (i) an initial response to a notice of claim is due within three days; (ii) while parties must provide details of their identities to the tribunal, they can maintain anonymity as between themselves; (iii) the tribunal will be appointed by the Society for Computers and Law (SCL), unless otherwise agreed; (iv) the tribunal has absolute discretion on the arbitral procedure to be adopted; (v) the tribunal shall use its best endeavours to determine a dispute within 30 days of its appointment (absent any other period agreed by the parties); and (vi) the tribunal has the power to operate, modify, sign or cancel any digital asset relevant to the dispute using any digital signature, cryptographic key, password or other digital access or control mechanism available to it, or to order any interested party to do such things.

It will be interesting to see the following. First, the development of a panel of arbitrators or experts by the SCL with expertise to render and implement fast decisions. Second, the extent to which parties and digital asset systems take up the UKJT's rules. Third, the extent to which parties are prepared to make available to tribunals the requisite private cryptographic key, or similar, to be able to actually

implement decisions within the digital asset system. Fourth, whether more complex disputes are capable

“This year has seen the publication of the UKJT’s ‘Digital Dispute Resolution Rules’, designed to enable fast and cost-effective resolutions to commercial disputes involving novel digital assets and technologies.”

of being resolved in such short time frames. Finally, the extent to which parties accept or seek to challenge decisions on the basis of the more novel aspects of the rules, or otherwise.

Scope for civil disputes

While the automaticity of smart contracts, automatic dispute resolution mechanisms built into digital asset systems, and power to implement arbitral or expert decisions directly within those systems, may in certain circumstances reduce the scope for legal intervention in digital asset relationships, the novel characteristics of digital assets, the uncertainties regarding their legal status, their increasing and diverse uses, and, in some

areas, their high value, may lead to a variety of interesting legal issues and disputes.

Governing law and jurisdiction. The rules of a digital asset system may specify the law and jurisdiction governing disputes between participants, although they may not bind a third party claiming to have rights in or to a digital asset related to that system.

Absent express provisions within rules or related agreements, the novel nature of digital assets may pose questions when seeking to determine the appropriate law and jurisdiction governing a dispute, such as: (i) should the location of the asset be considered a digital file on a server in a specific location, the place of centralised control of a digital asset system, the location from which it is being controlled by a person holding a private crypto-key, or elsewhere?; (ii) is the asset on a blockchain merely recorded on a blockchain but digitally stored somewhere separate and ascertainable, and is a digital token representing a real-world asset located otherwise than where the real-world asset is to be found?; and (iii) to what extent does anonymity of ownership of digital assets present difficulties, both in practically identifying (and proving) who controls an asset and from where?

The UKJT's legal statement suggests that factors determining applicable governing law and jurisdiction might include the location of any associated off-chain asset, the place of any centralised control system for the type of asset, the

location of the person in control of the asset, and any choice of law or jurisdiction, though it recognises the conceptual difficulty in seeking to allocate a location to an asset which is specifically designed not to have one, because it is part of a decentralised system. The English courts in *Ion Science and Fetch. ai Ltd* considered they had jurisdiction – for the purposes of interim injunction applications – on the basis that the location of a cryptoasset is the place of domicile of its owner, and the relevant assets had been taken from the owners' control in England. Ultimately, the legal statement considered that such complex issues may be best resolved by legislation following international cooperation, though market participants will need to navigate such interesting questions until then.

Ownership and transfer of digital assets. Instinctively, the 'owner' of a digital asset ought to be the person with control over it by holding a private cryptographic key, and the relevant distributed ledger ought to identify who, in practical terms, has control of the asset. But the holder of the key may not be legally entitled to control the asset in whole or in part and the ledger may not be a true record of the legal ownership of the asset. For example, the private key may have been misappropriated, the asset may be held on trust for the benefit of another, or as agent for a principal, or an asset might be in shared ownership controlled by more than one private key, or it may be leased.

Participants in a digital asset system may agree that the ledger is to be treated as a true record of ownership, but that would not necessarily bind a third party (not subject to the rules of the system), and challenges may arise in any event if a participant considers the ledger is not a correct reflection of ownership.

Digital assets can certainly be transferred. It is happening all the time and, in some instances, for significant sums of money.

However, it remains uncertain precisely how the law will treat a transfer of a digital asset. Is it a transfer of an asset, or the transfer of a right in connection with an asset, or in fact the creation of a new digital asset in the hands of the transferee which extinguishes the value and utility of the digital asset held by the transferor? Further, how will the law characterise the legal relationship between a digital token and an underlying real-world asset which the token represents? Does the transfer of a digital token transfer legal title in the underlying asset, or a right to or in the underlying asset? Participants may well assume that the purchase of a token gives them legal title to the underlying asset. They have paid for it and the token is in their digital wallet, but how will it be treated by the law?

Use of digital assets. Issues and disputes may arise in connection with the misuse of digital assets. The proliferation and increasing value of NFTs presents a useful example. What is the owner of an NFT entitled to do with it? Who is the owner of the intellectual

property in the underlying content of the NFT? Is the NFT purely a collectible to be bought, kept or sold, or is the owner entitled to commercially exploit its content in any way? If so, what royalties may be due to the underlying intellectual property owner? What happens if the NFT file is lost or deleted?

Answers may be found in the rules of the system of which the NFT is a part or the agreement by which it was acquired. However, disputes may arise in connection with the ongoing rights of original creators and the buyers of NFTs, especially if, for example, an NFT originally acquired for low value, subject to no or limited express rules or terms, later becomes popular and valuable.

The Law Commission's forthcoming consultation paper may shed further light. In the meantime, the nature of digital assets gives rise to a range of potential areas for dispute for investors, participants and their representatives to navigate. 



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