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Unlocking Value In An Insolvent Estate: An Update On Cryptocurrencies

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We previously considered the potential implications for insolvency professionals of the rise of cryptocurrencies (available here). One of the principal issues identified was the uncertainty surrounding the legal status of cryptocurrencies; what class of asset were they and, subsequently, how would they be treated under English law? This question had been subject to little legal or regulatory comment at the time, however the UK Jurisdiction Taskforce ("**Taskforce**") has recently issued a statement that brings some welcome clarity.

To summarise the extensive "Legal Statement on cryptoassets and smart contracts" (the "**Statement**"), the findings most relevant to the scope of this blog are:

1. Cryptoassets are to be treated in principle as property;

2. Cryptoassets can be the subject of security; and

3. Cryptoassets fall within the definition of property for the purposes of section 436(1) of the Insolvency Act 1986 (the "**Act**").

What impact does this Statement have for insolvency practitioners?

The Statement helpfully references cryptoassets in the context of insolvency, noting that the definition of property at s.436(1) of the Act is wider than the typical definition of property in common law, and concluding that cryptoassets must be accepted as property for the purposes of the Act.

The Statement is not legally binding but was considered recently in *AA v Persons unknown (2019) EWHC 3556* in the context of whether Bitcoin is a form of property and could be subject to a proprietary injunction.

The decision is helpful, because it highlights how the Court might be guided by the Statement and the Taskforce's conclusions, with Judge Bryan viewing the Statement as an "accurate statement as to the position under English law" and leading him to conclude that Bitcoin are property and could be

subject to a proprietary injunction.

Insolvency Practitioners can perhaps take some assurance from this case and the Statement that in an insolvency context, cryptoassets fall within the definition of property and should be treated as such.

However, it is worth remembering that it is the private key that allows access to a cryptoasset and governs its control. The Taskforce conclude in the Statement that private keys should be treated as information. Therefore, officeholders with an un-cooperative bankrupt/director will need to make sure that any application under the Act to gain control of the private key is made under the relevant provisions of the Act.

Cryptoassets as property

The Taskforce was posed the question "*under what circumstances, if any, would cryptoassets and a private key be treated as property?*" concluding that cryptoassets are best classified as property and, accordingly, "ownership" of cryptocurrency should be treated as a proprietary right.

The Taskforce considered that cryptoassets satisfied the accepted hallmarks of "property" and that the features most characteristic of cryptoassets (intangibility, authentication through cryptography, the use of a distributed and decentralised transaction ledger and the inherent self-governance of cryptoassets' systems) do not preclude them from being "property".

It is worth noting that, although the Taskforce was not prepared to accept that cryptoassets were "information", it was determined that a "private key" (the password through which cryptoassets are accessed and "used") constitute information.

Demonstrating ownership and transferring cryptoassets – potential difficulties for office holders

The Taskforce also considered how someone might demonstrate and transfer ownership of cryptoassets concluding ownership is demonstrated through lawful knowledge and control of the "private key" to the cryptoasset, and transfers can be affected "on-chain" or "off-chain".

For an insolvency practitioner, it is helpful to understand the difference between an "on chain" and "off chain" transfer to ensure that they take control of a cryptoasset. An "off chain" transfer could result in a valuable asset being transferred to a third party without the officeholder's consent.

An "on-chain" transfer means that the cryptoasset is transferred to another user on the blockchain ledger. The data representing the "old" cryptoasset remains but can no longer be accessed through the private key because the "new" cryptoasset received by the transferee has a new set of data and a new private key.

An "off-chain" transfer describes the situation where the parties agree to transfer a cryptoasset but this is not recorded in the blockchain ledger. The transferee gains knowledge of the private key and control of the cryptoasset but because no new key is created the transferor also retains control of and the ability to transfer the cryptoasset.

This could be problematic in the context of insolvency where the office holder is obliged to take

control of the assets. For that reason, an office holder will need to take proper advice to ensure an “on-chain” transfer to prevent a bankrupt/directors retaining knowledge of the private key and therefore control of the cryptoasset. This will require the holder of the private key to co-operate and the officeholder to create a cryptowallet on behalf of the estate.

Security

If a cryptoasset is to be treated as property, it follows that a mortgage or equitable charge can be created over it. This was confirmed by the Taskforce – although security, such as pledges and liens (which can only be created over property which can be possessed) cannot be created due to the intangible nature of cryptoassets.

For an office holder, the fact that a cryptoasset may be charged will have to be factored into decisions regarding their appointment and dealings with the estate.

Conclusion

The Statement gives a clearer view about how the UK courts might determine the legal status of cryptocurrencies but it remains a developing area. Office holders should be guided by the Statement but ensure that they also keep abreast of future cases as this area of law continues to evolve.

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