

## KEY POINTS

- The Law Commission has published its report into Digital Assets and makes the recommendation that the law recognise superior and inferior legal titles to such assets based on control.
- The recommendations are flawed in three main ways: (i) they reinvent the wheel; (ii) they are unnecessary; and (iii) they are conceptually incoherent and set up practical difficulties for parties.
- More detail is given in a longer article 'Digital Assets, Blockchains and Relativity of Title' published in the first issue of the *Journal of Business Law* in 2024.

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# Digital Assets: why the Law Commission are wrong about control

The article discusses the recent Law Commission report on Digital Assets and argues that the proposals for relativity of title to such assets are critically flawed.

## THE LAW COMMISSION'S PROPOSALS

Digital or cryptoassets are a new class of assets which are growing in importance. Bitcoin for example provides an alternative means for parties to pay each other which does not involve the intervention of a third-party intermediary such as a bank. A bitcoin is a wholly intangible ideational entity represented by a string of data attached to a particular public address on the blockchain. When Alice, who has two bitcoin, wishes to pay Bob she generates a message to pay one bitcoin to Bob and one bitcoin to Alice. That message is cryptographically signed using her private key. The transaction is then picked up by a miner who, in order to validate it and include it in a block which is cryptographically linked to the previous block, must find a value – a nonce as it is called – such that when hashed, hashing being a cryptographic function, with the transaction data it produces a hash within a particular target range. This method of verifying transactions is called proof-of-work. It is an arduous process of trial-and-error to find a nonce although easy to verify. The miner receives a quantity of bitcoin as a reward for his effort. Prior to the transfer to Bob, Alice controls the bitcoin via her private key. She can transfer the bitcoin because she alone has the private key that renders this possible.

Cryptoassets are intangible. They are not like chairs, which are tangible, but nor are they like debts which are claim-rights against another party. The Law Commission classify cryptoassets as a third category of personal property (Law Commission *Digital Assets* (Law Comm no 412 2023) paras 3.49-3.58)

and recommend statutory reform to make it clear that such a category exists. This is a red herring and a solution in search of a problem. What matters is a close analysis of the characteristics of the asset. It is here that the Commission's analysis fails.

Legal title to tangibles is based on entitlement to possess. I own the computer on which I type this article because I have a better right to possess it than anyone else. The Commission (paras 3.26-2.27) reject possession of digital assets. This is correct. Possession serves a publicity function. In the absence of a system of title registration for chattels (which would be obviously silly) the fact of my possession is the best evidence of my ownership. Factual possession demonstrates an intention to control which is accepted by other people. Yet this is not needed with a bitcoin where the blockchain provides a record of apparent, albeit pseudonymous, title. Second, title can be acquired through adverse possession by finding a lost asset, say if a ring is found on an airport floor (*British Airways Board v Parker* [1982] QB 1004); if you do not defend or maintain your possession therefore you may lose it, but this makes no sense in the crypto-context. A bitcoin cannot be found. You cannot "squat" on my non-fungible token. The only reason you have the asset at your public address is because a technically valid transaction put it there. A claim that I own it, but you have it is a claim for reconveyance of the bitcoin. It does not defend possession in any meaningful way. Third, possession as title was meant to deter violent dispossession. But this makes no sense in the crypto-context either. I cannot be violently dispossessed of my

bitcoin. You might dispossess me of a paper wallet containing my private key in the form of a QR code, but that is because bits of paper are tangible. The explanation for my action against you owes nothing to my bitcoin.

The alternative is, according to the Law Commission, control. The person in control is the person who can (Law Comm para 5.10):

- exclude others from the object;
- put the object to the uses of which it is capable;
- identify themselves as having these abilities.

The Commission do not recommend a statutory definition of control but suggest that there are cases where the question of control is vital. The first is the case where a mistaken payor (Alice) transfers a bitcoin to Bob but believes she is transferring an ether. Legal title remains with the mistaken, fundamentally so, party, Alice. Bob is in actual control, but Alice has "superior" legal title (Law Comm para 5.76). Another example is where a crypto-exchange providing custodial services in control of the bitcoin has lesser title to the bitcoin and the client superior title. This is needed because:

"There seems little sense in a legal system which does not permit a holding intermediary who holds digital assets on behalf of a large number of users to pursue a hacker ..." (Law Comm para 5.90)

## THREE FLAWS

### Control reinvents the wheel

The Law Commission has reinvented the possessory wheel. If the Commission wish to argue that cryptoassets should be possessable,

# Spotlight

## Biog box

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they should do so, although that would be a mistake as the policy drivers requiring possession to be protected are not present.

The criteria for possession and control are defined almost identically, evident from the fact that the criteria for the possession of electronic trade documents under the Electronic Trade Documents Act 2023 also apply to crypto-currencies like bitcoin. Possession requires sufficient factual control of the asset to exclude others and make use of the asset (*The Tubantia* [1924] P 78). Control of digital assets under the Law Commission's proposals is defined similarly as the ability to exclude others and take the benefit of the asset. Possession requires intention to possess and knowledge of what is possessed (*Lockyer v Gibb* [1967] 2 QB 243). If I do not know I have something, or what it is, I cannot intend to possess it. The same is true of digital assets. If I do not know assets have been "airdropped" to my public address, I cannot intend to control them and do not have legal title (Law Comm para 5.60).

### Control is unnecessary

As we have seen the Law Commission proposes that crypto-exchanges like Coinbase have lesser title to the assets. In effect the clients, who retain superior title, "bail" the assets to the exchange. This is all unnecessary. If Coinbase were a trustee, and there is good authority that cryptoassets can be held on trust and that crypto-exchanges may be trustees for their clients (*Ruscoe v Cryptopia* [2020] NZHC 728), they would be able – and arguably obliged – to sue to recover the cryptoassets. The clients would also be protected by their equitable title in the event of Coinbase's insolvency. There seems nothing for which relative legal titles might be used that could not be accomplished as easily in equity.

### Control is unhelpful

There are two aspects to this. First, there are practical issues. Parties may trip up over unexpected liabilities. The Law Commission raise the situation where a security interest is created over a digital asset and then perfected by the lender's taking control of it.

They suggest that this should give rise to a legal interest in the asset (Law Comm para 5.84). If, however, a crypto-lender creates an equitable fixed charge over a bitcoin, and then "fixes" that charge by effectively immobilising the bitcoin in a multi-sig account, the lender would be caught out to discover that he has legal title to the bitcoin and his equitable charge is actually a common law control-based pledge, which the Commission have accepted might be developed by analogy with the possessory pledge used by pawnbrokers (Law Comm paras 8.36-8.38). The lender might find himself needing to insure the cryptoasset or being liable to the borrower if the collateral is stolen – liabilities he has as a pledgee but not as a chargee or mortgagee (*AIB Finance Ltd v Debtors* [1998] 2 All ER 928).

Second, there are conceptual issues. The Commission suggest that the crypto-exchanges could be bailees of cryptoassets lodged with them, but do not reject the trust analysis. When I deposit a bitcoin with an exchange the latter usually holds this in an omnibus account. Equity has no problem with a property right in a commingled bulk. The common law sometimes does. Attornment of fractions of an undivided physical bulk is legally impossible (M Bridge et al (eds) *Personal Property Law* (3rd edn OUP Oxford 2021) paras 16.024-16.026); the same analysis is likely true of commingled cryptoassets, rendering transfer of bitcoin between account-holders difficult if the exchange cannot attorn to a new "bailor". Imagine as well, a trustee-custodian who mixes assets held on trust with other assets bailed to him in the same omnibus account. Do some clients (the A group with superior legal title) hold on trust for other clients (the B group with equitable title)? They do not. The A group cannot gain title to the B group's assets. If the trustee-custodian has superior title to the commingled assets, however, vis-à-vis the A group assets he has both superior and lesser title. This is conceptually impossible. This is only one interest (in control); the only question is how (relatively) strong it is. The lesser title held from the A group is subsumed in the

custodian's superior title over the whole fund. Yet this defeats the object of the A group. The outcome is unavoidable. If the assets are held at the same address, they cannot be split into two.

### CONCLUSION

While the Law Commission's work is extremely valuable and thought-provoking, English courts should not pick up on this aspect of the work and introduce relativity of title to digital assets. ■

#### Further Reading:

- Transferring legal title to a digital asset (2023) 5 JIBFL 317.
- Transfers of equitable interests in the digital asset world (2022) 5 JIBFL 325.
- Lexis+® UK: Banking & Finance: Article: Financial collateral arrangements in the digital asset world.
- Digital Assets, Blockchains and Relativity of Title [2024] JBL 77.