DISPUTES. NO CONFLICTS.

Law Commission's Final Report on Digital Assets

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Introduction

On 28 June 2023, the Law Commission of England and Wales published its much-awaited recommendations for reform and development of the law on digital assets. The report predominately focuses on how the principles of private law, specifically personal property law, apply to such assets. The report is extensively researched, welcomed by practitioners and market participants, and ultimately determines that the common law of England and Wales, in general, is flexible and able to accommodate developments in the digital assets market. It therefore remains well placed to respond to the challenges that the development of the market for digital assets evolves.

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Below you will find a summary of the key points, including the recommendations and conclusions made by the Law Commission (the "**Commission**").

Contents

- The tripartite approach to law reform
- A "third" category of personal property
- Control
- Transfers
- Intermediate holding arrangements
- Collateral arrangements
- Causes of action and remedies
- Conclusion

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The tripartite approach to law reform

In 2019, Sir Geoffrey Vos MR said:[1]

> ***"We should try to avoid the creation of a new legal and regulatory regime that will discourage the use of new technologies rather than provide the foundation for them to flourish."***

Not only does the Commission expressly support Sir Geoffrey Vos MR's view, but the underlying message throughout the report is that the law of England and Wales is *"sufficiently resilient and flexible to recognise some digital assets as capable of being things to which personal property can relate"*. Accordingly, it will come as no surprise that the Commission has concluded that the law in this respect is *"now relatively certain and most areas of residual legal uncertainty are highly nuanced and complex"*. The complexity remains given the ever-evolving digital asset market and technology.

In order to address the issue of "*residual complexity*", the Commission has proposed a tripartite approach to law reform by:

(i) prioritising common law development;

(ii) proposing targeted statutory law reform to:

(a) confirm and support the existing common law position so common law can continue to develop; and

(b) allow for a bespoke statutory legal framework that facilitates the entering into, operation and enforcement of certain crypto-token and certain cryptoasset collateral arrangements; and

(iii) recommending that the Government creates or nominates a panel of industry specific technical experts, legal practitioners, academics, and judges to provide non-binding guidance on the factual and legal issues relating to control involving certain digital assets (discussed further below).

A "third" category of personal property

English law distinguishes between things "in possession" (e.g., a bag of gold) and things "in action" (e.g., debt, and shares in a company). There are, however, now certain things that do not fit within the traditional categories of personal property but are capable of being things to which personal property rights can relate, such as cryptocurrencies and non-fungible tokens (NFTs).

The Commission's view is that the common law has moved towards the explicit recognition of a "third" category of things to which personal rights can relate. This is supported by a persuasive, clear and well-reasoned body of case law. There are now 24 separate cases - including the recent judgment of the Court of Appeal in Tulip Trading - which have concluded that digital assets are capable of being objects to which personal property rights relate, even where the thing in question does not neatly fit within either of the traditionally recognised categories of things. To that end, the report recognises a "third" category of things to which personal rights can relate - coined in the report as the "**third category things,**" such as crypto-tokens, cryptoassets, and digital bearer securities.

The Commission notes that things in possession, things in action and third category things are ultimately different and function in different ways. For instance, the third category things rely on novel and idiosyncratic technology, such as open-source code, public, distributed ledgers and public key cryptography. Therefore, to apply analogies between digital objects and things in possession or things in action would be "*imperfect*" and a "*legally erroneous step*", respectively. In light of this, the report concludes that the law should not attempt directly to apply legal principles applicable to things in possession or things in action to third category things. Rather, it should develop legal principles specific to third category things, by:

(i) focusing on attributes and characteristics of the thing with which it is concerned in a particular case; and

(ii) developing jurisprudence around a concept of control (discussed further below).

[1] Sir Geoffrey Vos MR, "*Cryptoassets as property: how can English law boost the confidence of would-be parties to smart legal contracts?*" (2019)

In light of the above, one of the Commission's welcomed recommendations is the introduction of legislation which expressly confirms and supports the common law position that a thing will not be deprived of legal status as an object of personal property rights merely by reason of the fact that it is neither a thing in action nor a thing in possession (**Recommendation 1**, §3.76, Final Report). It is also envisaged that such statutory confirmation will:

(i) lay to rest the lingering authority of *Colonial Bank v Whinney* [1885] 30 ChD 261, which suggested that there could be no third category things;

(ii) provide greater legal certainty; and

(iii) reduce the time spent by the Courts on questions of categorisation of objects of personal rights.

Mindful, however, that a statutory definition of a third category of things to which personal property rights can relate could risk drawing parameters that are too narrow or wide, as well as risk opening up difficult definitional issues that could reduce, rather than increase, certainty in the law, the Commission has concluded it is not appropriate nor necessary for there to be a statutory definition of a digital asset. Rather, the report acknowledges that common law is the "*better vehicle*" for determining those things that properly can and should be objects of personal property rights and which fall within the third category things.

Finally, when considering whether a thing should be capable of falling within the third category things, the Commission has set out the following indicia:

1. It is composed of (but more than) data represented in an electronic medium;
2. It exists independently of people and the legal system; and
3. It is rivalrous (i.e., if the use or consumption of the thing by one person, or a specific group of persons, necessarily prejudices the use or consumption of that thing by one or more other persons).

By way of an example, the above indicia can be applied to crypto-tokens as follows:

1. The Commission describes crypto-tokens as a "*notional quantity unit manifested by the combination of active operation of software by a network of participants and network-instantiated data*". This conceptualisation has been expressed in similar terms by expert market participants and academics including the Court of Appeal earlier this year in Tulip Trading in which Birss LJ distinguished a crypto-token to a physical coin at [72]:

> ***"[t]he unusual factual feature of the present case is that literally all there is, is software. A physical coin has properties which exist outside the minds of people who use it and in that sense is tangible. Bitcoin is similar. It also has properties which exist outside the minds of individuals, but those properties only exist inside computers as a consequence of the bitcoin software. There is nothing else."***

2. Crypto-tokens are not rights in themselves and they exist independently of any rights or claims that might also exist in relation to them. They can also be used and enjoyed independently of whether any rights or claims in relation to them are enforceable by action. In comparison, debts are co-extensive with legal recognition and cannot function, be used or enjoyed without legal recognition.
3. In Tulip Trading, Birrs LJ explicitly recognised the concept of rivalry as a relevant factor in the context of bitcoin (at [24]). Ultimately, a crypto-token is considered rivalrous because (i) its core function is that it manifests the ability / power uniquely to perform an operation within the crypto-token system in respect of certain notional quantity unit; (ii) the technology ensures that a crypto-token cannot be double-spent; and (iii) "forks" in crypto-token networks ensures that whilst the individual data elements of the crypto-element can be copied, the copier does not get the same discrete instance of crypto-token, rather the data in a different system.

Control

The Commission recognises that factual control is a highly technology-specific but broad concept.

In its consultation paper of July 2022, the Commission explained that the person in factual control of a digital object is one who is able to:

(i) exclude others from the digital object;

(ii) put the digital object to the uses of which it is capable; and

(iii) identify themselves as the person with the abilities specified in (i) and (ii).

The Commission now recognises that factual control may be more complex and there may be instances (e.g., where multi-signature arrangements are used in respect of crypto-tokens and in receipt of unexpected (or unknown) crypto-token airdrops) which are not covered in the description above. The Commission concludes that the common law is best placed as the "*principle driving force*" in developing jurisprudence on factual control that can apply to third category things as opposed to a statutory definition.

Its reasoning behind it is as follows:

1. First, factual control over digital objects is complex. Given this, the Commission considers that the law will find it difficult to maintain and uniformly apply rigid definitions to different types of technology or to different digital objects. This is because of the ever-developing nature of the things that are created by software developers and the novel ways in which they have (and will) devise ways in which they can be maintained, stored and traded electronically (including in ways that are open-source and permissionless).
2. Second, rather than defining digital assets in question by reference to control, the Commission concludes it more appropriate for the common law to focus on the rivalrous nature of a thing. As such, a static definition of control is not required and instead control should be treated as "*an important constituent part of a relationship that a person can have with the thing in question.*"
3. Third, like the principles of possession that have developed under common law in response to market developments and legal challenges, it considers that the same should apply to control in respect of third category things.
4. Fourth, the Courts are likely to turn to the concept of control as a matter of default, which in turn will allow legislative reform to focus on more nuanced and market-specific areas of law, such as regulating aspects of intermediated holding arrangements (discussed further below).

To assist with the above, the Commission recommends the creation or nomination of a panel of industry-specific technical experts in the crypto-token markets (not only in traditional financial markets or intermediated securities markets), legal practitioners, academics and judges to provide non-binding guidance on issues of control involving third category things (**Recommendation 2**, §5.36, Final Report), with the view of enhancing common law jurisprudence by making it easier for the Courts to make decisions that are sensitive and responsive to specific technology.

Helpfully, the Commission also sets out eleven principal (non-hypothetical) areas which it considers could be covered by the panel, such as the factual operation of control:

(i) within different types of public, permissionless Layer 1 protocols, such as Bitcoin, Ethereum, Solana and Avalanche;

(ii) within different types of private and permissioned blockchain systems, such as Hyperledger Fabric and Corda; and

(iii) within wallet software providers such as Metamask and Argent.

As expressed in its consultation paper, the Commission:

(i) maintains that the legal consequences that flow from factual control are "*complex and varied*" as control works differently for different digital assets, because of the inherent features and functions of the technology itself and the law should recognise and accept this reality; and

(ii) highlights when considering transfers of digital objects, intention, in the context of the specific technology or application in question, is likely to remain important in determining the legal consequences of control.

As part of its consideration of the legal consequences that arise from factual control, the Commission deems that there are situations in which superior legal title (i.e., ownership) can be separated from factual control over that object. For instance, with crypto-tokens, a controller might not be the same person as recorded by the state of the crypto-token system and that control may be joint, split or encumbered in a number of different ways. In light of this, the Commission considers that factual control (plus intention) can found a legal proprietary interest in a digital object and in certain circumstances such control based

legal proprietary interest can be separated from (and be inferior to or short of) a superior legal title (**Conclusion 1**, §5.104, Final Report).

Transfers

When a cryptoasset is "transferred", the transfer operation will result in the imposition or creation of varying degrees of technical encumbrances which makes it possible for a person to have a factual relationship of control within a crypto-token. Once the transfer operation is confirmed, it will result in a change of state of the distributed ledger or structured record according to the protocol rules of the crypto-token system.

The Commission discusses three different legal issues relating to a transfer of a crypto-token.

First, the report highlights and considers two opposing views as to the legal characterisation of a transfer operation within a crypto-token.

The first is known as the "**extinction/creation analysis**" whereby a transfer extinguishes a pre-transfer object of personal property right and creates a new post transfer object. This is an intentional design choice to avoid the double-spend problem. Greater analytical focus is placed on data at the blockchain level. This was considered by Birss LJ in Tulip Trading at [72]:

> ***"Since every transaction relating to that token adds to its chain, some would say a fresh piece of property is created every time bitcoin is transferred, but there is no need to on this appeal to get into that debate"***

The second and alternative argument considered is the "**persistent thing analysis**" which recognises that a transfer involves the persistence of an object through the transfer. In other words, the system tracks and records the location of the crypto-token as they persist and flow through the system. Greater analytical focus is placed at the system level.

Notwithstanding emphasis being placed on the latter argument as being "*practically accurate*", the Commission concludes that there is "*no single correct answer*".

Second, the Commission concludes that it is possible (with the requisite intention) to effect a legal transfer of a crypto-token off-chain (i.e., transactions that are external to the distributed ledger, structured record, blockchain or crypto-token system) by a change of control or on-chain (i.e., actions or transactions where the data is recorded by the distributed ledger or blockchain) by a transfer operation that effects a state change (**Conclusion 2**, §6.47, Final Report).

Third, and in line with other international law reform initiatives such as the UNIDROIT Working Group (p.44 para 8.4), the Commission concludes a special defence of good faith purchaser for value without notice applicable to crypto-tokens (and third category things) can be recognised and developed by the Courts by analogy with the existing defences applicable to money and negotiable instruments (**Conclusion 3**, §6.124, Final Report). One of the Commission's rationales behind the conclusion appears to be that in circumstances where society attributes value to crypto-tokens and system, by preserving and prioritising the sanctity of a crypto-token transaction, it would provide a net benefit to society. Further, it is envisaged that on the basis that an off-chain transfer, through a change of control, is a wider concept than an on-chain transfer, it is recognised that the application of any common law defence of good faith purchaser for value without notice would not be limited to on-chain.

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Intermediated holding arrangements

Crypto-token market participants rely on holding and trading crypto-tokens indirectly through account intermediaries (such as exchanges) for many reasons such as:

(i) improved security over holdings;

(ii) access to specific trading markets;

(iii) lower costs;

(iv) more efficient transaction execution;

(v) revenue-generating opportunities; and

(vi) access to different token functionalities.

Whilst the Commission concludes that the law is a highly flexible tool for structuring effective crypto-token intermediated holding arrangements, it acknowledges the need for greater clarity around terminology applicable to intermediated holding arrangements. Accordingly, and mindful of the benefits in using terminology similar to that used within regulated finance services, the report has revised certain terminology as follows:

- **Custodial intermediated holding**: arrangement whereby users retain superior legal or equitable title to the crypto-tokens or entitlements held on their behalf or for their account. In the event of an insolvency, the entitlements would not form part of the holding intermediary's estate and would not be available to meet the claims of its general creditors. The Commission anticipants such arrangements to mostly be structured as trusts.
- **Non-custodial intermediate holding**: arrangement whereby the holding intermediary acquires superior legal or equitable title to the crypto-tokens or entitlement held or acquired on behalf of the account of users. In the event of an insolvency, as the users would have a personal contractual claim to the return of assets, any claims would rank as unsecured claims.
- **Non-holding services**: technology-based services relating to the safeguarding or administration of crypto-tokens or crypto-token entitlements that do not involve a service provider holding those tokens.

In addition, the Commission makes the following points about crypto-token intermediated holding arrangements.

First, it concludes that crypto-token intermediated holding arrangements can be characterised and structured as trusts (providing the three certainties are fulfilled: (a) intention; (b) objects; and (c) subject matter), including 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 holding intermediary itself.

The best way to understand the interests of the beneficiaries under such trusts are as rights of co-ownership in equitable tenancy in common (**Conclusion 4**, §7.54, Final Report).

Second, the Commission does not recommend a presumption of trust as a new interpretative principle. Rather, it concludes the continued application of general interpretative principles is sufficient. Whilst the Commission agrees that a presumption would protect user rights; and incentivise the drafting of more precise terms of use and service agreements, which in turn would increase transparency, its view is that such issues are better dealt with within a regulatory framework and not by standalone principles of private law.

Third, section 53(1)(c) of the Law of Property Act 1925 (the "**Section 53(1)(c) LPA**") requires that any transfer of or dealing in an existing equitable interest that constitutes a disposition must be made "*in writing*" and "*signed*" by (or by the agent of) the person making it. The purpose of Section 53(1)(c) LPA is to safeguard against the fraudulent assertion of beneficial entitlements. The Commission's view is that specific forms of electronic communication used in connection with intermediated and "on chain" network transfers can satisfy the requirement under Section 53(1)(c) LPA. Accordingly, it concludes that:

(i) the existing common law is sufficiently certain when considering statutory formalities on the operation of trust-based crypto-token intermediated holding arrangements; and

(ii) clarificatory statutory reform in respect of Section 53(1)(c) LPA is not necessary for now.

Fourth, in the event of insolvency proceedings of a custodian holding intermediary that holds crypto-tokens or crypto-token entitlements on trusts on a commingled unallocated basis for the benefit of multiple users, the Commission does not recommend

an express statutory rule. Whilst a *pro rata* allocation of shortfall losses might be considered practical, fair and pragmatic, its overall view is that any shortfall must be considered within wider regulatory and policy frameworks.

Fifth, the Commission has considered how the common law might develop to support novel legal frameworks for custodian intermediated holding arrangements as an alternative to trusts. The Commission concludes that recognition of control-based legal proprietary interests could provide the basis for an alternative legal structure for custodial intermediated holding arrangements in addition to trusts. This could take the form of holding intermediaries being recognised as acquiring a control-based proprietary interest in held crypto-token entitlements that is subject to a superior legal title retained by users (**Conclusion 5**, §7.115, Final Report). The Commission does not recommend any statutory reform in this context but consider that the Courts are well placed to develop the law.

The report also discusses whether intermediated holding arrangements could rely on other legal frameworks such as agency. As part of this, the Commission acknowledges that in a strict legal sense, agency is a relationship that gives rise to fiduciary duties.

In Tulip Trading, Birss LJ explained that "*[T]he classic definition of a fiduciary*" was set out by Millett LJ (as he was then) in *Bristol and West Building Society v Mothew* [1998] Ch 1 at 18A-C:

> ***"A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary."***

In *Al Nehayan v Kent* [2018] EWHC 333 (Comm) Leggatt LJ said that "*fiduciary duties typically arise when one person undertakes and is entrusted with authority to manage the property or affairs of another and to make discretionary decisions of behalf of that person*" at [157].

The Commission notes that in a non-custodial intermediated holding arrangement, an intermediary owes contractual duties in relation to services provided, however certain activities may also give rise to implied fiduciary duties, even in the absence of agency, such as:

(i) provision of services relating to investment advice;

(ii) investments management;

(iii) brokering trades on a discretionary basis; and

(iv) arranging loans of crypto-tokens with third parties.

As such, it seems that the Commission anticipates a similar approach to controlling and defining the scope of fiduciary duties in the context of non-custodial intermediated holding arrangements to that in conventional securities markets whereby it is common practice for holding intermediaries to include in their service contracts provisions designed to modify implied fiduciary duties.

“Lock and mint” facilities

“Lock and mint” describes arrangements which involve relinquishing control over one form of crypto-token (the “locked” token), and the related receipt of control of a different form of crypto-token (the “minted” token). “Lock and mint” facilities are wide-ranging, including crypto-token “bridges”, wrapping protocols and fractional ownership token issuance platforms. Interestingly, in its consultation paper, the Commission considers the role of developers of “lock and mint” facilities and conclude that such developers would only be at risk of being characterised as fiduciaries, and of owing fiduciary obligations, if they were capable of “*exercising discretionary negative and positive control of crypto-tokens in a real and immediate sense.*”

An analogy to “lock and mint” facilities is drawn to the Tulip Trading case currently before the High Court. Tulip Trading involves allegations that the developers of the Bitcoin network and certain related fork networks owe fiduciary and tortious duties to all holders of tokens instantiated by those networks. Falk J (as she was then) held that the claims had no realistic prospect of success and that the software developers of the relevant networks consisted of a “*fluctuating and unidentified body*” at [73]. The decision of the High Court has since been overturned by the Court of Appeal which concluded that it was at least realistically arguable for the developers in question to owe fiduciary duties to legal title holders of crypto-tokens (at [40], [51], [74], [86]). Notably, such an argument would characterise the developers as undertaking a role involving discretionary decision-making and the exercise of authority and control over the state of and updates to the software code on which the Bitcoin network and related specific networks operated. This is an allegation that is strongly denied by the software developer defendants to that claim.

Notably, the Commission’s view is that the status of a developer as a holding intermediary depends on whether they have the practical capacity to hold crypto-tokens. This requires an ability to exercise or to coordinate or direct the exercise of full factual control over the tokens in a real and immediate sense. Arguably, this is a more direct form of control than under consideration in Tulip Trading, in relation to which the Commission accurately regards it as “*extremely unlikely*” that members of a decentralised, unidentified and shifting community of developers without any formal organisational structure would have the active capacity to exercise, coordinate or direct control of this type.

Collateral arrangements

There are two ways in which a collateral taker (i.e., the lender) can acquire a proprietary interest in the relevant collateral assets. A collateral taker either acquires an absolute interest in those assets (“title transfer collateral arrangements”) or is granted a security interest in them (“security-based collateral arrangements”).

The Commission concludes that crypto-tokens can in principle be the subject of title transfer collateral arrangements without the need for law reform, however, most market participants will not seek to rely on such an arrangement as a preferred structuring option because such an arrangement exposes collateral providers (i.e., the borrowers) to greater exposure of unsecured surplus risk. To that end, security-based collateral arrangements are likely to be a preferred structuring option.

There are two broad categories of security-based collateral arrangements:

(i) non-possessory security arrangements (e.g., mortgages and equitable charges); or

(ii) possessory security arrangements e.g., pledges and contractual liens).

The Commission concludes that whilst non-possessory security-based arrangements can be granted in respect of crypto-tokens without the need for law reform, crypto-tokens cannot be the subject of a valid possessory security arrangement because crypto-tokens are not things in possession. The Commission also concludes that the recognition of a control-based security interest in respect of crypto-token would be a coherent development within the common law (possibly by analogy with a pledge). Whilst the Commission does not recommend any statutory reform in relation to this, it acknowledges that in certain circumstances statutory reform, by way of a bespoke statutory legal framework for crypto-token and cryptoassets, might be necessary.

In considering the applicability of the Financial Collateral Arrangements (No 2) Regulations 2003 (“**FCARs**”) to crypto-tokens, the Commission concludes that the many crypto-tokens are likely to fall outside the scope of the FCARs regime. To that end, it recommends a number of statutory amendments on the clarification and scope of the FCARs. One example includes the clarification on the extent to which and under what holding arrangements crypto-tokens, cryptoassets and/or record/register tokens meet the definition of cash pursuant to the FCARs and are they relevant to the definition of “*money in any currency*”, “*account*” and “*similar claim to the repayment of money*” (**Recommendation 3**, §8.86, Final Report). Notably, the Commission does not conclude on what the complete scope of the FCARs regime should be given that questions involve policy considerations which falls outside the scope of the Commission’s mandate.

Despite clarification of the scope of the FCARs, and although the law provides options for granting security in respect of crypto-tokens and cryptosassets, the Commission's view is that the options are not adequate. This is for two reasons. First, clarification of the scope of "financial collateral" (currently defined as meaning, "cash, financial instruments or credit claims") could result in certain crypto-token and certain cryptoassets beings excluded from the FCARs. Second, even for those crypto-tokens and cryptoassets that do fall within the scope of the FCARs regime, the applications of the FCARs' "possession or control" requirements (which requires the collateral in question to be delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf) for crypto-tokens and cryptoassets collateral is complicated and/or problematic since many collateral arrangements for crypto-tokens routinely incorporate automated technological and/or operational processes which share control between parties, or make it conditional on specific conditions.

Accordingly, the Commission recommends that, as a matter of priority, the Government sets up a multi-disciplinary project to formulate and put in place a bespoke statutory legal framework that clearly facilitates the entering into, operation and enforcement of cryptoassets and crypto-token collateral arrangements (**Recommendation 4**, §8.161, Final Report).

Causes of action and remedies

In considering some of the causes of action and associated remedies that parties might pursue in the context of third category things, the Commission does not consider there is any need for law reform. Rather, the Courts should continue to "*recognise the nuances or idiosyncrasies of third category things (including their distinct functionality and technical characteristics) and apply existing legal principles to such things as appropriate*".

Overall, whilst the Commission concludes that the English Courts are capable of providing the relevant remedial tools to help protect rights in crypto-tokens, it makes a number of observations.

First, the Commission considers that crypto-tokens denominated in their own notional unit of account are unlikely to be money in the same way as fiat currency. In light of this, an action to enforce an obligation to 'pay' non-monetary units such as crypto-tokens would, under the existing law, be characterised as a claim for unliquidated damages for failure to deliver a commodity rather than as a monetary debt. Whilst the Commission acknowledges that this might be disadvantageous to claimants in some situations, it concludes that it is an accurate reflection of the current law. If and when crypto-tokens are treated as money (or analogous thereto), there will be a legitimate basis for those crypto-tokens to be considered the subject matter of an award of an agreed sum, and therefore actionable in debt. Obviously, the problem for the law with this will be identifying when and why this threshold has been crossed.

Second, vitiating factors of mistake, misrepresentation, duress, and undue influence apply similarly to contracts involving third category things as they do to contracts involving things in possession and things in action.

Third, the appropriate evidential principle (i.e., following or tracing) to third category things may be complicated for a number of reasons. For instance:

(i) when crypto-tokens are transferred to a public address they may become "mixed" on transfer (i.e., no longer possible to separate the pre-transfer components of the product from the post-transfer mixture); and

(ii) one type of crypto-token might be exchanged for a different type of crypto-token as part of the chain transactional processes.

As a result, the Commission concludes that the applicability of following or tracing should be determined on a case-by-case basis with specific reference to the technology in question. However, they note that a large number of crypto-related frauds and scams are likely to involve the application of principles relating to both.

Fourth, the Commission considers the application of principles relating to breach of trust, equitable wrongs, and constructive trusts. It concludes that as regards breach of trust and fiduciary duty, the principles of equity are sufficiently flexible to be applied in situations involving third category things. Further, in cases of theft or fraud, where a constructive trust may arise, despite inevitable interpretative difficulties when applied to third category things, it concludes that the common law is perfectly able to "*evolve in a logical and clear way*" and therefore does not recommend law reform; however, it would be important for the facts at hand to be described "*clearly and in full.*" By way of example, in order to ascertain whether a beneficial interest under a constructive trust arises or can be extinguished by a good faith purchaser for value without notice, it would be important to distinguish whether crypto-tokens are:

(i) self-held; or

(ii) held in "self-custody"; or

(iii) held in an intermediated holding arrangement; or (iv) held in a non-holding arrangement.

Fifth, the Commission considers the concept of "burning". This involves irreversibly sending a crypto-token to a "burn address" (i.e., a public address the private key to which is unknown) and removing it from circulation and reducing the total number. The Commission's view is that none of proprietary restitution, unjust enrichment, or the tort of conversion provides redress for a claimant whose token has been burned without consent, giving rise to a potential small lacuna in the law denying a claimant an effective cause of action.

Exploring each cause of action in turn:

- **Proprietary restitution**. In *Armstrong DLW GmbH v Winnington Networks Ltd* [2012] EWHC 10 (Ch), the claimant bought various claims to recover the value of EUAs, which had been transferred from the claimant to the defendant's account by a third party. Stephen Morris KC (sitting as Deputy High Court Judge) held there to be a basis of claim known as proprietary restitution, grounded in the claimant's "subsisting legal property rights in an asset" held by the defendant. The Commission acknowledges that whilst such a claim would be helpful in the context of third category things, it is unlikely to be available in the case of unauthorised burning of tokens without further common law development. Ultimately, when a crypto-token is burned it is sent to an inaccessible address, out of the claimant's and defendant's control and removed from circulation. When a defendant sends another person's crypto-token to a burn address without consent, it will hold neither the original object of personal property rights, nor any substitute object of personal property rights, eliminating the availability of a proprietary restitution claim.
- **Unjust enrichment**. The Courts in England and Wales have already recognised the potential availability of a claim in unjust enrichment in the context of third category things, including crypto-tokens (see *Fetch.ai Ltd v Persons Unknown* [2021] EWHC 2254 (Comm)). However, the Commission's view is that in order for such a claim to be capable of providing recourse following unauthorised burning of tokens, further development of the common law is required. The issue appears to be in relation to the establishment of the "unjust factor". This concept is already accepted in some common law jurisdiction such as Singapore which recognises that if a defendant obtains control of the claimant's crypto-token at any point during the process, they are likely to be have been enriched (regardless of their subsequent use of that token). In comparison, the Commission is unclear as to whether "an unjust factor" forms part of the law of England and Wales.
- **Tort of conversion**. Conversion lies in relation to things in possession. Existing judicial authority, namely *OBG Ltd v Allan* [2007] UKHL 21, [2008] 1 AC 1 prevents intangible things in action from being the subject matter of the tort of conversion. The Commission's view is this is also likely to encompass third category things, as well as unauthorised burning of tokens. Despite many consultees being in favour of extending the tort of conversion to third category things, the Commission is alive to the fact that despite facing analogous vulnerabilities, things in possession and third category things behave differently. For instance, tangible things have physical forms that are easily perceived by human beings, whereas third category things do not. As a result, humans have a stronger intuitive idea of how tangible things behave and are more easily able to identify who is in possession of tangible things, whereas third category things are less widely and instinctively understood. Mindful that such differences could cause difficulties if conversion were to be applied wholesale to third category things, the Commission's preference and conclusion is that it would be possible for the English Courts to develop specific and discrete principles of tortious liability by analogy with, or which draw on some elements of, the tort of conversion to deal with wrongful interference with third category things such as digital objects (**Conclusion 6**, §9.83, Final Report).

Conclusion

In its report, the Commission successfully champions the flexibility of the common law of England and Wales and highlights its achievements in the digital asset markets to date. This is further illustrated by the limited number of recommendations and conclusions made by the Commission. Whilst the recommendations and conclusions are for the Government to consider, in circumstances where the Government has committed to make the UK a more attractive centre for innovative technology, it will be interesting to see whether the Government adopts the proposals. Given the pace at which technology is evolving, if the law of England and Wales is to navigate such changes, it will need to adapt quickly. As a final thought, regardless of whether the recommendations and conclusions are implemented, it is certain that the Commission's hard work will inform legal analysis of these issues in this jurisdiction and elsewhere.

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