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UK Jurisdiction Taskforce Concludes Digital Assets Compatible With English Insolvency Law

The Legal Statement applies areas of insolvency law to digital assets, providing valuable guidance on the approach English courts will take.

In October 2023, the UK's Jurisdiction Taskforce (UKJT), which is made up of senior judges, lawyers, a law commissioner, and the Financial Conduct Authority as an observer, issued a consultation on the treatment of digital assets in an English insolvency. This has resulted in the issuance of a Legal Statement on Digital Assets and English Insolvency Law,¹ in which the UKJT has concluded that existing English insolvency law is "entirely capable of convenient and sensible application to disputes concerning digital assets". Although lacking any binding authority, the Legal Statement provides valuable guidance on the likely approach that the English courts will take to these issues.

While the outcome is in comprehensive support of compatibility, some elements of the analysis are likely to stimulate debate. The UKJT's detailed consideration of the issues provides helpful guidance to the English insolvency market.

The UKJT considered the compatibility of digital assets with eight specific areas of English insolvency law. We have summarized its views on each below, together with our observations of what otherwise remains to be addressed.

1. Digital Assets Are Property for the Purposes of English Insolvency Legislation

The English courts have decided in several cases that digital assets are capable of being property as a matter of common law. As the definition of property in the Insolvency Act 1986 (IA 1986) is wider than at common law, there can be no doubt that digital assets are caught within it.

2. International Allocation of Insolvency Jurisdiction: COMI Principles Apply

The English courts have decided in non-insolvency cases that the location of a cryptoasset is the place of domicile of its owner.² However, seen through the lens of the location of a debtor's "centre of main interests" (COMI) for the purpose of opening insolvency proceedings, the influence of digital assets is likely to depend primarily on how the debtor interacts with its digital assets and where third parties perceive the debtor carries out its commercial operations in relation to the digital assets.

Digital assets are global in nature. An issuer of digital assets, the exchange through which they are traded, the way in which they are held (through a custodian or otherwise), and the identity of their holders may point to multiple jurisdictions. The Legal Statement highlights the recent Singaporean judgment relating to *Zipmex*,³ a cryptoasset exchange. Although the company was incorporated in Singapore, it had multiple operations and subsidiaries incorporated outside of the jurisdiction. That did not prevent the Singapore court from finding that the COMI for all group companies was in Singapore, which is where the omnibus “hot wallet” was located and administered. The COMI evaluation is likely to be easier when a debtor is an exchange than when it is the principal holder or issuer of the digital assets. The UKJT acknowledges that the location of the digital assets and the approach of English law to conflict of law issues arising from their multi-jurisdictional nature was beyond the scope of the Legal Statement. This important issue therefore remains at large.

3. Digital Assets May Be the Subject of a Proprietary Claim

The UKJT sees no reason why digital assets should not be the subject of a proprietary claim, subject to the satisfaction of the legal requirements to create one. This would result in the digital asset falling outside of the debtor’s insolvency estate. The Legal Statement comments that this is likely to arise most commonly with trust arrangements and cites with approval decisions from other common law jurisdictions in which valid trusts have been created over digital assets, including over commingled and unallocated holdings of digital assets. However, the Legal Statement is reticent on the question of how a valid English law security interest could be created over digital assets and how the insolvency of an issuer, custodian, or collateral-giver would affect the position of the collateral-taker. The UKJT’s 2019 legal statement on cryptoassets and smart contracts⁴ confirmed the conceptual possibility of security interests over the asset class, but the Legal Statement does not take the practical detail any further forward.

4. A Digital Asset is neither a Debt nor a Foreign Currency

The English courts have determined that, at least for the time being, digital assets do not constitute a debt for a liquidated amount that can be expressed as a “money sum”. This is because digital assets (including stablecoins) fluctuate in value against fiat currencies. No legal right exists to exchange a digital asset for a fiat currency; rather, a holder’s claim is for the relevant digital assets to be delivered to the holder, which would give the holder no more than a claim in damages if delivery was not made. While that claim would be a provable debt in an insolvency as a contingent claim for damages upon breach, it cannot form the subject of a statutory debt and be used for the basis of issuing a winding-up petition because no liquidated sum is due under the digital asset.

As digital assets are not (yet) “money”, the Legal Statement states that they cannot be deemed foreign currency for the various purposes of the Act and the Insolvency (England and Wales) Rules 2016 (the Rules). However, if any digital assets were to become currency in future, they would likely fall within the meaning of “foreign currency” in the Rules because they would be a non-sterling currency.

5. Issues for Insolvency Office-Holders

An insolvency office-holder’s duty is to collect in and distribute an insolvent company’s assets, and the UKJT has concluded that this duty applies equally to digital assets owned by the company. The office-holder will need to ask the usual questions about when and how to sell digital assets in the way they must about all other assets, or whether to make a distribution *in specie* of digital assets if permitted to do so. The volatility of digital assets and the associated difficulties determining when to sell them do not change this fundamental analysis. While regulatory issues may need to be taken into account (and those regulatory issues in relation to digital assets are likely to develop), those issues do not create any new considerations for digital assets from an office-holder perspective. Notwithstanding this, the UKJT makes

the valid point that an office-holder might want to ensure that creditors are supportive of their proposed treatment of digital assets by obtaining consent through their proposals.

6. Avoidance of Prior Transactions Powers Can Apply to Digital Assets

The UKJT has found no reason why any of the potential grounds for a challenge to a transaction prior to insolvency would not apply to a transaction involving a digital asset. The inability to restore the *status quo ante* due to the immutability of distributed ledger technology-based transfers should be no obstacle: any legislative provision requiring a transaction to be undone can be interpreted purposively by the court to permit any replacement digital asset to reverse the effect of a transfer of the original digital asset.

7. Mixing and Shortfalls: Normal Rules Apply

While practical questions arise about how English law principles around mixing and tracing apply to digital assets, the UKJT agrees that these relate to questions derived from contract and the algorithms applicable to the relevant digital asset, rather than from anything inherent in the digital asset itself.

Although digital assets may constitute “specified investments” under the Financial Conduct Authority’s Client Assets Sourcebook rules, for the time being, they are not “client money” for those purposes. However, that position could change if any digital assets become currency. Similarly, the UKJT does not consider that any digital assets currently constitute “financial instruments” under the Financial Collateral Arrangements (No. 2) Regulations 2003, so they will not be treated as “securities” in a special administration of an investment bank or subject to the separation requirements.

8. Practical Hurdles to Enforcement Procedures under the IA 1986

The duties that directors and third parties have to hand over information and cooperate with an insolvency office-holder, and the court’s powers to assist the office-holder to collect in the company’s assets, will apply equally to a company holding digital assets as to any other company. However, the UKJT notes that practical difficulties may arise in obtaining information about and access to digital assets as a result of the way they are held (e.g., by an individual with access to a private key or wallet, who cannot be found) and establishing ownership. While these issues may apply to any assets, uncertainties will likely remain in relation to international recognition, recovery of assets in other jurisdictions, and enforcement of duties to assist the office-holder where the assets in question are digital.

Conclusion

The UKJT’s report clarifies that English insolvency law is more than capable of dealing with digital assets. As the world of digital assets continues to develop and the amount of regulatory oversight increases, additional hurdles are likely as the law applies itself to novel situations. Of particular interest will be the responses to and outcome of the Law Commission’s recent call for evidence on conflict of law issues relevant to digital assets, which may result in a further statement from the UKJT.⁵ All practitioners will need to watch this space for developments.

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Endnotes

¹ <https://lawtechuk.io/our-reports/>.

² *Ion Science Ltd v Persons Unknown* (unreported) (21 December 2020); *Fetch.AI Ltd v Persons Unknown* [2021] EWHC 2254 (Comm).

³ *Re Zipmex Pte Ltd and other matters* [2022] SGHC 196.

⁴ https://www.blockchain4europe.eu/wp-content/uploads/2021/05/6.6056_JO_Cryptocurrencies_Statement_FINAL_WEB_111119-1.pdf.

⁵ <https://lawcom.gov.uk/project/digital-assets-and-etds-in-private-international-law-which-court-which-law/>.