

Consumer Finance Monitor Podcast (Season 9, Episode 49): Digital Commercial Law in the Age of Digital Assets

Speakers: Alan Kaplinsky, Christopher Odinet, and Andrea Tosato

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr law firm. And I'm your host, Alan Kaplinsky, the founder and former practice group leader for 25 years, and now senior counsel at the Consumer Financial Services Group.

For those of you who want even more information about either the topic that we're going to talk about today, that I will describe to you in just a moment, or anything else in the world of consumer finance, please don't forget about our blog, which also goes by the same name as our podcast show, namely Consumer Finance Monitor.

We've hosted our blog since July 21, 2011, the very same day that the CFPB became operational, so there's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog or to get on the list for our webinars, please visit us at ballardspahr.com. And if you like our podcast show, please let us know about it. You can leave us a review on whatever platform you're using today to access our show.

And also, please let us know if you have ideas for any other topics in the world of consumer financial services, and whether we should consider inviting other speakers to be guests on our show. We have, from time to time, come up with ideas and speakers based on people just emailing me. Very often, however, I do get emails from a lot of other people that are promoting something. Usually has nothing to do with consumer finance. And unfortunately we're not a general podcast show. We're very much a niche show.

So let me talk about today's episode, because I'm very excited about it. I think it's one of the most important and timely subjects in the area of commercial law, namely the legal framework governing digital assets. Over the past several years lawyers, regulators, financial institutions, FinTech companies, and investors have devoted enormous attention to cryptocurrencies, stablecoins, tokenized assets, decentralized finance or DeFi, and blockchain technology.

Much of that discussion has centered on regulations, or the lack of regulations. Whether the regulations are being considered or promulgated by the SEC, the CFTC, the federal banking agencies, state regulators and, more recently, Congress through legislation such as the GENIUS Act. But today's guests argue that we've been looking at only part of the picture. And they've done what I consider to be a fabulous job in making that point in their new book called *Digital Commercial Law: Private Law in the Age of Tokens, Platforms, and Automation*.

The authors really make a very compelling case that, while policymakers have understandably focused on public law regulation, the real legal questions that determine who owns digital assets, who bears losses when platforms fail, and how transactions should be structured, they're fundamentally questions of private law.

Their work demonstrates that doctrines governing property, contracts, secure transactions, custody, bailments, trusts, and bankruptcy remain every bit as important in the digital economy as they have been in traditional commercial law. Let me say this at the beginning: The book is available on Amazon. It's readily available. I think it got published on Amazon about a month or so ago, so it is definitely available there. And I think you're going to want to pick it up if you're involved in this area because it's really, I think, extremely important.

Well, let me introduce our two guest speakers today, and the authors of the book. First I'm going to introduce Christopher, or I'll call him Chris Odinet. He is a very highly regarded legal scholar specializing in commercial and property law with a particular focus on digital assets and financial law. His research has appeared in leading Law Reviews and he's co-authored several case books. His book, *Foreclosed*, was published by Cambridge University Press in 2019.

Chris Odinet teaches at Texas A&M University School of Law and is active in numerous law reform organizations, having served as both the commissioner and a reporter for the Uniform Law Commission. He's also a member of both the American Law Institute and the European Law Institute. Before joining Texas A&M's Law faculty he taught at the law faculties of the University of Iowa, University of Oklahoma, and Southern University. So Chris, a warm welcome back. I know it's been a while since you've been on our show, but it's delighted to have you.

Christopher Odinet:

It's my absolute pleasure. I'm so happy to be here to talk about this project with you.

Alan Kaplinsky:

Okay. And joining Chris today is Andrea Tosato, who is another leading private law scholar whose work focuses on commercial law and emerging technologies. His award-winning scholarship has been published in leading law journals in both the US and Europe, and has been cited by many courts. Professor Tosato teaches at SMU, Southern Methodist University, the Dedman School of Law, and he has served as a reporter for the Uniform Law Commission and is an expert advisor to both UNCITRAL and UNIDROIT. I hope I pronounced them correctly.

He also serves as associate research director of the permanent editorial board for the Uniform Commercial Code, and contributed to the drafting of the 2022 amendments to Uniform Commercial Code. Before joining SMU he taught at the University of Nottingham and at the University of Pavia. Okay. Very warm welcome to you, Andrea. I know it's your first time on the show, so a special welcome to you.

Andrea Tosato:

Thank you for having me, Alan. I'm delighted to be here.

Alan Kaplinsky:

Okay. Well, I've got a lot of things I want to cover during our show, so let's get into it. And whenever anybody writes a book, particularly a book like the one that the two of you have written, I always begin at the very beginning and I ask, what motivated the two of you to write the book? Was there a particular development or series of events that convinced you that private law was missing from our conversation?

Andrea Tosato:

I think I can take this one, Alan.

Alan Kaplinsky:

Okay.

Andrea Tosato:

Life always has stories of human elements to them. Chris and I actually met for the first time in person in 2022 at a conference, the American Bar Association Business Law Section. In fact it was a common friend who introduced us, Carla Reyes, who was a colleague of mine at SMU. And it was around lunchtime and Carla had to go do something else, and so Chris and I just went to grab a bite together. And as we got to know each other we quickly realized that we shared certain common views about what was going on in the world of digital assets.

So I suppose that there was no single catalyst that drove us to write the book. We both had been sort of maturing, thinking about this space and what was going on and what we felt didn't work so well in this space independently. And then we met and we realized, hey, look. There's someone who looks at this space and sees the same things that I see. And so we quickly started working together on several projects, and eventually these projects bloomed into the book. So the story is we had been

involved in this space for quite some time independently. We ended up sharing very similar views and then, out of pure fate, we met. And it's all history from there.

Alan Kaplinsky:

So Chris, I'm going to ask you this next question and that is, your central thesis is that lawyers, regulators, and market participants have focused overwhelmingly on public regulation while largely ignoring private law. Why do you think that happened?

Christopher Odinet:

That's a very interesting question because it's such a part of the spine of the book. I think a little of it is this institutional gravity, if you will. I think, for the most part, financial regulators and public law folks, but I'll say financial regulators particularly, they kind of have the microphone. They certainly have the enforcement power. Your folks are consumer finance people, so they know the space all too well. They also tend to get most of the political attention.

The law of bailments and intangible personal property tends to show up a little less in the news, so I think that's naturally where the public conversation tends to go. I think part of it also has to do with the way in which crypto has sort of marketed itself from the beginning as something that operates outside of traditional legal categories. That's a little bit of the original ethos. Decentralized, self-executing, code is law, right? These are all of the mantras.

And I think that sort of encourages everyone, including lawyers, to assume that kind of ordinary, first year, 1L property and contract law, commercial law, payment law, et cetera just doesn't apply here. So I think that that institutional gravity is one. The other thing, and this is kind of a big critique in our book, is a little bit of a generational thing happening here. This makes me sound old, but I think secure.

After the 2008 financial crisis there was more of a focus, particularly in the legal academy, on financial law than what there had previously been in the past, particularly banking. Not just around corporate law, but around financial markets law. And I think that spilled over to where the securities and banking lawyers were the folks who got to the digital asset space first. And so the frame that they brought was a FinReg frame. It was a financial regulatory frame. Disclosures, registration, market conduct. That became the frame at the start, and so that became the default frame for everyone else, including judges and lawmakers.

Alan Kaplinsky:

Yeah. So I think you probably have already answered the question, at least implicitly, but let me ask you, Andrea. What exactly do you mean when you refer to private law? Are we talking about contract law? Common law more generally?

Andrea Tosato:

Yeah. This is another one of those things that Chris and I share. I would say that three, four decades ago it was very common to rely on a dichotomy or a division in law between public law and private law. And public law really is the whole body of rules that governs the relationship between an individual and the State, whereas private law is sort of the other side of the sphere, is the rest of the sky. And that is to say it's the whole body of rules that governs relationship between individuals.

And so this spans from contract, which is really about voluntary obligations. So if people exchange promises, and those promises are binding, and all the rules governing that. Or tort, whereas someone incurs an obligation that is involuntary because they've done something that caused harm, et cetera, et cetera. So for us, but I think, again, we're tapping really into three millennia worth of legal tradition. Private law is really the whole body of rules governing relationship between individuals.

So when the state is not involved. And this goes back to the answer that Chris gave you. Really we found, and this was the common intuition that we shared, we felt that, when looking at digital assets, everybody, or the vast majority of the attention was between individuals and the state. How governments, how regulators were trying to attack this space and creating rules for this space.

And we felt that insufficient attention was being devoted to the rules that govern the interactions between those who are sort of holding these digital assets, selling them, using them as collateral, me entrusting a digital asset to Chris for custody. All of these are private relationships or interactions between individuals in which the state is not involved. And so when we say, "Private law," we speak of this body of rules. And the message that the book sends is, don't forget about the fundamental importance of these rules.

Alan Kaplinsky:

The application of the Uniform Commercial Code. Would that be considered a private law or would that be a... It's a statute, obviously, but it tends to govern the relationship, not with the government so much but among individuals.

Andrea Tosato:

Correct. The UCC, the Uniform Commercial Code is firmly a private law statute. It sets rules that apply to individuals in their relationships. It is not a statute that defines relationships between an individual and the state, an individual and the government.

Alan Kaplinsky:

Right, right, right. So Chris, one of the book's first questions that you grapple with is whether digital assets constitute property. Why is that such a foundational issue?

Christopher Odinet:

The reason why that matters so much is because kind of everything downstream really depends on that. You can't have, for instance, a bailment. In many ways you can't have a secure transaction or bankruptcy priority or a meaningful sort of theft conversion claim unless you, to some degree or another, grapple with that underlying thing. And part of that grappling is to recognize, and then the consequences that follow, whether the thing is considered to be property in the first place.

So in the United States courts have, and we go into this in great detail in some of the early chapters of the book, which are kind of the foundational chapters, courts have generally gotten to a yes on that question for things like Bitcoin. But the analysis when they've gotten to yes is often either very thin or it's kind of missing entirely and it's just kind of treated like a fait accompli.

Of course it's property. But that analysis has gotten more difficult when you get to the contours of non-fungible tokens, or NFTs. Tokenizing real world assets. Or purely contractual tokens, if I could use that phrase, that represent, maybe, a claim rather than an asset. This is all to say if the property characterization is wrong or undeveloped or even sort of unstable then, in that way, the entire legal architecture that is built on top of that, so that's custody, collateral, inheritance, how you treat something in an insolvency proceeding. That's all sort of built on sand.

Alan Kaplinsky:

Yeah. Okay. So you argue in your book, and I'm going to ask this, direct this question to you, Andrea, that many lawyers mistakenly assume that contracts can accomplish far more than they actually can. Could you explain the difference between contractual rights and property rights?

Andrea Tosato:

Yeah, no, absolutely. And this is kind of the second core contribution, second core element of the book. The first is, as we said a moment ago, trying to rebalance public law and private law. And the second is when we say that the little attention that has been devoted to private law in this space tends to be completely focused on contracts. And there is this mistaken view that is really embraced by some practitioners that, in this space, you can do everything via contract and software.

The classic example is I create a token on a blockchain and I go on to say that this token... By way of contract I say that, "This token, my terms of service, I say that this contract represents ownership of the Brooklyn Bridge." And I now say, "Look. By

transferring on the blockchain this token to you, here we go. I've transferred ownership of the Brooklyn Bridge." And this is an extreme example that I'm giving but, really, if you look around, especially at some of the things that we've seen over the past two, three years, this example is not that far from what we saw in reality.

And the point that we make in the book is market participants should not forget that contracts are agreements, agreements between parties, and they bind those two parties and no one beyond that. Property rules bind the world. The way in which ownership of land, or even ownership of a car, the way in which that works, that is established by law. The contours of that property are determined by statute, by the state in a sense, and parties cannot remake property as they wish. So the rules for transferring land, the rules for transferring a home. Those are set out and cannot be changed simply by an agreement between two parties.

And this issue of differentiating between contractual rights and property rights, with contractual rights only binding the two parties to the contract and property rights binding the world, this is one of those core fundamental tenets of private law that students should learn in their first year of law school but that gets very, very easily forgotten. And in the book we go through certain key sort of case studies, some involving NFTs that supposedly are linked to artwork, or NFTs or other tokens that are linked to real estate. And we show that you have these terms of service that make these grand claims that the token does this, the token does that and transfers this rights and those rights. And really, that is not the case. The terms of service can say whatever they want. An agreement between two parties can work as the case may be between those two parties, but not beyond. And so in order to have those effects against the world, you need to be dealing in property rights and following the rules of personal property or, if it's real estate, following the rules that apply to real estate.

Alan Kaplinsky:

Let's talk about custody. When customers leave digital assets with an exchange or a custodian, what legal relationship is actually created? Let me ask you, Andrea, if you could handle that one.

Andrea Tosato:

Yeah, I'd love to. And this is one topic that we explore in the book extensively in the third chapter. We have a chapter devoted to custody. And that Chris and I are still exploring today, even in greater depth. And here the point is simple, really. Digital assets, especially all the digital assets that have become so popular in these blockchain networks; Bitcoin, NFTs, stable coins, they were all designed, and were presented as disintermediated.

People could hold them directly without relying on anyone, and that this was going to be one of the great selling points of this technology. Well, it turns out that, even though there are some people out there who like to hold these assets directly, the vast majority of people out there, dare I say the vast majority of consumers, actually rely on custodians to hold these assets. And so this question as to, what is the nature of the relationship between a customer and their custodian? The relationship between, say Coinbase and its customers, or any one of these platforms, is super important.

And the problem here is that we have a vast body of rules dealing with this, but there are trust. The most ancient body of rules dealing with this is just bailment, the idea that you entrust a possession, a tangible asset, to someone and, in so doing, you end up being in a bailor-bailee relationship. And for other forms of property we have more specialized body of rules. So for securities we have UCC Article 8. Kind of broad body of adjacent rules. For money, we have all The rules that govern money deposits, right? For digital assets, this question has been ignored by practitioners and legal academy. And when did things really come to a halt? When around 2022, 2023 a bunch of crypto platforms, the business model of which largely relied on taking digital assets in custody from customers, they went bankrupt. And so suddenly, up to that point, everybody had kind of went with the flow.

Well, I'm just transferring my assets to this platform, and they've been making all these promises to me. They're going to give me all these benefits. They're going to return even more assets to me. Suddenly bankruptcy comes and now the question is, okay, wait a minute. What was actually going on here? And the crucial question is, when the customer entrusts, when a person entrusts a digital asset to someone else, do they retain ownership of it, as is the classic case in an old school bailment, so that if the custodian goes bankrupt, they can go back and reclaim the asset that was left in custody?

Or is this relationship between a customer and a crypto platform one of, so to speak, debt-creditor, the same kind of relationship that people have when they deposit money in a bank, and that therefore requires FDIC insurance and all that? And in the book we go through the history. We explain why digital assets are particularly complicated because they're intangibles. A lot of the bailment law relies on transfer of possession. And we kind of try to entangle all of this and propose solutions.

But the most important thing, I think, from this chapter is really how powerfully it presents the private law, public law interface. Everybody was focusing on the public law financial regulation rules that should apply to these platforms. The disclosures they have to make, the contracts that they have to give or the conduct that they maintain. And nobody was focusing on the very basic relationship between the platform and the customer. When the customer entrusts the digital asset, what kind of transaction is this? Who remains? Who is the owner of a digital asset? Is it the platform or is it still the customer? What happens in a bankruptcy? Who has priority? All these are private law questions.

They are essential both for the platform, but especially for the individuals who are involved. All of these are private law questions that have been, I think ignored, culpably so. And when the bankruptcies occurred, so many people suffered. And again, the book makes the case of understanding. So first identifying the problem, identifying it as a private law problem, then understanding which private law rules give you the answers. And in the book we also make... We advance, and I won't bore anyone here, but we advance some reviews as to how we think things could be fixed, how things could work a little better, which kind of pathways are available today to market participants.

So we try to also kind of give some practical answers as well as some normative answers. But really, if I can repeat myself, the real point is everybody was looking in the wrong direction. Everybody was focused on not the wrong thing, but they were only focused on one thing, and they ignored that fundamental private law relationship.

Alan Kaplinsky:

So did you in the book... And maybe I'll direct this one to you, Chris. Did you conclude that these custodian relationships were really more like a true bailment? Or were they a debtor-creditor relationship?

Christopher Odinet:

Much like Andrea mentioned, these are kind of the two roads. And we looked closely at many of these bankruptcies and the short answer is, most of the time, they were debtor-creditor relationships. In other words, most of the time the agreement between the parties, so you would look at the terms of service between the customers and platforms. The actual language of the custody or the terms of service would generally either explicitly say, "These are owned by the platform. You only have a claim for a return of the thing."

And sometimes they would even go so far as to say, "In the event of the insolvency or bankruptcy of this platform, we do not or we cannot guarantee you return of your assets." So that's one bucket which makes it kind of easy for a court to say, "This is a debtor-creditor relationship." But then there were many other instances. And I would say this is poor lawyering. So this is on our profession. This is on us.

And this is one of the things that we hope the book does, is to spur more rigorous lawyering in the drafting of the terms of service and the representation of these platforms, because there was a whole other set of platforms in our study, in the chapters where the terms of service actually contradicted themselves or created these really opaque impressions of, what exactly was the nature of the way in which the digital assets were being held by their customers? Sometimes part of the terms of service or, and I will note for many of these platforms the terms of service would actually be several different documents denominated differently but taken together, represented the agreement of the parties. And they would sometimes have conflicting provisions where, some components of the terms, the language made it seem as though the customers maintained a property interest.

It was like parking your car in the parking garage. The parking garage company does not own your car. In other ways it seemed a whole lot more that you were actually handing over ownership to the platform. They were going to do things, maybe lend out, engage in various transactions with your stuff and, in exchange for that, you were going to get some kind of yield. But you did expose yourself to credit risk and solvency risk. So-

Alan Kaplinsky:

Chris, do you think the consumers who got involved in giving, let's say Coinbase, custodianship of a certain crypto that they have purchased, that they understood they were giving up ownership? Or do you think, aside from what was in the agreement, because who's going to read the terms of service? What do you think-

Christopher Odinet:

No, that's a great question. And I recognize that this is an empirical question.

And we did not conduct interviews of aggrieved customers in the various bankruptcies. One could do that. But I think it is a pretty easy position to defend, that most average everyday retail users of these platforms did not appreciate that there was a chance that, if the platform became insolvent, they would just be an unsecured creditor. I think that they probably had a very clear understanding that they were engaging in an investment and that perhaps they would end up having purchased this particular crypto asset for more than what it would ultimately be worth, but I don't think that they would've anticipated that they would be exposed to the insolvency risk of the platform such that the upside of an increase in the digital asset would really not enure to their benefit. It would just stand in line like all other unsecured creditors.

And I think that probably has something to do with the fact, this is just an intuition, that individuals typically deal in digital assets like they are investments, like they would in their Edward Jones or their Vanguard account. And it feels like that's what you're doing. You're, like, investing in stock. You're investing in a digital asset. Buy low, sell high.

You have this impression that it's an investment and that you're dealing with sort of a broker-dealer type scenario because that's sort of the same motivation. And in fact, in some ways, the platforms have a similar feel. They'll even have a ticker to tell you what the digital assets that are trading on the platform are valued at that day. But those are two different legal regimes. When you're dealing with a broker-dealer for securities, not only is there SEC registration, but there's a whole body of private law. Andrea mentioned it earlier, Article 8 of the UCC, which is the indirect securities holding system that creates all of these insolvency protections for you and me and everyone who holds securities accounts. That does not exist in that crypto space.

Certainly as a default matter, it does not exist. So I think that's a disconnect for consumers. It feels like you're dealing in those same sorts of transactions, but that invisible private law substructure with a regulatory overlay does not exist over in the crypto space.

Alan Kaplinsky:

Right. Right. Let's turn now to stablecoins. They've become one of the hottest topics in financial regulation. And it's really the enactment of the GENIUS Act that tried to create some certainty with respect to people who were purchasing stablecoins. Andrea, let me ask you this: What private law issues make stablecoins unique? Maybe, first of all, we shouldn't assume everybody knows what a stablecoin is. So maybe if you could just give a very brief definition of a stablecoin.

Andrea Tosato:

Right. Yes, absolutely. Stablecoins are, in a sense, the response of the blockchain world to the problem that early cryptocurrencies are so volatile. So Bitcoin famously came to be, was created to serve as a currency, but has never been successful as a currency because its price moves too much, and an asset cannot work well economically, as a currency, if it's too volatile. And so the blockchain world answered this problem by saying, "Well, we still want to use the blockchain technology for something that operates as a currency, but we have to invent something that is alternative to Bitcoin."

And the response were stablecoins. And the idea is quite simple. A stable coin is a digital asset, the price of which whose price is pegged to another asset. And the simplest example is creating a stablecoin that is pegged to the US Dollar, whereby one token equals \$1. That's what a stable coin is supposed to be. Now, there are very many stablecoins out there. And the way in which this is achieved, so the stabilization mechanism, the way in which the issuer of a stablecoin ensures that the token remains pegged in price to the Dollar, the way in which this is achieved technically and economically, varies enormously. But the two leading stablecoins by market supply, which are Tether and Circle, they adopt a pretty similar model, which is actually, historically, nothing new under the sun.

People had figured this out in the 18th century. It is very simple, and that is the issuer of a stablecoin holds in reserve \$1 for every token that it is creating and putting out in the world and, concurrently, it provides a promise. It says, "Look, we are a stablecoin issuer. In our vault in the basement of our business, we hold one Dollar bank note for every token that we are putting out in the world out there. And at any moment in time, if you come back to us with one of our tokens, we will in exchange give you back a \$1 bill." This is the basic proposition of stablecoins today. So you're getting the benefits of the technology. You're getting to use the blockchain rails. You transfer these tokens whenever you want to settle some kind of obligation where you owe Dollars or you owe something else. And the value of a stablecoin is pegged to the US Dollar through this reserve exchange mechanism.

And I think that if I did a decent job at describing the basic mechanics of a stablecoin, the private law problem should immediately jump out. And that is, okay, so the whole stablecoin architecture here relies on that promise. The promise that the issuer is making when the issuer says, "If you come back to us with a token, we promise to give you back \$1 in exchange." That is a clean contractual promise, and that is 100% private law.

And once again, one of the points that we make in the book, the GENIUS Act aims to create in the United States a landscape to regulate and standardize how stablecoins work, and create a more predictable and transparent framework. And that is all great. And in the book, and in a more recent paper that we have co-authored. Again, it's me, Chris, and our friend Yesha Yadav, which is called The Minus of Stablecoins. And it's forthcoming in the Yale Law Journal.

We really analyzed the GENIUS Act, and we say, "Look, the GENIUS Act does a number of things well when it tries to create rules on how stablecoin issues should behave." So the conduct rules and the rules of the reserves and all that. But when it comes to the central private law problem, that promise, the so-called redemption right, the right that a token holder has to demand \$1 back in exchange for that token. That private law right has been not ignored, but not considered with sufficient attention.

The GENIUS Act pays very little attention to it. Prior to the GENIUS Act, market practices are horrible. And so when you dig into the terms of service of different stablecoin issuers you discover that, yeah, they're promising that they'll give you back \$1, but then they start adding caveats. Again, from a consumer perspective I think this is super important to understand. First of all, they say, "Look, we will actually only give you \$1 back if we have a previous relationship with you. So you either have already an account with us..." And they don't give accounts to everyone. In fact, they give very few accounts. Or you can't redeem in the first place.

Even if you have an account with them, it then turns out that this right of redemption is subject to a really long list of caveats and conditions. And they can suspend it, they can delay it. They're supposed to give you \$1 but if it turns out that, if there's market turbulence, they can suspend that redemption right for as long as they want. And again, this is that core private law relationship that exists between the holder of the token and the issuer. And then there are some even more complex private law problems. And that is this redemption right, this promise to exchange the token for \$1, does that actually travel with the digital asset in the same way in which an order of payment travels with a check?

Or are we again in one of those situations in which market participants just made a bunch of contracts and said, "This is all going to work the way we say it does," but then when you pass it to close scrutiny on the property rules you discover that there are many failings. And in the book we show that, unfortunately, there are many failings. And again, it's not all bad. But people sort of operating and holding stablecoins should be aware that there are some issues, some very significant. And the GENIUS Act settles some but not others. But I think that I should really let Chris come on on this one, because he's also done so much work on stablecoins and the bankruptcy of stablecoins and all that. So maybe, Chris, you'd like to add something here?

Christopher Odinet:

I think we'll let Alan go to the next question. We could talk about this for a long time but, Alan, if you want to have us back to talk about the money in this paper, we could talk about this forever.

Alan Kaplinsky:

Yeah, yeah, because we do have a lot to cover. I want to talk now about tokenization. What does tokenization actually accomplish from a legal standpoint? And what does it not accomplish?

Christopher Odinet:

Yeah. Tokenization. My gosh, that has been probably one of the hottest terms thrown around in the digital asset space aside from stable coins although, as Andrea said, there's even a tokenization component to the stablecoin market as well. So what is tokenization? Nothing new. Tokenization in this context would be the process of creating a digital asset recorded on a blockchain or some sort of similar ledger that is meant to actually embody a right or an interest in something else. Writing out real estate, a debt instrument, a bankruptcy claim, a piece of art, a share of a fund. That's sort of the idea.

The pitch is that tokenization is going to make something that was previously illiquid or a hard-to-transfer asset really easily tradable and divisible and programmable, et cetera. Now, what tokenization does not automatically do, and this is really a central point of one of the chapters in our book on that subject, is to create these new self-executing, if I could use that word, legal right. So the token is a representation. Whether that representation actually carries with it an enforceable legal right against third persons with respect to some kind of underlying asset. That depends totally on the legal structure connecting the token to the asset that was built. And what that means is there needs to be some law that allows you to merge rights in this thing with this digital asset. It is not something that you can just do by freedom of contract.

Alan Kaplinsky:

Right, right, right. So does placing an asset on a blockchain change the underlying ownership rights? Or is it simply a different method of recording what those rights are? Andreas?

Andrea Tosato:

I'm going to give the classic law school answer. It depends. But as a general rule, the notion of placing an asset on the blockchain, I'm not even sure that that totally works. And equally, recording rights on a blockchain, that only has significance insofar as you have the law saying as much. Code is not law. So to make this sort of concrete, I can create a token and say that, "This token represents ownership to a painting." This does not change the fact that the painting is a tangible corporeal object and that, if someone tries to buy and sell that painting, the general body of rules that applies to the buying and selling of tangible things applies to it, so UCC Article 2.

The fact that I concurrently created a token, that that token is on the blockchain, that I'm moving that token around and then I'm saying a bunch of things that that token might or might not do does not change the underlying fact that the buying and selling of the painting is governed by the usual body of rules to buy and sell things. Equally, if I have sort of a ledger, if I hold an Excel spreadsheet in which I record things, the law tells me the legal relevance of that record.

The law allows me to use whatever technology I want to hold that record. I can do it on a piece of paper, I can do it on Excel spreadsheet and, yeah, I can do it on a blockchain as well. But the legal significance, the consequences, everything about that record is established by the law. So the fact that I hold my books, my accounts on a piece of paper or an Excel spreadsheet or on a blockchain makes no difference. That's just the medium. And there is no new set of rules that automatically apply.

There is no new rights or leeway or powers that I suddenly grasp simply because I'm transferring records on a blockchain, unless the law says so. Unless you have a statute or a holding of a common law court that says, "Okay. Because you have done A, B, C, D, now the body of rules changes." And to a limited extent we have seen a little bit of this starting to happen. We have seen some states enact statutes that create new asset-specific rules for digital assets, for DAOs, and similar.

But the key point here is this is not something that market participants can do freely as they wish simply through their terms of service or some other contractual agreement. And unfortunately many fail to recognize this limitation. And so the answer about tokenization is, so long as you try to link a token to an asset in the real world, be it a painting, a vintage car, or Apple shares, you can do it insofar as the law allows for it. And there are many ways in which one can operate within the confines of the law and have these transactions work from a property law perspective. But if you step outside of those boundaries, the transaction, the scheme that you are effectively creating no longer achieve those results. And from a consumer perspective,

that's really the big problem, that a lot of people out there are exposed to these schemes, to these new technologies. And they think that they are getting something only to discover that actually, in law, they don't because there is no framework supporting this whole castle that the issuer or the market participant purportedly was providing.

Alan Kaplinsky:

So your book devotes a lot of attention to secure transactions. Why should banks and lenders care about Article 9 of the UCC in the digital assets space? Chris, you want to take that one?

Christopher Odinet:

Sure. I'm happy to take this one. And I'm sure Andrea will have quite a bit to say about this because, although we both participated and contributed to the drafting of the 2022 amendments, Andrea was very much hands-on with the portion of those amendments dealing with digital assets and how they become collateral. So of course any commercial law scholar, and I would hope any lawyer, any commercial law lawyer, and I would hope any lawyer generally, knows that Article 9 of the UCC governs secured transactions, so security interests in personal property. And now, since the 2022 amendments, there are these sort of explicit tools in the UCC for collateralizing digital assets. That's the 2022 amendments, which created this new type of subcategory under general intangibles called controllable electronic records. Sort of a distinct collateral category that exists alongside the others.

And essentially, the new rules allow a secured party to perfect a security interest in certain digital assets through control, in some ways similar to how you would take possession of certain types of goods or similar to how you would take control. Control exists in the context of taking a security interest in securities or deposit accounts, et cetera. And this is in lieu of relying upon the traditional way that you perfect a security interest in general intangibles, which was just to file a financing statement.

So why does this matter? Well, it matters pretty enormously in practice because control-based perfection generally produces superior priority over perfection that is merely filing-based. And getting that wrong as lender's lawyer could mean that a secured lender discovers only after a default occurs that their security interest is actually subordinate to someone else's.

Alan Kaplinsky:

So after you completed your manuscript, and then the GENIUS Act was actually enacted after it to regulate payment stablecoins. Does that legislation address any of these private law concerns that you've identified? Or does it largely reinforce your thesis that public law regulation alone isn't enough? Chris?

Christopher Odinet:

It helpfully for us but unhelpfully for, I guess the larger market, I think very much validated our book. The GENIUS Act was passed in July, while we were finishing the book up. So actually, the penultimate chapter of the book, which deals with stablecoins, does have an analysis of the GENIUS Act in it.

We then said a little bit more about that in a subsequent article that we've referenced with our colleague, Yesha Yadav, a couple of times in this podcast. But stepping back and just talking about the GENIUS Act, it is without a doubt, unmistakably a financial regulation statute. It sets up licensing and reserve composition rules, supervisory authority over the issuers. And it does have some attention to private law components of the issuer-customer relationship. So in that way, although it is primarily a financial regulation type statute, it does pay some attention to private ordering. But as we detail in the book, and then even more fully in the subsequent paper, there are plenty of places where either it just ignored a private law problem in that market or it addressed it but it addressed it very poorly. So I'll give you two examples of that.

One is the question that Andrea raised earlier. You have a stablecoin, but of course the big thing that you also need to have is the ability to hand that stablecoin back to the issuer and get \$1, the redemption right. That's like the core of the entire business model, the proposition. So you would think that the question of whether or not the redemption right is merged with the token would be answered by the GENIUS Act. In other words, the GENIUS Act would say, "If you buy a stablecoin from one of our approved issuers, you have the right to redeem that token even if you bought it on the secondary market. Even if you

didn't get it from the issuer." That question is still open in the GENIUS Act, whether the right of redemption is like this contractual right subject to the law of assignment and the stablecoin is actually governed by Article 12's rules on transferring controllable electronic records, or they're put together is an open question, which is kind of wild considering that the redemption right is really the crux of the entire proposition.

So that's one place where it just sort of didn't answer that question at all in any kind of direct way. In a place where it did try to address a private law problem but did it in a really poor way is what happens when there is an insolvency. So what happens if an issuer becomes bankrupt? What is the priority position of the customers? The GENIUS Act says the reserve assets, which are the things that are held in the vault in the basement to make good on the redemption right, to use Andrea's analogy, those are separate and apart from the bankruptcy estate of the issuer. So basically, the creditors of the issuer can't get at those reserves.

Instead, the only people who have a action to get those reserves are the customers. Okay. Well, that sounds good. However, if there is a shortfall in the reserves, meaning the reserves, they're not valued at enough to make good on all of the redemptions, then the customers have a superpriority claim over the issuer's assets to get paid for that shortfall. So that sounds good. So you're imagining that the reserve assets are there but they're not worth enough to liquidate and pay all the customers. So the customers get to then go after the issuer's assets ahead of any other creditors that the issuer has.

The problem with that is the superpriority given to the customers is over every single other party to the bankruptcy, including the lawyers, the trustee, the professionals who would make the bankruptcy actually happen, particularly for a reorganization.

So in this way, it's very possible that if the float is really that big in the shortfall, no lawyer will ever take the bankruptcy of the issuer. And so in that way the issuer is sort of administratively insolvent and there can be no bankruptcy at all, which is just to say, for having tried to address a private law problem, they did it in a way that really evidenced that they didn't understand the private law insolvency regime.

Alan Kaplinsky:

Yeah. Well, thinking more broadly, Congress is continuing to debate comprehensive digital asset legislation, although it's beginning to look like nothing's going to happen imminently. Are lawmakers paying enough attention to commercial law principles in this latest bill?

Andrea Tosato:

Well, that's always very hard because part of the answer requires predicting the future. Let me put it this way: I think that, following the GENIUS Act, some of the proposed... The GENIUS Act requires certain federal agencies to issue rules to support the implementation of the GENIUS Act. And we have seen the FDIC, we have seen the OCC. We have seen several federal agencies approach this task paying attention to private law. They have proposed rules out there. They've put out public consultations.

So when we saw this, I think that both Chris and I, we thought, okay, well, this is a good sign. Maybe they've listened to us. Or in any event the trajectory is starting to change a little bit, so that's good news, at least regarding the GENIUS Act. I think that you are, for the most recent legislation, I think that you're probably referring to the draft CLARITY Act that is going through Congress at the moment. I think that that is still very much in flux.

Some of the things in CLARITY show some attention to private law issues. So for example, as it stands today, CLARITY does pay some attention to the custodial problem. And it tries to introduce roles so that, by mandatory rule, when customers entrust digital assets to these platforms, they retain a property right which would make it so that, in case of a bankruptcy, they don't become unsecured creditors. That's good news.

The bad news is that, again, as it stands today the draft of the Act is, how shall I say this? Perhaps it can be improved. It's a little clumsy in how it's addressing this problem. But more broadly speaking, I fear that CLARITY continues to be very much dominated by financial regulation concerns. But to be fair to them, it is presented as a market structure bill, and that is perfectly fine.

What would be even better, however, would be if such an act, so a market structure act, were built on knowledge and understanding of private law. This is again one of those themes, one of those drums that we keep beating in the book. There is

no opposition, there is no conflict between financial regulation and private law. Private law is just setting the groundwork. It's just laying the foundation.

So when that financial regulation layer comes on top, that's perfectly fine. And that's certainly in the gift of regulators. But that financial regulation layer cannot be built coherently, strongly, robustly if those underlying private law foundations are not considered, or worse they are ignored. And that is, again, when looking at CLARITY, I have a few question marks as to whether the CLARITY Act is really understanding the nature of certain private law issues that exist in digital assets, certain issues of property, certain issue of secure transactions. But on the bright side, there's still time. Congress is still working on the text, and so hopefully they'll be able to improve it.

Alan Kaplinsky:

Yeah. So Andrea, do you think that Congress should eventually enact a federal commercial law governing digital assets? Or is state commercial law still the better approach here?

Andrea Tosato:

This is a difficult question. I don't know what the best answer would be if we were starting from scratch today but I think that, as Chris sort of mentioned at the tail end of his answer, there's sort of a path dependency here. And the split between federal and state competency was set a long time ago, and states have been dealing with private law and commercial law for a very long time.

The UCC itself, the Uniform Commercial Code, has been around since 1952. It is enacted across the 50 states. There is a very robust tradition around it. There is very robust case law. So I think that, how things stand right now, it would be much... Well, the sensible thing would be for federal law to continue covering financial regulation. If need be, very targeted surgical intervention in the private law domain for issues that federal lawmakers consider to be absolutely paramount. But otherwise, really building on that backbone of state law, common law that has been sort of providing the framework in all private law matters of contract of property, of tort, restitution for such a long time. I don't think that it would work very well if suddenly the private law framework for digital assets were stripped away from states and drawn into federal law as an island onto itself. I think that it's much more coherent to have the private law treatment of digital assets to remain with the states, with the general body of state law, with the common law. It is far more organic and, I think, predictable and robust than doing otherwise.

Christopher Odinet:

And I guess the only thing I'd add to that is to go way back in time. I was just reading something that Andrea and I have been talking, this long history of the UCC. In the late 1800s there was a move to create a federal commercial code because there was, all of a sudden, tons of... In the late 1800s, early 1900s all of this interstate commerce was really taking off and there was this great realization that, the different states and their systems, it was too different to really engender a robust interstate commercial market. So there was a great move.

And in fact, the Uniform Law Commission, which came along later, was in part sort of meant to cut off any sort of federalization of commercial law. So of course then we start getting attempts at a commercial code, although originally it was like a uniform law just governing the sale of goods. It wasn't like a big comprehensive one. But only later, in the 1940s and the 1950s, when it was decided we have all these piecemeal uniform statutes governing commercial law. Let's have a Uniform Commercial Code. It was decided to continue having this at the state level. But it was also confounded by the Erie decision by the Supreme Court, which said, "There is no federal common law."

And so that, plus this kind of history since the late 1800s of commercial law being, even if it's going to be harmonized, it's going to be at the state level, that has sort of sent us in this direction. And as Andrea mentioned, that's I think a pathology, that it would be really hard to change that. But funny enough, that was the original conversation, was to have a federal commercial code.

Alan Kaplinsky:

Yeah, yeah. So what practical lessons? And Chris, I'm going to ask you this one. What practical lessons should banks and FinTech companies and payment companies and digital asset custodians take away from your book?

Christopher Odinet:

That's a great question. I think it goes back to the beginning, is don't forget about the private law. Don't forget about the difference between contract and property. Don't forget about the difference between default rules, things that you could contract around. And don't forget about mandatory rules, rules that you cannot. Let's just say you are a bank entering into the digital asset space, or you're any kind of FinTech company or something. Think about custody. It's not simply a technology or like a compliance exercise. It's a private law exercise. And maybe that means... I think for us academics, law schools need to remember and sort of invest or reinvest in making sure there is strong coverage of these core private law courses. Debtor-creditor, coverage of things like bailment and property law. Not farming out secured transactions every couple years to an adjunct who does it on the side. Having a real commitment in your hiring and your faculty and your curriculum to these core concepts, and then having them supplemented by practitioners who really understand what it's like to practice in this space.

So that's on us. But for lawyers who are operating here, make sure that when you are advising clients who are worried about getting a letter from the SEC or worried about getting a UDAP lawsuit from an AG relative to their client's business models, they also have good private law, commercial law lawyers who are looking at the documents and that are looking at the transactional structures and being rigorous with, is what we are saying we're doing what we're really doing? How would this play out in the crucible of bankruptcy?

Alan Kaplinsky:

Okay. If you could recommend one legal reform that would most improve the digital asset marketplace, what would that be?

Christopher Odinet:

Well, I would say nationwide adoption of the 2022 amendments, in other words... Including in my own state of Texas here. Uniformity across-

Alan Kaplinsky:

How many states have enacted it already?

Christopher Odinet:

Isn't it 30-something, Andrea? Where are we at right now?

Andrea Tosato:

37, and the amendments are being considered by two more. And we could be close to 39. And I have no doubt that we'll reach 50. It was a struggle to get here, and that's a story for another day, but I think we're past the hardest-

Alan Kaplinsky:

Yeah. Okay, so-

Christopher Odinet:

Yeah, so I would say adoption of the amendments, because uniformity among the states is what makes commercial law actually useful for a national and global traded asset class. And at the federal level I'd like to see any future sort of financial market structure legislation include really robust involvement by private law, commercial law experts in that drafting process so that those private law questions get addressed really proactively rather than as in an afterthought, discovered in litigation or by academics like Andrea and I and our co-authors.

Alan Kaplinsky:

Yeah. So if you look ahead five years now, what developments in digital commercial law are you watching most closely?
Andrea?

Andrea Tosato:

Well, I think we have a bit more to go in the space of stablecoins. I think that we'll see that. I'm really looking with great interest to the whole conversation around tokenized deposits. That's another key favorite topic for Chris and I, but I think it's going to effect a lot of consumers. I think that, yes, let's see what happens with CLARITY and with all the rules that govern platforms. But if you were to ask me to pay attention, like, what are the two things that I'm looking at most keenly? Tokenized securities and tokenized deposits.

Alan Kaplinsky:

Yeah. Yeah. We haven't really talked too much about tokenized deposits, but do you see that happening soon, that banks are going to be offering that?

Christopher Odinet:

Well, funny enough, the FDIC released a proposed rule, which is still in comment period right now.

Alan Kaplinsky:

Yeah.

Christopher Odinet:

Way too much to talk about there. Andrea and I and our colleague Yesha, we are working on a paper on tokenized deposits. So when we have it out, please have us back for that.

Alan Kaplinsky:

I will. Yeah. When will that be, do you think?

Christopher Odinet:

I would say give us until probably the end of the fall semester.

Alan Kaplinsky:

Yeah. Okay.

Christopher Odinet:

So that'd be like December-ish.

Alan Kaplinsky:

Yeah.

Christopher Odinet:

I don't want to spoil anything, because we have lots of thoughts on that, including on the FDIC's rule.

Alan Kaplinsky:

Yeah. Interesting. Okay. So final question for today, because we really have covered a lot. And that is, if our listeners remember only one takeaway from your book, what do you hope it will be?

Andrea Tosato:

I am afraid that I'm going to repeat myself, and that is the one takeaway would be not to forget private law and the importance of the interface between public law and private law. For the past 20, 25 years around the world, but especially here in the US, there's been this huge, and in many respects for understandable reasons... In our world, Chris mentioned the Great Financial Crisis, and there's so much going on with government, and so on. But private law doesn't go away simply because people stop paying attention to it.

And so you can't ignore it. And if you do so, it's at your own peril. So don't ignore private law. The relationship between private law and public law is not a conflictual one. They're wedded. It's a synergistic relationship, and ignoring one or the other results in disaster.

Alan Kaplinsky:

Right, right, right, right. Well, Chris and Andrea, thank you very much for joining us today, and congratulations on writing what I believe will become one of the leading treatises in this very rapidly developing area of law and this incredibly rapid business that hasn't existed for all that long and is continuing to evolve.

One of the themes that really stood out to me is that innovation in digital finance depends on much more than sound regulation, which is what Congress seems to be very focused on. As your book demonstrates, innovation also requires very clear rules governing ownership and custody, secured lending, bankruptcy, and the allocation of rights among competing claimants. Those issues may not receive the same public attention as new legislation or regulatory developments, but they are fundamental to creating the legal certainty that financial markets always have to have in order to flourish.

For lawyers that represent banks, FinTech companies, digital asset firms, investors, or consumers, this book is going to become an indispensable resource for understanding how traditional commercial law applies in this age of blockchain and tokenization and automation. To our listeners today, thank you very much for joining us for this episode of our Consumer Finance Monitor podcast. Thank you for listening, and I hope you all enjoy the rest of your day.