From: Martinson, Pamela <pmartinson@sidley.com>
Sent: Tuesday, November 15, 2016 6:10 PM
To: Hughes, Sarah Jane
Subject: Thoughts on Article 8 and the Virtual Currency Act draft

Hello – I have done some noodling over Article 8 and whether to extend its protections to our Act. I do think that we need to include specific duties of the virtual currency business (VCB) vis a vis its customers, similar to those contained in UCC Article 8. Specifically, the duties contained in Section 8505 – 8508 to exercise rights as directed by an entitlement holder, and to comply with the directions of an entitlement holder, are needed in the Act.

If we accept that protecting investors (consumers) from the wrongful acts of their intermediaries (those who hold an asset on behalf of a consumer) is a critical purpose of the proposed Act, then we need to address whether adequate protections exist outside the Act or whether certain protections should be included in the Act. Outside of the Act, remedies in tort for the **conversion** of the virtual currency may be limited. The law contemplates a loss of tangible property. (Restatement (2d) Torts 222A). While there is significant support for the view that intangible property also carries value, and interpretations have stretched to protect intangible property represented by a tangible item (e.g. stock certificate, savings passbook), the case law is still divided, making recovery for conversion of virtual currency uncertain at best. We could provide that the virtual currency be merged with a document (a virtual currency certificate?), but that would defeat the purpose of having a virtual asset and run counter to the beauty of the blockchain. A paper requirement would not allow the distributed technology to operate as intended.

An equitable lien may be possible if we include duties of the VCB in the Act, and the VCB fails to perform these duties.

So, UCC Article 8-type protections should be incorporated into the Act.

There appears to be general agreement that 8503 (Property Interest of Entitlement Holder in Financial Asset Held by Securities Intermediary) should be incorporated into the Act to express what Official Comment 1 to 8503 refers to as "the ordinary understanding" that the VC asset is not a general asset of the VCB, and is therefore not available to the creditors of the VCB.

8503 (d) and (e) are aimed at protecting transferees of the VCB. However, they outline the circumstances in which the customer may claim against a transferee, and are a valuable protection for that customer. [Con argument: The licensing scheme is meant to protect the customer and should be its sole source of relief. If the regulations do a good job of allowing only licensees who have financial means, no criminal history, and proper insurance, among other things, then the need for customers to have to go after transferees is limited. Prevention vs. remediation. I end up believing that this provision is not necessary for the Act.]

8504 (Duty of Securities Intermediary to Maintain Financial Asset) ensures that the level of assets necessary to meet entitlements is maintained. The Act approaches this issue in its requirements for a particular net worth, and the type of investments that are permissible. The Act (208(a)) specifies that a level of virtual currency sufficient to satisfy the interests of all users be maintained. No change is needed.

8505 outlines the duties of the intermediary with respect to payments and distributions owed to the customer. The Act approaches this through its Section 502 which calls for the establishment of user protection policies and procedures. Should the Act go further and specifically place a duty on the VCB to perform? I believe that it should. Without this, there is no ability to maintain an action for conversion. 8506, 8507 and 8508 are also worthy of inclusion in the Act, requiring the intermediary to act as directed by a customer.

There should be a private right of action, but only to the extent of the included Article 8 protections. A failure to comply with general terms of its license should not open a VCB to suit from its customers. Failure to perform as directed by a customer should give rise to the ability to sue the VCB. Because a customer's directions are specific to it, there is not the risk of class-action claims.

I look forward to hearing others' thoughts on this subject.

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