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The third category conundrum: Digital assets as objects of personal property rights: the Law Commission's supplemental report and revised draft bill

05 September 2024

Key takeaways

- The Law Commission has published a draft Bill recognising certain types of digital asset as objects of property rights under English law.
- The Bill also extends to certain other assets e.g. voluntary carbon credits.
- This post discusses the context of the Bill and how it may benefit digital assets markets if enacted.

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Overview

The UK digital assets community has widely welcomed the 29 July 2024 publication by the Law Commission[1] of a supplemental report on digital assets and a revised draft bill. The draft bill is intended to support the development of the English common law in recognising certain types of digital asset, as well as other assets such as voluntary carbon credits, as objects of property rights under English law.

This is intended to provide greater legal certainty for those transacting in these assets, as well as those looking to raise finance against them, thereby supporting the growth of the digital assets industry.

The bill would provide that a "thing" is not prevented from being the object of personal property rights merely because it is neither (a) a thing in possession; nor (b) a thing in action.

This article discusses the context to the bill, why it takes this approach, and whether and to what extent it would benefit digital asset markets if enacted.

Why do property rights matter?

To the extent an asset can be subject to property rights, it would benefit from a more certain legal regime, opening up opportunities for market participants to invest in or finance the asset. The more comfortable a lender can get with the rights attaching to an asset, the more likely the lender is to finance that asset class. Accordingly, this bill may present opportunities both for digital asset owners looking to raise capital

against digital assets, and for investors looking to deploy capital against alternative and non-correlated assets.

The two categories of personal property

English law has traditionally recognised two categories of personal property:

- Things in possession: in broad terms any object the law regards as capable of possession, e.g., tangible commodities such as a barrel of oil or a bar of gold.
- Things in action: any form of personal property that can only be claimed or enforced through legal action or legal proceedings. Examples of such objects of property include debts, rights of action for breach of contract, or shares or bonds issued by a company.

Which category a thing falls into is important for various reasons, including to determine how property interests may be transferred and how security is taken. For example, things in possession are typically secured by a security interest such as a charge or pledge, whereas things in action are usually secured by an assignment by way of security.

Digital assets do not fit easily into either category. They are not tangible in any traditional sense, so it is hard to see them as things in possession. At the same time, unlike things in action, they are not claimable or enforceable only through legal action. They continue to exist irrespective of whether the law recognises them as property or even prohibits their existence.

Some older authorities[2] indicated that the only forms of personal property recognised under English law are things in possession and things in action. In other words, there is no “third category” of personal property.

Expanding the scope of what constitutes an object of property

Developments in English law over many years have called those older authorities into question. Developments in technology, regulation and policy have created various new things which the courts have been quite prepared to recognise as being objects of property rights. These include:

- milk quotas;
- EU emissions allowances (EUAs);
- waste management licences; and
- various types of digital asset.

The basis on which the courts have concluded that such assets are property has varied. In the case of waste management licences and EUAs, which provide exemptions from statutory prohibitions or from fines, the analysis was based on the characteristics of objects of property traditionally recognised by English courts. In particular, these assets:[3]

- can be defined;
- can be identified by third parties;
- can by their nature be assumed by third parties; and
- offer some degree of permanence and stability.

When considering Bitcoin as an object of property rights, the Court of Appeal[4] also noted that Bitcoin is "rivalrous", i.e., that the holding of that thing by one person necessarily prevents another person from holding that thing at the same time. This is a feature most associated with things in possession, but it is also a feature of many digital assets, as well as of voluntary carbon credits, and is regarded by the Law Commission as indicative of an object of property rights.

In these cases, the courts have tended to refrain from making any ruling regarding whether such objects constitute things in possession or things in action, but have indicated that they are not strictly things in action. In one case, the High Court went further in saying that cryptocurrencies are neither things in action nor things in possession but nonetheless constitute a form of property.

Most respondents to the Law Commission's original consultation said that these developments indicate that a third category of personal property, which are neither things in possession or things in action, has already emerged in England and should be recognised by legislation.

If the common law is doing this anyway, why do we need a bill?

The adaptability and practicality of the common law as evidenced by the cases discussed above raise a question: why should Parliament pass an act providing that things can be objects of property rights when the courts are well capable of making rulings relating to this in any event?

The Law Commission points out several benefits:

- It would confirm the existing law and remove any lingering uncertainty.
- It would save time because in cases where these issues are relevant, courts could focus on substantive issues rather than considering doctrinal issues relating to the exact category that a particular asset falls into.
- It would demonstrate the flexibility and forward-looking nature of English law in this field.

These are all fair points, but they show that the bill would represent a small incremental change rather than a radical transformation.

Next steps

It will be for the UK Government to determine whether to implement the Report and introduce the draft Bill into Parliament.

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1. The Law Commission advises the UK government on law reform for England and Wales.
2. *Colonial Bank v. Whinney* (1885) 30 CH D 261.
3. *See National Provincial Bank v. Ainsworth* [1965] AC 1175 at 1247 to 1248.
4. *Tulip Trading Ltd v. Van der Laan* [2023] EWCA Civ 83.