

Title	Proposal for Joint Work: HCCH-UNIDROIT Project on Law Applicable to Cross-Border Holdings and Transfers of Digital Assets and Tokens
Document	Prel. Doc. No 3C of January 2023
Author	PB
Agenda Item	Item II.5.
Mandate(s)	C&D No 14 of CGAP 2022
Objective	To seek a mandate for joint work with UNIDROIT to examine the desirability of developing coordinated guidance and the feasibility of a normative framework on the law applicable to cross-border holdings and transfers of digital assets and tokens, covering relevant private law aspects
Action to be Taken	For Decision <input checked="" type="checkbox"/> For Approval <input type="checkbox"/> For Discussion <input type="checkbox"/> For Action / Completion <input type="checkbox"/> For Information <input type="checkbox"/>
Annexes	Annex: Table of Contents, Principle 5 and its Commentary of the Draft UNIDROIT Principles on Digital Assets and Private Law
Related Documents	Prel. Doc. No 3A of CGAP 2022 Prel. Doc. No 4 REV of CGAP 2021

Table of Contents

I.	Introduction.....	2
II.	PIL Aspects of the Work of UNIDROIT's DAPL WG	2
III.	Recent Developments Concerning Digital Assets and Tokens	3
	A. The current assumptions on PIL and digital assets and tokens	3
	B. New assets revive old connecting factors	4
IV.	Proposed Joint Work with UNIDROIT.....	6
V.	Proposal for CGAP	7
	ANNEX	8

Proposal for Joint Work: HCCH-UNIDROIT Project on Law Applicable to Cross-Border Holdings and Transfers of Digital Assets and Tokens

I. Introduction

- 1 In fulfilment of Conclusion and Decision (C&D) No 33 and following the mandate of the Council on General Affairs and Policy (CGAP) in March 2022,¹ the inaugural HCCH Conference on Commercial, Digital and Financial Law Across Borders (CODIFI Conference) was successfully held online from 12 to 16 September 2022. The CODIFI Conference included three tracks of discussions to address matters related to the digital economy, informed by the requests of Members that had responded to a survey distributed by the PB in late 2021. The report of the CODIFI Conference is provided as Annex I to Prel. Doc. No 3A.²
- 2 One of the outcomes of the CODIFI Conference was the conclusion by several experts that work on private international law (PIL) relating to digital assets, specifically the determination of applicable law, is both timely and desirable. This conclusion dovetails with findings by UNIDROIT's Working Group on Digital Assets and Private Law (DAPL WG), which has concluded that clear rules on digital assets and tokens, including on PIL, will have several benefits to States, including increased efficiencies and cost reductions.³
- 3 In response to this input, this Prel. Doc. describes foundational work carried out by UNIDROIT's DAPL WG, focusing on the PIL aspects of that work; reports on significant developments concerning digital assets and tokens that relate to the question of the applicable law; and seeks a mandate from CGAP to examine, jointly with UNIDROIT, the desirability of developing coordinated guidance and the feasibility of a normative framework on the law applicable to cross-border holdings and transfers of digital assets and tokens, covering relevant private law aspects.

II. PIL Aspects of the Work of UNIDROIT's DAPL WG

- 4 Over the last year, the PB has continued to closely coordinate with UNIDROIT, including through active participation as an observer in UNIDROIT's DAPL WG, which is finalising a set of Principles with commentary relating to the legal nature, transfer and use of digital assets.⁴ The DAPL WG concluded that "it is important to have clear rules that apply to the key aspects of these transactions",⁵ and that guidance, including on PIL issues relating to digital assets, "will increase the predictability of transactions involving these assets that occur".⁶
- 5 In particular, Principle 5 of the draft UNIDROIT Principles pertains to Conflict of Laws. For ease of reference, Principle 5 and its Commentary can be found in Annex I of this Prel. Doc. Principle 5 provides a conflict rule in a waterfall format, describing factors for the determination of the applicable law governing the proprietary issues in respect of a digital asset – the first consideration would be to apply the domestic law of the State explicitly

¹ C&D No 33 of CGAP 2022; see also C&D No 38 of CGAP 2021, available on the HCCH website at www.hcch.net under "Governance" then "Council on General Affairs and Policy" and "Archive (2000-2022)".

² "Digital Economy and the HCCH Conference on Commercial, Digital and Financial Law Across Borders (CODIFI Conference): Report", Prel. Doc. No 3A of January 2023 for CGAP 2023, available on the HCCH website at www.hcch.net under "Governance" then "Council on General Affairs and Policy".

³ Draft UNIDROIT Principles on Digital Assets and Private Law ("draft UNIDROIT Principles"), January 2023, draft for public consultation, online at <https://www.unidroit.org/wp-content/uploads/2023/01/Draft-Principles-and-Commentary-Public-Consultation.pdf>, Introduction, paras 2 and 4.

⁴ *Ibid.*

⁵ *Ibid.*, para. 2.

⁶ *Ibid.*, para. 4.

specified in the digital asset itself, and then the law of the State specified in the system or platform on which the digital asset is recorded. Absent these specifications, two possible options are provided: option A gives the forum State the freedom to specify which of its own rules apply, and, to the extent not addressed by the application of that specification, the possibility to establish that the Principles apply in whole or in part; according to option B, the first of the alternatives in option A disappears, and the possibility of specifying the Principles is the only possibility left to the forum State. As stated below (see para. 21), a special rule applies to the relationship between a custodian and its client.⁷

- 6 UNIDROIT's DAPL WG has completed work on the draft UNIDROIT Principles, which are "designed to facilitate transactions in digital assets". On 10 January 2023, UNIDROIT commenced a public consultation on the draft UNIDROIT Principles to ensure that the instrument is well suited to application in different contexts, and to seek feedback from parties engaged in the digital asset industry. The deadline for the submission of comments is 20 February 2023, and the DAPL WG will consider comments received at its next session from 8 to 10 March 2023. The PB, in coordination with the UNIDROIT Secretariat, will report on the relevant comments received to CGAP at its meeting in March 2023.

III. Recent Developments Concerning Digital Assets and Tokens

A. The current assumptions on PIL and digital assets and tokens

- 7 Digital technologies have advanced more rapidly than any innovation in history. The current climate surrounding digital technologies is characterised by ubiquitous connectivity through mobile, internet-connected devices and low-cost computing and data storage; together, these factors enable new business models for the delivery of services and the leveraging of large stores of data. The financial sector is the largest user of digital technologies and represents a major driver in the digital transformation of the economy and society, which is a crucial catalyst in enabling equitable access to finance.⁸ More recently, the decentralised exchange of digital assets and tokens, including through the use of distributed ledger technology (DLT),⁹ rely on a register or database split across an online network without a central control point.¹⁰ Adding a further layer of complexity, many technologies are designed, developed and deployed on infrastructures or in spaces that remain beyond any single State's jurisdiction.
- 8 From a PIL perspective, such platforms have unique design characteristics that strain the application of traditional connecting factors.¹¹ Experts have noted that traditional connecting factors will be difficult to apply to these technologies; PIL challenges are inherent in DLT systems because the pseudonymity of users and the decentralised nature of the ledger may

⁷ Draft UNIDROIT Principles, Principle 5 and its Commentary are in Annex I of this Prel. Doc.

⁸ European Commission Fintech Action Plan <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0109>.

⁹ See also the discussion about recent developments and trends in the digital economy, including DLT systems and applications, in "Developments with respect to PIL Implications of the Digital Economy", Prel. Doc. No 4 REV of January 2022 for CGAP 2022, paras 9-35, available on the HCCH website at www.hcch.net (see path indicated in note 1).

¹⁰ DLT is the protocol on which blockchain is based. See also UNCTAD (2021), "Harnessing Blockchain for Sustainable Development: Prospects and Challenges", UNCTAD/DLR/STICT/2021/3 and Corr. 1, p. 2.

¹¹ CODIFI Report, Annex I of Prel. Doc. No 3A, *supra* note 2. Experts agreed that DLT poses technological and legal challenges based on the pseudonymity of users, the immaterial nature of digital assets, and the uncertainty of the location of network nodes. See also the discussion about connecting factors in relation to digital assets created and transferred via decentralised systems, in "Developments with respect to PIL implications of the digital economy, including DLT", Prel. Doc. No 4 of November 2020 for CGAP 2021, paras 15-21, available on the HCCH website at www.hcch.net (see path indicated in note 1).

either make it difficult, or perhaps impossible, to determine the *situs* of an asset.¹² The issues that would traditionally be determined by *lex situs* would therefore have to be determined by another law.

9 Complicating this matter, some proponents of DLT resist formal regulation in favour of self-regulation or adherence to the ethos of *lex cryptographica*.¹³ Other PIL issues that arise in DLT use cases include:¹⁴

- the characterisation of, and law applicable to, the relationship between participants in a DLT system, including digital asset holders and DLT intermediaries such as crypto-exchanges and wallet providers;
- the characterisation of, and law applicable to, the holding and transacting of digital assets in a DLT system;
- the law applicable to the proprietary effects of digital assets towards third parties, including issuers of crypto-securities, takers of collateral in digital assets, heirs in succession of digital asset holders, and creditors of digital asset holders who have become insolvent;
- the jurisdiction of courts to hear disputes related to the outcomes of self-executing smart contracts deployed on DLT systems;
- the recognition and enforcement of DLT-based dispute resolution outcomes; and
- the question of how to determine the law relating to linked assets.

B. New assets revive old connecting factors

10 In general, the application of PIL connecting factors to cross-border technological platforms is exemplified in the rise of the Internet. While the Internet “almost immediately triggered a debate among legal scholars [...] about whether the new medium should be governed by state law at all”, the conclusion that State law could regulate quickly took hold.¹⁵ Little difficulty is posed in the application of connecting factors that allow for identification of a specific State or legal system, independently of the technology involved, such as the defendant’s domicile, habitual residence, and establishment.¹⁶ Another available method to determine the applicable law is to rely on the explicit choice of law defined in the host / user relationship in the contractual terms of online platforms.¹⁷

11 Without an explicit choice of the applicable law, the application of connecting factors would be thwarted by the pseudonymity of the users and the inability to locate the DLT platform’s connections to a certain jurisdiction, though some authorities have made attempts to do so based on the concentration of nodes.¹⁸ While the explicit determination of the applicable law in an online platform agreement would be ideal, it does not consistently account for

¹² M. Lehmann (2019) “Who Owns Bitcoin? Private (International) Law Facing the Blockchain”, *European Banking Institute Working Paper Series 2019*, No 42, p. 2.

¹³ See, e.g., P. de Fillippi and A. Wright (2018), *Blockchain and the Law – The Rule of Code*. For an opposite view, see D. Sindres (forthcoming 2023), “Is Bitcoin out of Reach for Private International Law?”, in *Blockchain and Private International Law* A. Bonomi and M. Lehmann (eds).

¹⁴ See also the discussion about the different PIL implications of permissioned and permissionless systems, in Prel. Doc. No 4 of November 2020, para. 16 and Annex I, available on the HCCH website at www.hcch.net (see path indicated in note 1).

¹⁵ T. Lutz, “Private Ordering, the Platform Economy, and the Regulatory Potential of Private International Law”, in *Conflict of Laws in the Maze of Digital Platforms*, pp. 130-131.

¹⁶ T. Lutz, *Private International Law Online: Internet Regulation and Civil Liability in the EU*, p. 102.

¹⁷ T. Lutz, “Private Ordering, the Platform Economy, and the Regulatory Potential of Private International Law”, *supra* note 15, p. 136.

¹⁸ Any computer connected to the DLT or blockchain network is referred to as a “node”. Each of these nodes operates a full copy of validated transactions of the blockchain ledger, see UNCTAD (2021), *supra* note 10, p. 51. The US Security and Exchange Commission has claimed jurisdiction over all transactions on the Ethereum blockchain based on the location of nodes within its territory. See U.S. Securities and Exchange Commission against Ian Balina, Civil Action No. 1:22-CV-950 filed on 19 September 2022, para. 69.

circumstances where users choose to avoid the services of a centralised platform, for reasons including security, lack of platform trust, and personal philosophy.

- 12 It is possible, however, that further developments will require reconsideration of the assumption that traditional connecting factors have no useful role to play. One example is digital assets linked to securities, where there may be some degree of identification of the parties to the transactions so that the issuer may identify the shareholders of the asset.
- 13 Another example is that of “Soulbound tokens”.¹⁹ Soulbound tokens are defined as publicly-visible, non-transferable tokens representing affiliations, memberships, and credentials, enabling a digital DLT wallet to act as an “extended resumé” of the holder’s activities and relationships.²⁰ Illustrations of use cases include tokens that could be:
- issued by a university to certify that the wallet holder is a graduate;
 - acquired by participation in activities of organisations, providing proof of attendance at a conference or recognition of more substantial relationships, such as extensive contributions to a charity or extensive participation in the governance of decentralised autonomous organisations (DAOs); or
 - used to model traditional financial systems and arrangements. For example, a lien-like token may show that the wallet holder has an outstanding debt obligation or, conversely, a credit score-like token may show that the wallet holder has consistently made payments on a loan.
- 14 These “social, community and reputation tokens” (SCRTs) provide a digital method of representing a wallet holder’s location, personal identification, or affiliations. An elaborated arrangement of SCRTs could provide indication of real-world identities, locations, places of business, and patterns of social or economic behaviour – in other words, facts that facilitate the application of traditional connecting factors. Furthermore, users would be incentivised to voluntarily acquire more SCRTs because their possession can signal the authenticity of their own digital wallets and the consistency and reliability of their performance of obligations. Such markers of reliability in a wallet would facilitate access to more privileges and services for the holder. For this reason, SCRTs may overcome the location- and identity-based barriers of PIL and DLT, and do so while respecting the ethos of peer-to-peer exchange that guides many DLT users and communities.
- 15 It should, however, be noted that SCRTs may challenge traditional notions of control under property law. SCRT use cases rely on the principle that a user cannot freely transfer an SCRT to another user after the initial acquisition – a user may only “destroy” it.²¹ Some SCRTs also may not be modifiable without the consent or sign-off of the issuer (for example, when a bank-issued SCRT represents an outstanding debt obligation). This has implications for whether they may be accurately characterised as property. While this behaviour is touted as an advancement in the digital assets world because it enables use cases apart from the collection and sale of currency-like tokens, this raises a further complication in the hunt for general rules that may be used to characterise assets on digital platforms.

¹⁹ E. Weyl, P. Ohlhaber, V. Buterin, “Decentralized Society: Finding Web3’s Soul”, available from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4105763.

²⁰ The term “Soulbound” is borrowed from massively multiplayer online games, where Soulbound equipment is typically rewarded for accomplishments of high complexity and time investment, and is “bound” to the player’s “soul” because it cannot be traded or sold to other players. The equipment therefore has reputational value because it proves that the owner accomplished a significant challenge in the game.

²¹ The hypothetical disincentive to doing so is that a wallet devoid of SCRTs will appear as a new user with no reputational markers, *i.e.*, potentially risky to transact with.

IV. Proposed Joint Work with UNIDROIT

16 The developments described in the section above support two areas of inquiry concerning the PIL rules for digital assets and tokens, including linked assets and SCRTs.

- First, a choice of law rule requires further clarity on the applicable law in cases where no explicit choice is made, either by users or the owners of platforms. Subsidiary questions also arise in the matter of the protection of weaker parties where an explicit choice of law is, in fact, made.
- Secondly, SCRTs may create a digital environment that decreases the anonymity of users and increases precision for locating users, assets, and transactions. SCRTs may, in turn, facilitate the application of more traditional connecting factors to decentralised digital platforms in the search for the applicable law, while necessitating further study into the differences between SCRTs and freely tradeable digital assets.

The PB proposes that both areas of inquiry would benefit from collaboration and input from UNIDROIT in relation to modernising, harmonising and coordinating private commercial and digital law.

17 As the DAPL WG seeks final completion of the draft UNIDROIT Principles in 2023 according to its mandate,²² the PB and the UNIDROIT Secretariat have discussed continued cooperative work on a joint project focused on digital assets and tokens. The scope of this proposed joint project would, broadly, build on and expand the work that has been carried out by the DAPL WG, focusing on Principle 5 of the draft UNIDROIT Principles. Tentatively, this proposed joint work would examine the desirability of developing coordinated guidance and the feasibility of a normative framework on the law applicable to cross-border holdings and transfers of digital assets and tokens, covering relevant private law aspects. The proposed name of this joint project is “HCCH-UNIDROIT Project on Law Applicable to Cross-Border Holdings and Transfers of Digital Assets and Tokens” (“HCCH-UNIDROIT Digital Assets and Tokens Project”). It is proposed that the project be undertaken jointly by the PB and the UNIDROIT Secretariat, together with relevant subject-matter experts.

18 This joint project is proposed to comprise an initial phase leading up to March 2024, starting with Principle 5 of the draft UNIDROIT Principles, and focusing on the inquiries described above, including:

- the applicable law in the absence of an explicit choice of law by the parties;
- weaker party protection in transactions relating to digital assets and tokens;
- connecting factors that would impact on the law applicable to cross-border holdings and transfers of digital assets and tokens; and
- the law applicable to linked assets.

19 The PB will report back to CGAP at its meeting in March 2024 (with the UNIDROIT Secretariat reporting to its governing bodies) on the outcomes of this initial phase of the project, including suggestions as to the desirability and feasibility of continuing work on this topic through the establishment of a joint Experts’ Group. The PB will continue to closely coordinate with the sister organisations to ensure that work on this initiative is focused on its defined goals, does not conflict with other existing projects or mandates, and is in line with the goals of coordination and fluid cooperation.

²² Summary Conclusion No 26 of the UNIDROIT Governing Council (June 2022).

- 20 If CGAP concludes that the PB should proceed with this joint project proposal, the UNIDROIT Secretariat will present the proposal to its Governing Council at its next meeting from 10 to 12 May 2023.

V. Proposal for CGAP

- 21 Given the expert recommendations of the CODIFI Conference, the implications on PIL that developments in the digital economy have for HCCH Members, and the work by UNIDROIT, as well as having in mind the available resources at the PB and the work programme assigned to the International Commercial, Digital and Financial Law Team, the PB proposes the following Conclusion and Decision:

CGAP welcomed the cooperation between the PB and the UNIDROIT Secretariat on matters relating to digital assets. CGAP mandated the PB to examine, jointly with the UNIDROIT Secretariat and in light of work already completed at UNIDROIT as well as decisions that may be taken by the UNIDROIT Governing Council, the desirability of developing coordinated guidance and the feasibility of a normative framework on the law applicable to cross-border holdings and transfers of digital assets and tokens, covering relevant private law aspects, through the HCCH-UNIDROIT Digital Assets and Tokens Project. The PB will report on the results of the Project to CGAP at its 2024 meeting, including suggestions on the desirability and feasibility of continuing work on this topic through the establishment of a joint Experts' Group.

ANNEX



**Digital Assets and Private Law
Public Consultation**

UNIDROIT 2023
Study LXXXII - PC
English only
January 2023

DRAFT UNIDROIT PRINCIPLES ON DIGITAL ASSETS AND PRIVATE LAW

TABLE OF CONTENTS

INTRODUCTION	3
SECTION I: SCOPE AND DEFINITIONS	7
Principle 1: Scope	7
Principle 2: Definitions.....	8
Principle 3: General principles	14
Principle 4: Linked assets.....	17
SECTION II: PRIVATE INTERNATIONAL LAW	21
Principle 5: Conflict of laws	21
SECTION III: CONTROL	26
Principle 6: Definition of control.....	26
Principle 7: Identification of a person in control of a digital asset	30
Principle 8: Innocent acquisition.....	31
Principle 9: Rights of transferee.....	33
SECTION IV: CUSTODY	34
Principle 10: Custody	34
Principle 11: Duties owed by a custodian to its client.....	39
Principle 12: Innocent client.....	42
Principle 13: Insolvency of custodian	44
SECTION V: SECURED TRANSACTIONS	46
Principle 14: Secured transactions: general	46
Principle 15: Control as a method of achieving third-party effectiveness.....	49
Principle 16: Priority of security rights in digital assets	52
Principle 17: Enforcement of security rights in digital assets	54

SECTION VI: PROCEDURAL LAW INCLUDING ENFORCEMENT	57
Principle 18: Procedural law including enforcement.....	57
SECTION VII: INSOLVENCY	59
Principle 19: Effect of insolvency on proprietary rights in digital assets.....	59

SECTION II: PRIVATE INTERNATIONAL LAW***Principle 5:******Conflict of laws***

(1) Subject to paragraph (2), proprietary issues in respect of a digital asset are governed by:

(a) the domestic law of the State (excluding that State's conflict of laws rules) expressly specified in the digital asset as the law applicable to such issues;

(b) if sub-paragraph (a) does not apply, the domestic law of the State (excluding that State's conflict of laws rules) expressly specified in the system or platform on which the digital asset is recorded as the law applicable to such issues;

(c) if neither sub-paragraph (a) nor sub-paragraph (b) applies:

OPTION A:

(i) [the forum State should specify here the relevant aspects or provisions of its law which govern proprietary issues in respect of a digital asset];

(ii) to the extent not addressed by sub-paragraph (c)(i), [the forum State should specify here either that these Principles govern proprietary issues in respect of a digital asset or should specify the relevant Principles or aspects of these Principles which govern proprietary issues in respect of a digital asset];

(iii) to the extent not addressed by sub-paragraph (i) or (ii), the law applicable by virtue of the rules of private international law of the forum.

OPTION B:

(i) [the forum State should specify here either that these Principles govern proprietary issues in respect of a digital asset or should specify the relevant Principles or aspects of these Principles which govern proprietary issues in respect of a digital asset];

(ii) to the extent not addressed by sub-paragraph (c)(i), the law applicable by virtue of the rules of private international law of the forum.

(2) In the interpretation and application of paragraph (1), regard is to be had to the following:

(a) proprietary issues in respect of digital assets, and in particular their acquisition and disposition, are always a matter of law;

(b) in determining whether the applicable law is specified in a digital asset, or in a system or platform on which the digital asset is recorded, consideration should be given to records attached to or associated with the digital asset, or the system or platform, if such

- records are readily available for review by persons dealing with the relevant digital asset;**
- (c) by transferring, acquiring, or otherwise dealing with a digital asset a person consents to the law applicable under paragraph (1)(a) and (b);**
- (d) the law applicable under paragraph (1) applies to all digital assets of the same description from the time that a digital asset is first issued or created;**
- (e) if a digital asset, or the system or platform on which the digital asset is recorded, expressly specifies the applicable law effective from a time after the time that the digital asset is first issued or created, proprietary rights in the digital asset that are established before the express specification becomes effective are not affected by the specification.**
- (3) Notwithstanding the opening of an insolvency proceeding and subject to paragraph (4), the law applicable in accordance with this Principle governs all proprietary issues in respect of digital assets with regard to any event that has occurred before the opening of that insolvency proceeding.**
- (4) Paragraph (3) does not affect the application of any substantive or procedural rule of law applicable by virtue of an insolvency proceeding, such as any rule relating to:**
- (a) the ranking of categories of claims;**
 - (b) the avoidance of a transaction as a preference or a transfer in fraud of creditors;**
 - (c) the enforcement of rights to an asset that is under the control or supervision of the insolvency representative.**
- (5) Other law applies to determine:**
- (a) the law applicable to the third-party effectiveness of a security right in a digital asset made effective against third parties by a method other than control; and**
 - (b) the law applicable to determine the priority between conflicting security rights made effective against third parties by a method other than control.**
- (6) Other law applies to determine the law applicable to the relationship between a custodian and its client.**

Commentary

1. It is recognised that a conflict-of-laws rule will always be imperfect. The aim of these Principles is therefore to improve the clarity and legal certainty surrounding the issue of conflict-of-laws to the largest possible extent.
2. Principle 5 addresses the applicable law for proprietary issues in general and is not limited to those issues that are covered by the Principles. The law of the forum determines what would qualify as 'proprietary issues'. This broad scope of Principle 5 is to prevent the issues covered by these Principles, which are limited in scope, being governed by laws different than those governing

proprietary issues that are closely connected with the issues covered by these Principles, but fall outside its scope. See, e.g., the issues listed in [Principle 3\(3\)](#).

3. Principle 5 recognises that the usual connecting factors for choice-of-law rules (e.g., the location of persons, offices, activity, or assets) have no useful role to play in the context of the law applicable to proprietary issues relating to digital assets. Indeed, adoption of such factors would be incoherent and futile because digital assets are intangibles that have no physical situs. Instead, the approach of this Principle is to provide an incentive for those who create new digital assets or govern existing systems for digital assets to specify the applicable law in or in association with the digital asset itself or the relevant system or platform. This approach would accommodate the special characteristics of digital assets and the proprietary questions concerning digital assets that may arise.

4. Principle 5(1) provides a 'waterfall' of factors for the determination of the applicable law. Under Principle 5(1)(a), the applicable law is the law of the State specified in the digital asset itself. If Principle 5(1)(a) does not apply, the applicable law is that of the State specified in the system or platform in which the digital asset is recorded. Those choice-of-law rules are based on party autonomy. This approach is appropriate because Principle 5(2)(c) treats every person dealing with a digital asset, and who could be affected by a determination of a proprietary issue, as consenting to the choice of law rules in Principle 5(1) (see also paragraph 10 below). Such persons will know about the specification of the applicable law, since it will be in records readily available for review by such persons (see Principle 5(2)(b)). (Moreover, although many digital assets, or systems or platforms, currently do not include a specification of applicable law, the rules in Principle 5(1)(a) and Principle 5(1)(b) provide an incentive for such a specification to be included. This reliance on party autonomy is consistent with Article 3 of the Hague Conference Principles on Choice of Law in International Commercial Contracts ('Hague Conference Principles'). It would also be possible for a digital asset, or a system or platform, to specify that the UNIDROIT Principles (supplemented where necessary by the law applicable by virtue of the rules of private international law of the forum) would be the law applicable to proprietary issues.

5. At the bottom of the 'waterfall', in the absence of a specification made in the digital asset or the system or platform as contemplated by Principle 5(1)(a) and Principle 5(1)(b), Principle 5(1)(c) provides a state with a considerable degree of freedom to choose the appropriate rules for a forum sitting in that state. An overarching consideration is the fact that in many cases the digital asset may have no significant connection with any state. It is not feasible to specify in Principle 5(1)(c) a definitive, "one size fits all" approach to be applied by the forum to proprietary questions in respect of a digital asset. Paragraph (1)(c) provides for two Options (A and B): each includes the provision of some or all of the Principles to such questions. Because these Principles are generally accepted on an international level as a neutral and balanced set of rules, their application at the bottom of the waterfall is appropriate (see Article 3 of the Hague Conference Principles that 'allows the parties to choose not only the law of a State but also "rules of law", emanating from non-State sources.')

6. Within each option in Principle 5(1)(c), there is a 'waterfall' set out in sub-paragraphs. The wording inside the square brackets found within the various sub-paragraphs explains what content the forum state should include within that square bracket, in order to specify what legal provisions apply in respect of proprietary issues in relation to a digital asset.

Option A

Option A recognises that a state may determine that it is appropriate for the forum sitting in that state to apply some aspects of its own domestic laws. This might be the case, for example, if the state has adopted laws that deal specifically with proprietary issues relating to digital assets. The aspects of domestic laws form the first part of the waterfall (Principle 5 (1)(c)(i) of Option A). Within this sub-paragraph, the state should specify those aspects of its domestic laws that should be applied, as a matter of Private International Law in respect of proprietary issues in relation to a digital asset. The second part of the waterfall, in relation to matters not addressed by paragraph (1)(c)(i), is

comprised of either the (entire) Principles, or some Principles or some aspects of the Principles. Which of these is the case should be specified by the forum state within Principle 5 (1)(c)(ii). The third part of the waterfall, which applies to the extent not addressed by other clauses, requires the forum to apply the law otherwise applicable under its private international law rules.

Option B

8. Option B consists of the second and third parts of the waterfall set out in Option A. It therefore is suitable for a state which determines that proprietary issues relating to digital assets should be determined only by the Principles or some portions thereof, without any reference to substantive domestic laws. This might be the case, for example, if the state has not adopted laws that deal specifically with proprietary issues relating to digital assets.

9. By making reference to these Principles, Principle 5 provides an innovative means of permitting a forum to adopt the Principles for persons and matters subject to its jurisdiction when Principle 5(1)(a) and Principle 5 (1)(b) do not apply. The adoption of Principle 5 would accommodate the wish of a forum to adopt the Principles in such situations. In particular, the forum would apply the Principles even when the substantive law of a forum state itself otherwise would apply, without the potential delay and complexity in making substantial revisions of otherwise applicable local private law. Indeed, a forum state might choose this approach either as its primary means of adopting the Principles or as an interim approach. Of course, if the relevant digital asset or system specified the substantive law of the forum state (which would thereby apply under Principle 5(1)(a) or (b)) it is reasonable to assume that the forum state would have adopted acceptable substantive rules such as those exemplified by these Principles. Principle 5 leaves considerable flexibility for a state to craft choice-of-law rules that conform to its policy judgments and are compatible with its domestic laws.

10. Paragraph (2) provides additional guidance on the interpretation and application of Principle 5(1)(a) and Principle 5(1)(b). Principle 5(2)(a) confirms that law applies to a proprietary issue regardless of whether (i) the participants in the relevant network refute the application of any law and exclusively want to rely on code, and (ii) the application of the law is said to be too complex or to produce unclear outcomes or to disrupt the functioning of the network, as a consequence of the nature of the technology, or of the international character of the network. Principle 5(2)(b) makes it clear that a specification of applicable law in a digital asset, or in a system or platform, can be determined by looking at records attached to or associated with the digital asset, system or platform, but only if such records are readily available for those dealing with the asset. Persons dealing with the asset, who will be able to view these records, are treated, by virtue of their dealing, as having consented to the specified applicable law: this is the effect of Principle 5(2)(c). Principle 5(2)(d) and (e) provides that the specified applicable law applies to all digital assets of the same description from the time the digital asset is created or issued, but if a law is specified from a later time, pre-existing rights in the digital asset are not affected. Principle 5 concerns only choice-of-law issues and does not address the question of the jurisdiction of any tribunal over a party or the subject matter at issue.

11. Principle 5(3) makes it clear that in an insolvency proceeding Principle 5 should be applied to proprietary questions in respect of a digital asset. Principle 5(4) provides the usual exceptions that defer to the applicable insolvency laws. These exceptions are discussed in the commentary to [Principle 19](#), paragraphs 7 to 10. It should be noted that the term 'control' in Principle 5(4)(c) is used in a broad sense, and not as defined in [Principle 6](#) (see commentary to [Principle 19](#) paragraph 4).

12. Principle 5(5) recognises that the approach taken in Principle 5(1) would be inappropriate to determine the law governing a registration system for security rights, which must be based on objective indicia (such as the location of the grantor) that could be determined by a third-party searcher of the registry.

13. The recognition mentioned in Paragraph 13 is given effect to in Principle 5(5) by providing that other law (in this case, the conflicts of law rules contained in other law) determines the law applicable to third-party effectiveness of a security right in a digital asset made effective against third parties by a method other than control. In addition, because the same law also needs to govern priority between two or more such security rights, Principle 5(5) provides that other law determines the law applicable to determine priority between such conflicting security rights. If however, one conflicting security right is made effective against third parties by control (even if it is also made effective against third parties by a method other than control), Principle 5 does apply to determine the applicable law.

14. Principle 5(6) makes it clear that Principle 5(1) does not determine the law applicable to the relationship between a custodian and its client. This question is determined by other law (in this case, the conflicts of law rules contained in other law) because it is appropriate for one law to apply to that relationship, rather than different laws, as might be specified in different digital assets or different systems or platforms as contemplated by Principle 5(1)(a) and Principle 5(1)(b). By excluding the custody relationship from the application of Principle 5(1), it is not suggested that this Principle does not apply to proprietary issues such as where a custodian acquires a digital asset or where the issue to be determined is whether the client is an innocent acquirer of a digital asset (see [Principle 12](#)).

15. Where a digital asset is linked to another asset, other law (in this case, the conflicts of law rules contained in other law) determines the law applicable to determine the existence of, requirements for, and legal effect of any link between the digital asset and the other asset. These matters are determined by other law under [Principle 4](#).