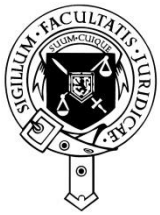

RESPONSE ON BEHALF OF THE FACULTY OF ADVOCATES

DIGITAL ASSETS IN SCOTS PRIVATE LAW CONSULTATION

1. We generally support the policy of recognising digital assets as property and improving the legal certainty surrounding them. We recognise that this consultation focusses upon a particular subset of digital assets—namely those having a rivalrous nature and an independent existence. It is clear that the main purpose is an economic one—to clarify the property status of this subset for primarily economic reasons. Our responses below are given against that background.

2. We note that the consultation does not extend to that class of digital assets which do not have the two qualities referred to above. This might tend to lead to apparently anomalous results: for example a digital image which is hashed to a blockchain would be covered whereas the same image stored in a cloud storage account would not. It also has the potential to exclude digital assets which have an apparently considerable economic value such as in-game/in-world currencies or collectibles which may be capable of being exchanged either inside or outside of their respective platforms. We see value in a wider-ranging exercise considering the status of digital assets in all of their forms, and, whilst recognising that such a review is outwith the scope of this consultation, nonetheless suggest that an understanding of the class of digital assets which is not covered assists in clarity of thought as to the nature of that which is.

3. Where we discuss digital assets in our responses below, unless the context requires otherwise, we are discussing the types of digital assets which are within the scope of this consultation.

QUESTION ONE

Is primary legislation the most effective way to resolve uncertainty about the status of digital assets in Scots private law?

If you do not agree, please explain your reasons.

4. Yes, we agree. We recognise that the volume of litigation in Scotland is such that sufficient certainty is unlikely to be achieved through case law alone. Primary legislation is more likely to achieve the desired result, and to do so sooner.

QUESTION TWO

Should any possible future primary legislation have a narrow scope of application by being limited to a statutory definition of digital assets as property, rules governing the transfer of ownership, and provisions confirming that the principles of Scots private law continue to apply to digital assets?

If you do not agree, please explain your reasons.

5. Yes, we agree, given the scope of this consultation and the stated policy aims. Other classes of digital assets would likely require to be dealt with by wider-ranging reform.

QUESTION THREE

For the purposes of Scots property law, should digital assets be classified as incorporeal moveable things?

If you do not agree, please explain your reasons.

6. It is important to remember that, when discussing digital assets (belonging to whichever of the two classes mentioned in our introduction) we are discussing things which are intangible. Since a digital asset cannot be touched, that might lead to an assumption that such an asset is necessarily incorporeal. However, the existing

classification of corporeal and incorporeal things evolved in a world in which digital currencies, non-fungible tokens and blockchain technology did not exist.

7. Confronted with this new species of thing, some have suggested that it should be regarded as a new, third, species of property. We are not persuaded that the invention of a new, hitherto unknown species of property is either necessary or proportionate. However, we do consider that it is helpful to examine more critically what are the defining features of corporeal and incorporeal property, respectively.

8. It is of the essence of corporeal property, as hitherto understood, that it has a *corpus*. That has led to the development of legal principles which peculiarly apply to objects having such a real existence. Such objects are, by their nature, rivalrous and independently existing. It is of the nature of incorporeal property that it is not an object at all but is defined exclusively in terms of legal rights—for example, a debt is an obligation owed by a debtor to a creditor with a concomitant right on the part of the creditor to demand payment. Similarly, it is clearly the case that a digital asset which is neither rivalrous nor having an independent existence, can be defined only in terms of rights, typically the rights of a licensee against a licensor. To take the example given above, a visual image stored in iCloud is defined in terms of the rights of the uploader under the licensing agreement against Apple (as well as more fundamentally by intellectual property rights in the image). For that reason, digital assets in the generality are, indeed, incorporeal.

9. However, it is the purpose of the proposed legislation to seek to make special provision for digital assets which are both rivalrous and have an independent existence. These will have different legal qualities from other digital assets. Therefore, properly analysed, to treat rivalrous, independently existing digital assets in the

manner proposed is, indeed to create two different species of digital assets namely: (1) digital assets and (2) digital assets possessing special statutory characteristics.

10. This creates anomalies, not the least of which is what to call each of these two classes of digital asset. More materially, it means having to make special rules with respect to these independently existing, rivalrous assets, which might appear to be arbitrary. A fundamental difference of approach is, we believe, called for.

11. Since we are dealing with something different from what has existed before, and to define which the law has not historically evolved an explanation or categorisation for, it must be recognised that in seeking now to define rivalrous independently existing digital assets, we must necessarily seek to proceed by way of analogy. So, one asks, what else is rivalrous, and has an independent existence? As explained above it is not incorporeal moveable property. It is, rather, corporeal moveable property, which, we propose, is what independently existing rivalrous digital assets ought statutorily to be deemed to be.

12. We recognise the view that independently existing, rivalrous digital assets should be treated as corporeal moveables may appear to be counter-intuitive as such digital assets are not obviously tangible. However, we consider the broader practical and legal character of independently existing rivalrous digital assets to be much closer in character to other corporeal moveables than to the generality of incorporeal moveables. The character of the assets ought to be the basis for classifying them. To distinguish between corporeal and incorporeal moveables based solely on the tangibility of the asset, ignoring the legal context within which the asset exists, seems to us to be too simplistic an approach.

13. We recognise that tangibility has, traditionally, been the distinguishing factor between corporeal and incorporeal property. However, one of the proposed limiting characteristics of digital assets is that they are capable of independent existence. Digital assets within the scope of this consultation are capable of independent existence. Take Bitcoin as an example. It exists in the form of the entries on the blockchain. Arguably, it has some tangibility in the form of the electro-magnetically charged particles, which (from time to time) constitute those entries in the distributed ledger. In that sense, they could be regarded as tangible. Of more materiality however is the circumstance that, if the legal system were to disappear, Bitcoin would continue to exist. Likewise NFTs have the same independent existence. The same is true for all currently recognised forms of corporeal property. Each such item of property—a chair, a table, a computer, a unit of digital currency, a non-fungible token—has a real existence outside the legal system.[1] In the context of a system of digital assets which properly track and preserve the uniqueness of assets (i.e. such as a blockchain), these types of digital assets have a 'permanence' equal to or greater than traditional corporeal property and arguably also greater than incorporeal property. In contrast, no incorporeal property can exist without the legal system to give it reality.

14. In short: corporeal property has an independent existence as an object to which rights attach, whereas incorporeal property is defined solely in terms of rights.

[1] It has been suggested that an NFT or unit of digital currency is simply a right to be hashed to the blockchain. That is incorrect: up until the point of hashing to the blockchain a person may indeed have a right to be hashed – which, clearly, as with all else defined solely in terms of rights, is truly incorporeal, but once the (say) NFT is hashed to the blockchain, the right flies off and is replaced by the independently existing object.

15. Following this train of logic, it follows that where the digital asset does not have an independent existence as an object and is defined solely in terms of rights, then it must be incorporeal property.

16. Therefore the true distinction lies not between corporeal property on the one hand and all digital assets as incorporeal property on the other, with independently existing rivalrous digital assets being incorporeal property, separated from other digital assets by reason of being incorporeal digital assets subject to a special statutory regime. The correct (and greatly more elegant) distinction lies between incorporeal digital assets and corporeal digital assets.

17. If one draws that distinction, apparent anomalies highlighted in the consultation paper disappear. The paper notes that incorporeal property is typically transferred by assignation. However, assignation is inappropriate for corporeal digital assets because they are not rights against persons. Instead, control is proposed as the hallmark of ownership, and a transfer of control is proposed as the mechanism of transfer. We comment on those matters further below. However, we note at this stage that control and a transfer of control appear to be digital equivalents to possession and the delivery of traditional corporeal moveables.

18. If digital assets are classified as corporeal moveables, it is appropriate for the law to fall back upon, by analogy, the rules of law applicable to traditional corporeal moveables. If they are classified as incorporeal moveables, it seems to us that positive rules departing from those typically applicable to incorporeal moveables would need to be adopted. That may well increase the complexity of the envisaged legislation.

19. We note that the way in which you classify these rivalrous independently existing digital assets may not make a great deal of difference to the answers to some of the questions below. It may, however, make some difference to others. As we answer the remaining questions, we will deal with both possibilities of categorising rivalrous independently existing digital assets where there is a relevant difference.

QUESTION FOUR

Should any future statutory definition of the category of digital assets considered an object of property be technologically neutral and avoid being too prescriptive?

If you do not agree, please explain your reasons.

20. Yes, we agree (irrespective of whether rivalrous independently existing digital assets are corporeal or incorporeal moveables).

21. We consider the definition ought to actively and positively define digital assets. That would lend certainty to dealings with assets falling within the scope of that definition. We note the Property (Digital Assets Etc.) Bill in the UK Parliament provides that digital assets can be things, notwithstanding the fact that those things do not fall within one of the two traditional categories of personal property in English and Welsh law. While that is arguably a more flexible approach, we do not consider it would be appropriate in Scots law, given the discussion above in relation to corporeal versus incorporeal property.

22. While we support adopting a technologically neutral definition to future-proof the legislation, we consider that the certainty of the definition should not be overly compromised to achieve this aim. The difficulty will, of course, be in drafting a definition that suitably balances those considerations. Any definition will need to carefully take into account what the defining characteristics of the relevant digital

assets—that deserve protection as a type of property—are, as opposed to digital assets protected through contractual or similar rights (see our comments below). For instance, 'skins' (character or item cosmetic decorations in games) are, in some cases, 'independently' tradeable on external marketplaces where the developer creates an API (application programming interface) to allow that to occur.[2]

QUESTION FIVE

The ERG proposed that digital assets be defined with reference to two limiting characteristics. The first characteristic would be that the digital asset is capable of independent existence. Should this be a defining criterion?

If you do not agree, please explain your reasons.

23. We agree that this is an appropriate defining criterion. It is consistent with our view that digital assets should be treated as corporeal moveables. On the other hand, it does not fit well with the proposal that they should be treated as incorporeal moveables.

24. If other forms of digital assets outwith the scope of this consultation were to be classified as incorporeal digital assets, the independent existence criterion may not apply to them.

25. Any digital asset will almost always need to be implemented on the basis of a particular platform, protocol or set of software. Consideration needs to be given also to making the definition of independent existence more precise so as to define when and where a digital asset is sufficiently independent from its underlying technical implementation or context so as to attract protection. Presumably digital assets implemented solely in respect of a particular piece of software which are not independently verifiable by reference to a separate ledger or record-keeping protocol

[2] See, for instance: https://arstechnica.com/gaming/2016/10/valve-pushes-back-against-government-threats-over-steam-skin-gambling/.

would lack such independence. However, there are bound to be more difficult 'edge cases' and some statutory guidance would assist in understanding what "independence" is intended to mean in this context.

QUESTION SIX

The second characteristic would be that the digital asset is of rivalrous nature, in that the use or consumption of the digital asset by one person will prejudice the use or consumption of that same asset by another person. Should this be a defining criterion?

If you do not agree, please explain your reasons.

26. We agree that this is an appropriate defining criterion, although for the purposes of any proposed legislation, it may require some expansion.

QUESTION SEVEN

Should any possible future primary legislation refer to the category of digital assets which are to be classed as objects of property for the purposes of Scots property law as "digital assets", without creating any other defined term to describe this category, such as "digital objects"?

If you do not agree, please explain your reasons and what defined term or terms you would consider more appropriate to use.

27. We disagree. While we recognise the term "digital asset" has achieved some amount of usage in the rest of the United Kingdom and internationally, we consider it is too broad in scope to be used as the statutorily defined term for the assets which are the subject of this consultation. As noted, we consider that digital assets may be either corporeal or incorporeal. The defined term used in the legislation envisaged by this consultation should recognise that distinction.

28. In some respects, the term that is used matters little in comparison to the definition attached to it. Where any parties wish to make use of the defined term, they are likely to do so with reference to the relevant legislation. The legislation need not reflect colloquial usage. However, a more descriptive defined term would seem appropriate

to enable the defined term to have currency outside of the legislation. "Digital object" would be an improvement over the more generic "digital asset". However, we suggest using a term that better reflects the definition, such as "corporeal digital asset" or "corporeal digital object" (with the definition of other digital assets or objects bearing the "incorporeal" modifier, instead).

29. If the classification to be adopted for all digital assets, contrary to our primary position, is that they are incorporeal moveables, the defined term ought to make a clear distinction between rivalrous, independently existing digital assets (i.e. those that will be subject to the statutory regime) and other digital assets. Defined terms such as "independently existing digital object", "definite digital asset", or similar may be appropriate.

QUESTION EIGHT

Should control over a digital asset generally be the basis for establishing ownership of that asset?

If you do not agree, please explain your reasons.

30. Scots property law draws a sharp distinction between ownership (or *dominium*) and possession. Very broadly, possession is a matter of fact, and ownership is a matter of law. Ownership of an object will necessarily imply a right to possess it (whether physical possession or civil possession), but possession does not necessarily imply ownership; the right to possess an object can arise in any number of legal arrangements (loans, leases, pledges, and so-on) which do not amount to ownership. Ownership is, following the Roman conception of property, a right fundamentally distinct from the subsidiary rights which it entails—the right to possession, the right to take profits, the right to dispose of an asset, etc. The fact that a person has possession of an object can (particularly in the case of corporeal moveables) indicate that that

person owns it, but it is not determinative of the matter. A person's attorney may be given control over digital assets, but that would not amount to a transfer of ownership. Given the general approach of this response, which is to encourage the assimilation of corporeal digital assets to the general law of property in Scotland, it follows that we do not agree with the premise behind the question.

31. Derivative acquisition of the asset should be subject to appropriate rules on the transfer of ownership and the *nemo plus iuris ad alium transferre potest quam ipse haberet* principle. Original acquisition (for example, mining digital currency) should likewise be treated in accordance with the normal rules of property law—occupation and (perhaps) specification are likely to be appropriate models for corporeal digital assets.

32. We do, however, agree that some legislative consideration of what it means to 'possess' a corporeal digital asset would be appropriate. Control of a corporeal digital asset (which would generally be evidenced by access to the private key which controls it) would naturally be the foundation for possession, although consideration would need to be given to situations in which a person might control an asset without formally 'possessing' it.

QUESTION NINE

Should the voluntary transfer of the ownership of a digital asset require the transfer of control over that asset from the current owner to another person, coupled with the current owner intending to transfer ownership to that other person?

If you do not agree, please explain your reasons.

33. Yes, we agree. Scots property law draws a distinction (common to all civilian systems) between an agreement to transfer ownership (whether as a result of sale, gift, and so forth) and the act of transfer. A mere agreement to transfer property does not, on its own, effect any change in the ownership of that property.

34. If control is (broadly speaking) the equivalent of possession, the transfer of control is the equivalent of delivery. That is consistent with treating digital assets as corporeal moveables.

35. We consider the intention to transfer ownership to be essential. This is consistent with other forms of transfer of ownership of property, both corporeal and incorporeal. An implication of this rule is that control, as evidenced by the entries on the blockchain or otherwise, would not be determinative of ownership. Although perhaps contrary to some expectations, this is consistent, as noted above, with the status afforded by possession of traditional corporeal moveables and the *vitium reale* principle. In short, a transfer of control should be a necessary, but not sufficient, condition for the transfer of ownership of corporeal digital assets.

36. We consider the transfer of control could occur in a number of ways:

    36.1. The simplest mode would be completion of a transfer on the blockchain or its equivalent in a given technology. Such a transfer of control would operate similarly to actual delivery of corporeal moveables.

    36.2. Transfer could also be completed 'off-chain' by granting access to a private key. Given that to do so would allow the transferee full control of the corporeal digital assets which correspond to that private key, we are unable to see how granting access in this way would not constitute a transfer of control. A transfer of this sort would be the equivalent of delivery *longa manu*, and is reasonably well understood. Roman texts give, as an example of this sort of delivery, the transfer of the contents of a warehouse by handing over the keys to the

warehouse (Digest 41,1,9,6; 18,1,74)—granting access to a private key which controls corporeal digital assets appears to us to be broadly equivalent.

QUESTION TEN

Should a person who acquires control of a digital asset in good faith and for onerous consideration be recognised in Scots property law as acquiring the ownership of that digital asset, even where the transferor from whom they acquired the digital asset was not the owner?

If you do not agree, please explain your reasons.

37. The *nemo plus* principle and the *vitium reale* must be the primary position, consistent with Scots property law generally. However, the question of who should be protected in a transaction—the true owner or the good faith acquirer—is a matter of policy. The policy decision may require a departure from the general legal rule.

38. Applying the *nemo plus* principle, a good faith acquirer would not become the owner of, for example, stolen digital assets. We are of the view that it would be inappropriate for digital assets to benefit from a greater degree of protection than other classes of assets to which they are analogous.

39. By way of comparison, we acknowledge that good faith acquirers of heritable property may benefit from the realignment of rights provisions in the Land Registration etc. (Scotland) Act 2012. However, those provisions must be seen in the context of the statutory compensation provisions applicable to land registration. There is no equivalent to the Keeper for digital assets.

40. However, we recognise that the policy intention behind this consultation may be served by some form of protection of good faith third-party acquirers. It may be appropriate for the applicable rules to differ depending on the fungibility of the asset.

A Non-Fungible Token may have different considerations than Bitcoin, for example. Protecting a good faith third-party acquirer would arguably be more appropriate for a fungible asset. If the policy decision is to have some form of protection for good faith acquirers, consideration would need to be given to the scope of that protection, and suitably defining the assets (if not all rivalrous, independently existing digital assets) to which it applies.

QUESTION ELEVEN

Should any possible future primary legislation make provision confirming that the principles of Scots private law continue to apply to digital assets, so far as those principles are consistent with the characteristics of those assets?

If you do not agree, please explain your reasons.

41. If the classification of corporeal and incorporeal digital assets is accepted, this would seem to follow automatically by the definition of those asset classes. It would be unnecessary to make specific provision in the legislation.

42. If all digital assets are to be classified as being incorporeal moveable assets, it leaves issues with how you regulate those assets which are non-rivalrous and non-independently existing. This provision may lead to unintended consequences in relation to assets which are not within the scope of the definition, and begs the question: are they not to be subject to the principles of Scots private law?

QUESTION TWELVE

Should any possible future primary legislation make provision to clarify that digital assets which qualify as property may be held on trust?

If you do not agree, please explain your reasons.

43. We agree with this only if there is a cogent justification for making such a provision for the sake of avoiding potential uncertainty. However, we do not consider it is

necessary, provided the digital assets are suitably defined as a form of property. If they are property, it would appear to follow, necessarily, that they may be held on trust. Making specific provision to this effect, but without specifically providing for the application of other rules of property or private law, may have unintended consequences. We also refer to our answer to Question Eleven.

QUESTION THIRTEEN

Should any possible future primary legislation contain any other substantive provisions within devolved competence which are not set out in this consultation? If so, please explain what additional provisions you consider would be needed and why they would be needed.

44. Consideration ought to be given to the interaction of rivalrous, independently existing digital assets, however they are defined, with other rules of law and legislation. For example, in relation to the Sale of Goods Act 1979, consideration should be given to ensuring that rivalrous, independently existing digital assets are compatible with its provisions, or if not, making appropriate modifications or exclusions as is appropriate.