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Authors: Michael Bacina, Steven Pettigrove, Jake Huang, Luke Higgins, Luke Misthos, Anson Lee
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Blockchain Bites: Aussie Judge argues crypto is property, Legal uncertainty looms over digital wallets, US Court rejects SEC's token theory, SEC Sues MetaMask

Michael Bacina, Steven Pettigrove, Tim Masters, Jake Huang, Luke Higgins, Luke Misthos and Anson Lee of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

Your keys, your crypto: Aussie Judge argues crypto is property

Cryptocurrency is property – at least according to Federal Court Justice Ian Jackman.

In a recent extracurial speech to the Commercial Law Association, his Honour undertook a comprehensive analysis of case law and scholarship across the common law world, concluding that cryptocurrency is personal property at common law in Australia, specifically a chose in action.

In so doing, his Honour charted a middle course between the insistence by a vocal minority of scholars that 'Crypto is Not Property', and the UK Law Commission's proposal to recognize crypto-assets as a 'third category' of personal property called 'data objects'.

Justice Jackman stressed that the recognition of cryptocurrency as property did not depend on any novel statutory invention, but rather the common law's timeless ability to adapt to changing circumstances. According to his Honour, the common law:

> operates by close observation of the facts as they are revealed by actual experience in the real world, and provides an educated response… [it] embod[ies] in a relatively predictable way the reasonable expectations of ordinary and honest people.

His Honour also warned that:

> the rigidity of a statute would inhibit experimentation, and suffers from the problem that you cannot regulate something in advance of its invention.

Justice Jackman's argument adds to a growing mountain of scholarship and jurisprudence from jurisdictions around the world to the effect that the time to recognize crypto's proprietary nature has come.

The starting point: property is a relationship to a thing

While many cases in this area begin their analysis with Lord Wilberforce's four criteria of property in *National Provincial Bank v Ainsworth* (1965) AC 1175, Justice Jackman considered it more appropriate to start with the High Court's observation in *Yanner v Eaton* (1999) 201 CLR 351 that 'property' is not a thing, but a relationship between a person and a thing, usually treated as a bundle of rights.

This sidesteps the argument that the *Ainsworth* criteria as a 'definition' of property (which Gendall J adopted in the New Zealand High Court case *Ruscoe v Cryptopia (in liq)* [2020] 2 NZLR 809), does no more than state *necessary* conditions for the existence of property.

There is no third category of personal property

Justice Jackman rejected the UK Jurisdiction Taskforce's conclusion that cryptocurrencies fall into a third category of personal property. According to his Honour, the recognition of cryptocurrency as property is entirely compatible with the traditional dichotomy between choses in possession and choses in action going back to *Colonial Bank v Whinney* (1885) 30 ChD 261. That is because, in Australia, it is not necessary for something to be enforceable by court action to be classified as a chose in action, nor does there need to be an identifiable counterparty against whom the right can be so enforced. Citing *National Trustees Executors and Agency Company of Australasia Limited v Federal Commissioner of Taxation* (1954) 91 CLR 540 (**Cain's Case**) and *Commonwealth v WMC Resources Ltd* (1998) 194 CLR 1, which took a broad commercial approach to recognising choses in action, Justice Jackman contends persuasively that the chose in action is a broad tent encompassing a diversity of intangible rights, including milk quotas, statute-barred debts, government bonds and, yes, cryptocurrencies.

Cryptocurrency is not mere information

Justice Jackman then dealt with a common objection to recognition of crypto's proprietary nature – that it is only information, which the law typically does not treat as property (the **mere information objection**). His Honour noted that the rationale behind the mere information objection is that information is 'open to all who have eyes to read and ears to hear' per *Boadman v Phipps* [1967], and thus lacks the exclusivity required to amount to property.

However, the immutability of the transaction ledger achieved through consensus mechanisms like Proof of Work and Proof of Stake eliminate that concern, by ensuring that the same 'unit' of cryptocurrency cannot be under the simultaneous control of different persons (known as the 'double-spend problem'). For that reason, says Justice Jackman:

> We are thus a long way removed from the general objection to information as property that the information has an inherent value and benefit over which there is no exclusive right or control

Public policy is no obstacle to recognition

The final objection Justice Jackman tackled was that of public policy: that cryptocurrency, by enabling pseudonymity, is associated with criminal activity, and recognition of it as property may embolden those actors. Jackman countered this point by observing that:

> A very great number of honest people are, as a matter of fact, currently buying and selling cryptocurrency, declaring trusts over it, and bequeathing it in their wills.

His Honour went even further to say that public policy **favoured** recognition of cryptocurrency as property. For this proposition, Jackman made reference to the High Court in Cain's Case, which took into account:

> the actual conduct of the commercial community in the way in which assets are trade or otherwise dealt with as a compelling reason for recognising those assets as proprietary in nature.

Put another way:

> [I]f market participants in very large numbers are satisfied… in undertaking transactions on the basis that cryptocurrency is property, then it would be most surprising if the judiciary were to disagree.

Conclusions

While Justice Jackman's speech has no binding weight at law, his extra-curial comments may well prove influential when an Australian Court is called upon to formally determine whether cryptocurrency is property at law. His Honour's conclusion relies upon a considerable body of common law authority and is noteworthy for its recognition of the common law's ability to adapt to new facts and circumstances (including new innovations) as they arise. His Honour also demonstrates a keen

sense of pragmatism in recognizing the commercial realities of an emerging technology which has received wide adoption by the Australian public.

Written by Michael Bacina, Steven Pettigrove and Anson Lee

Legal uncertainty looms over digital wallets: not just for Qoins?

In the wake of the recent Federal Court ruling in the Qoin case, the question of whether digital wallet products qualify as non-cash payment facilities (NCPFs) under Australian law has become more important than ever in terms of regulatory compliance. The decision notes that the defendant in that matter identified their digital wallet as a financial product on their website, but the court drew a distinction between the wallet and the blockchain to which the wallet sent commands for balances of crypto-assets to change. This division has potentially significant implications for the regulatory classification of digital wallets, particularly as the Australian Securities and Investments Commission did not highlight that distinction in their press release about the matter.

Are digital wallet products non-cash payment facilities?

The Federal Court's judgment in the Qoin case provides a pivotal reference point for examining whether a blockchain could be considered a non-cash payment facility or part of one. The court found that the Qoin Wallet, as part of the "Qoin Wallet App", was a financial product because it facilitated non-cash payments by allowing users to send and receive Qoin tokens, a matter which was not in dispute in the matter and accepted by Qoin.

The court distinguished between the Qoin Wallet and what was called the broader "Qoin Facility", which included the Qoin Wallet App, the Qoin Blockchain, and the smart contracts necessary for the broader facility to function. This distinction raises important questions about the scope and definition of non-cash payment facilities under the Corporations Act.

Analysis of the Qoin Wallet Product

Her Honour Justice Downes described the Qoin Wallet in paragraphs [36]-[48] of the judgment. The WayBackMachine shows the Financial Services Guide (FSG) and Product Disclosure Statement (PDS) available on the Qoin website as at 3 November 2022 (shortly before ASIC commenced their initial action against Qoin). The PDS and FSG explicitly state that Qoin's services "allow you to securely and conveniently make payments".

How did the Qoin Wallet actually function?

The Qoin Wallet was a component of the broader Qoin App (which was required to be installed for the Qoin Wallet to function), and the data for the Qoin Wallet was stored on a user's personal device. The Qoin Wallet used a specific application programming interface (API) gateway to send requests to, and receive responses from, the Qoin blockchain's nodes in order to process transactions.

Each Qoin Wallet has its own public key/address which a user can provide to another user either by transcribing the string of letters and numbers comprising the public key, or by providing them with a QR to scan which contains the address information. The private key was stored on the user's mobile device.

The Qoin Wallet component of the Qoin App had the function of both viewing the balance of Qoin each user had in their Qoin Wallet address recorded on the blockchain, and also the payment facility (i.e., the ability of the user to send and receive Qoin). Users could only send Qoin from their Qoin Wallet to another Qoin Wallet.

A user's Qoin balance in a newly created Qoin Wallet started at 0, with the only way to increase Qoin was if they acquired it froom other users, or by purchasing Qoin directly from BPS Financial Pty Ltd.

Her Honour extracted several sections of the PDS, FSG, and Whitepaper that explicitly referenced the payment functionality of the Qoin Wallet. The completion of a transaction through the Qoin Wallet was also described paragraph [56] of the judgment. For illustrative purposes, the process for sending Qoin was described as follows:

1. A user opens the Qoin Wallet on the Qoin App and presses a button marked "Send". This brings up the payment screen.
2. To create a transaction, the user fills out necessary information in accordance with the send prompts displayed on the payment screen, being the recipient's Qoin Wallet address, and the amount of Qoin to be transferred.
3. To sign or validate the transaction, the private key stored on the user's mobile device is used. The private key is safeguarded by biometric security or a PIN authentication system, which the user is prompted to provide when clicking the "Confirm" transaction button.

4. The private key is then used internally by the wallet software to sign the transaction, and a unique transaction hash for the transaction on the Qoin blockchain is created.
5. Once signed, the transaction information is sent to the Qoin blockchain as a raw transaction.
6. Once received by the Qoin blockchain's nodes, the transaction data is broadcasted to the network participants and validated.
7. If the transaction is verified, it is then processed and the state of the blockchain is updated to reflect the transfer.
8. The transaction details are then recorded in the user's respective Qoin Wallets and their Qoin balances are updated.

What is a non-cash payment facility?

A non-cash payment facility is defined in section 763D of the Corporations Act. It refers to a facility through which a person makes payments, or causes payments to be made, other than by the physical delivery of Australian or foreign currency in the form of notes and/or coins.

What did the parties argue?

ASIC's primary case was that the broader "Qoin Facility", being the Qoin App, the Qoin Wallet, Qoin tokens (including the means of acquiring Qoin from BPS), the Qoin Blockchain, and related software, comprised a financial product in the form of a NCPF.

BPS did not dispute that the Qoin Facility included a NCPF, but contended that the financial product was specifically the Qoin Wallet (which was merely a component of the overall facility) and the balance of the arrangement were not a financial product.

Noting that both parties agreed there was a financial product, the court's analysis focused on what constituted a "facility" within the definition of a NCPF under section 763D(1) of the Corporations Act 2001 (Cth). Under s762B of the Corporations Act, if a financial product is a component of a facility that also has other components, the financial services regulations only apply in relation to the facility *to the extent* it consists of the component that *is* the financial product.

Despite ASIC's contention that the financial product in question was effectively the entire Qoin scheme (which ASIC argued was a "single scheme which has been implemented by BPS for a substantial purpose of enabling customers [to make payments] otherwise than by the physical delivery of cash"), her Honour found that the financial product in question was specifically, and only, the Qoin Wallet.

Her Honour's reasons

Justice Downes' reasoning stemmed from two primary considerations. First, her Honour stated that simply because a financial product's functionality requires integration with another thing does not necessarily mean that other thing forms part of the financial product. Although the Qoin Blockchain was integral to the overall operation of the Qoin Wallet, it was a single piece of structural software that existed separately to each Qoin Wallet and therefore was not part of the financial product.

Second, her Honour clarified that a system by means of which a facility operates is not itself a financial product that is capable of being "issued" or "acquired" as contemplated in the Corporations Act. Accordingly, the identification of the financial product should focus upon the point at which a person makes a non-cash payment. Her Honour posted the framing question:

> what is the direct mechanism or thing which is allowing the person to [make a non-cash payment]?

Applying this to the question at hand, the Qoin Blockchain, Qoin itself as a token, and the means of acquiring Qoin from others or from BPS were not components of, nor were not themselves, aspects of the direct mechanism which allowed the user to make a non-cash payment. Her Honour stated that one could not "deal" in these aspects of the overall system, which could be contrasted against the ability to issue Qoin Wallets to users.

Her Honour drew comparison to the examples of NCPFs given in the Corporations Act definition, one of which was "making payments by means of a facility for a direct debit of a deposit account". Her Honour found that the Qoin Wallet was analogous to the direct debit facility example and that the systems with which it was integrated and in relation to which it functions were separate considerations to the actual facility itself.

Take-aways

The decision has helped to clarify the scope of the NCPF definition by finding that simply because a financial product's functionality requires other elements, it does not mean those other elements form part of the financial product in question. Although the blockchain (and other aspects) in this instance were necessary for the wallet's operation, they were separate from the wallet itself as a financial product.

By way of analogy, the underlying internet software and infrastructure necessary for an online banking applications to operate cannot be included in the definition of the financial product which is used over the internet.

The Need for Legal Advice in a Complex Regulatory Environment

This judgment underscores the critical importance of obtaining specialised legal advice when navigating complex regulatory landscapes. The case highlights the nuanced approach that Australian courts may take in applying existing financial services laws to emerging technologies and broad arguments the regulator is bringing in their enforcement actions.

The recent decision in the Block Earner case is worth mentioning as well, where the Federal Court relieved Block Earner from civil penalties for its unlicensed financial product due to the company's honest and fair attempt to comply with the law. Part of the reason for that decision, which is under appeal by ASIC was that the defendant had sought legal advice in addressing an inherent complex and uncertain area of financial services legislation. The take-away is that legal advice isn't only useful in the careful design of products, but could be useful if a product is found to be infringing despite efforts to ensure it is not.

Written by Luke Higgins and Michael Bacina

US Court rejects SEC's token theory

On 28 June 2024, Judge Jackson of the US District Court for the district of Colombia issued a lengthy order resolving the pending motion to dismiss complaints by the Securities and Exchange Commission (**SEC**) in *SEC v Binance*. While the Court allows the majority of SEC's claims to proceed, it also dismissed several of the SEC's core arguments.

The SEC's June 2023 charges raises thirteen claims in relation to violating US federal securities laws against Binance Holdings, its founder Changpeng Zhao, and two US-based entities, BAM Trading and BAM Management (together, **Binance**).

Among the complaints, SEC alleged that:

- Binance offered unregistered securities to the general public in the form of the its BNB token and Binance-linked BUSD stablecoin;
- Binance's staking-as-a-service violated securities law, following the reasoning in *SEC v Coinbase*; and
- Binance entities failed to register as a clearing agency, a broker-dealer and an exchange with the SEC.

The Court allowed most of the claims to proceed, including claims based on Binance's own post-ICO (i.e. Initial Coin Offering) sales of BNB. However, the Court dismissed claims based on other parties' subsequent sales of BNB (i.e. secondary sales), as the Court found the SEC had not plausibly alleged that purchasers on secondary markets expected Binance to use their "investment" in buying BNB to generate profits.

The Court also found that Binance's stablecoin BUSD was not credibly alleged to be offered or sold in a securities transaction and rejected the SEC's allegation that Binance's promises to develop the BUSD "ecosystem" would lead purchasers to expect an increase in value "when the alleged defining feature of the 'stablecoin' was that its value would remain constant."

Another key issue at the heart of the ruling was the rejection of the SEC's broad assertion that the crypto tokens themselves are investment contracts subject to SEC oversight. Jackson J wrote that,

> The Court notes that several of the district courts presented with SEC enforcement actions involving cryptocurrencies have taken pains to differentiate the alleged investment contracts from the tokens themselves… The Court finds these observations to be clarifying and persuasive…'"

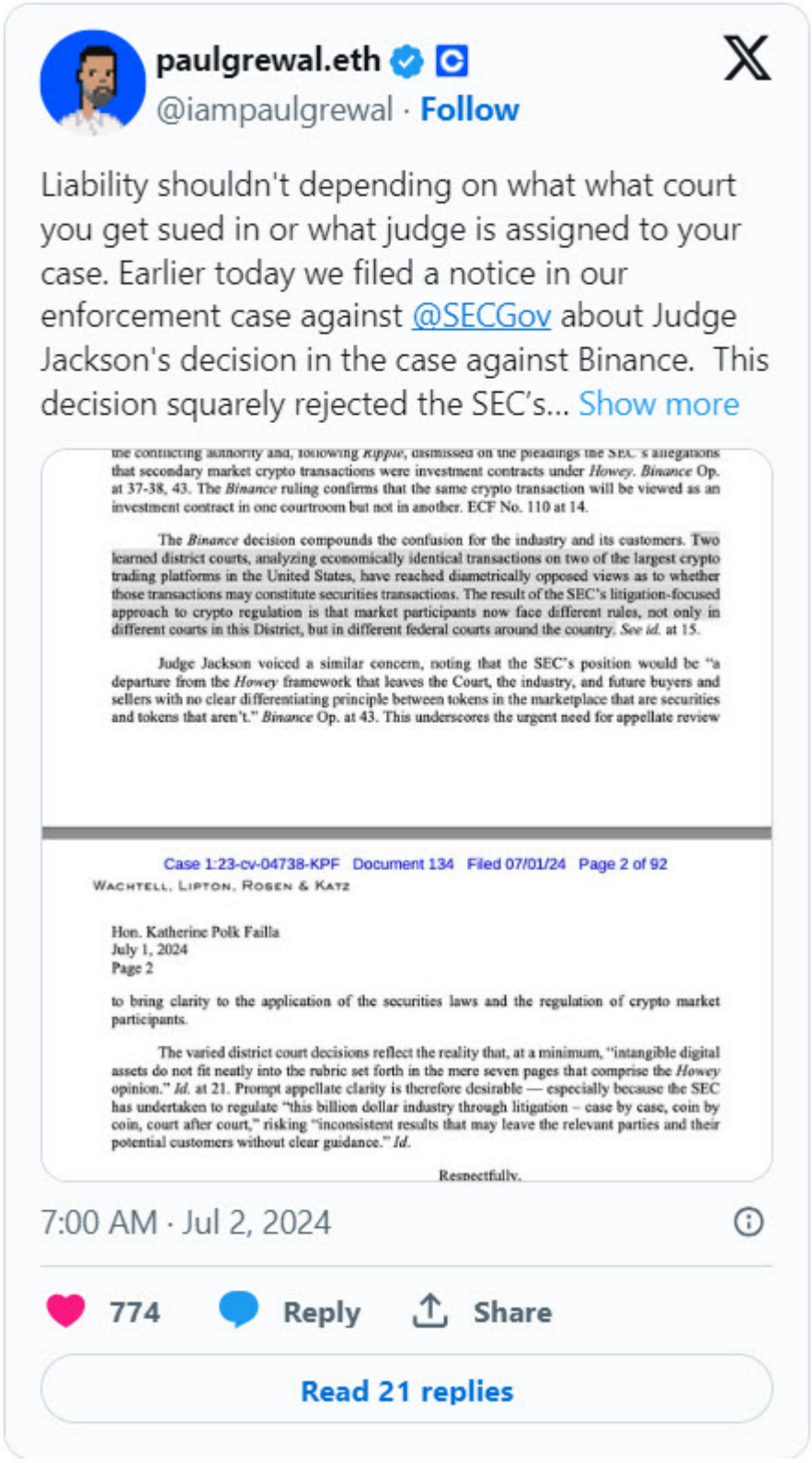
Binance heralded this ruling as an important clarification on the legal position and a blow to SEC's case to regulate the crypto market by enforcement, saying:

The Court found that the SEC's approach muddied the issues and ignored controlling United States Supreme Court precedent. The court also emphasized that the focus should be on whether the circumstances surrounding each transaction renders it a securities transaction. The focus should not be on the tokens themselves, which are not securities.

In light of the Court's ruling on secondary sales of crypto assets, Coinbase and Ripple Labs are both seeking to include this decision in their cases with the SEC. This week, Coinbase filed a new motion to support an appeal of *SEC v Coinbase*, saying:

> [The decision in] *Binance* further supports requiring the SEC to engage in rulemaking regarding digital assets

Paul Grewal, Chief Legal Officer of Coinbase, posted on X (formerly Twitter) saying the fact that two US district courts reached very different views as to whether secondary transactions of crypto assets are securities transactions creates uncertainty for market participants, and is the result of SEC's litigation-focused approach to crypto regulation:



While some view the Binance ruling as a partial victory for Binance and the broader crypto industry, many challenges remain. The court allowed most of the SEC's most serious claims to proceed (as the court is required to assume that the allegations are true at this stage of the proceedings when considering whether claims should be dismissed).

The burden of proof is on the SEC to demonstrate, among other things, that customers purchased these tokens as "investment contracts" rather than for other uses. The Court scheduled a hearing for this case on 9 July.

Written by J Huang and M Bacina

SEC Sues MetaMask

In a significant escalation of regulatory scrutiny in the United States, the US Securities and Exchanges Commission (**SEC**) has filed a lawsuit against software provider Consensys over their very popular MetaMask wallet, alleging the software operates as an unregistered broker and engaging in the sale of unregistered securities.

The SEC's regulatory action, which may have been triggered by Consensys suing for declaratory relief that MetaMask is not infringing, centers around MetaMask's 'Swaps' and 'Staking' features. The Swaps service, which allows users to buy and sell digital assets directly within the MetaMask app, has facilitated over 36 million transactions in the past four years.

According to the SEC, at least 5 million of these involved what the SEC calls "crypto asset securities", claiming that Polygon and Luna in particular fall within what the SEC considers a security under US law.

The SEC has also taken issue with MetaMask's staking functionality, which integrates with Ethereum staking services Lido and Rocket Pool. Users can deposit assets to secure the Ethereum blockchain and receive liquid staking tokens, stETH and rETH, in return.

The SEC argue that these tokens constitute unregistered securities, making MetaMask's involvement an illegal 'investment contract.'

The lawsuit appears to be another attempt by the SEC to broaden the scope of what are considered securities, a sentiment echoed by a representative from Consensys speaking with Coindesk:

> The SEC has been pursuing an anti-crypto agenda led by ad hoc enforcement action…This is just the latest example of its regulatory overreach – a transparent attempt to redefine well-established legal standards and expand the SEC's jurisdiction via lawsuit.

Consensys recently sued the SEC in Texas, seeking judicial relief from the regulator's attempts to classify MetaMask as a broker and its staking service as a securities offering.

> We will continue to vigorously pursue our case in Texas for a ruling on these issues because it matters not only to our company but the future success of web3

The lawsuit follows the SEC's recent enforcement actions against Kraken and Coinbase (not to mention the Wells Notice that was sent to Uniswap, which is usually a pre-curser to a lawsuit).

The battle between the SEC and the crypto industry rages on, with Consenys becoming the latest industry player forced to incur costs defending a claim that they contravened securities laws that might not even apply to the products they offer. As many have previously observed, there appears to be no way for these products to be offered as compliant investment contracts under US law by registration with the SEC in any event, leaving the operators in a precarious position which could amount to a shadow-ban. The fact that MetaMask is non-custodial, and so has more in common with a password manager than what is commonly understood to be a digital wallet, means that many other non-custodial wallet product developers will be watching the outcome of the case closely, lest their business models be found to be in breach of US law.

Written by Michael Bacina and Luke Misthos