

A Basic Guide to Digital Assets: How to Define, Find, Value, & Distribute Select Digital Assets.

Presented by Carla Hartley, Esq. and R. Ben Vojtik, Esq.

Presented by
Family Law
Bar Association



1

What is a digital asset?

- A digital asset refers to any type of content or resource that exists in a digital or electronic form and holds value or ownership rights. These assets can be stored, transmitted, and accessed electronically.

2

What types of digital assets exist?

- Cryptocurrencies
- Digital Tokens
- Digital Currencies
- Digital Securities
- Digital Collectibles
- Domain Names
- Digital Media
- Digital Intellectual Property
- Digital Subscriptions
- Cloud Storage
- Virtual Currencies in Online Games

In your materials you'll see we have included language identifying a few types of digital assets for discovery demands.

3

What is Web 3.0?

- The term "Web 3.0" refers to a presently developing and increasingly active iteration of the internet that envisions a more advanced and decentralized web experience. While there isn't a universally agreed-upon definition, Web 3.0 generally represents a set of principles and technologies that aim to overcome limitations of the current web (Web 2.0) and introduce new capabilities.
- One common definition of Web 3.0 seems to include technical applications built on blockchain technology for sharing information.
- It's important to note that Web 3.0 is still an evolving concept, and its specific characteristics and implementation details may vary depending on different interpretations and ongoing technological developments.
- In your materials you'll see we have included a handout defining essential characteristics and services of Web 3.0.

4

What are common services offered on Web 3.0?

- While Web 3.0 is still in its early stages, several types of digital services are being built on this emerging paradigm. Here are some of the most common ones:
 - Decentralized Finance (DeFi)
 - Non-Fungible Tokens (NFTs)
 - Decentralized Storage and Computing
 - Decentralized Social Networks
 - Decentralized Identity and Authentication
 - Supply Chain Management
 - Gaming and Virtual Reality
- These are defined and expanded in our handout defining essential characteristics and services of Web 3.0.

5

Today we are focusing on two types of digital assets integral to, or inherent in, Web 3.0.

- Cryptocurrencies
- Digital securities

Why is it important for family law and probate attorneys to know?

- You cannot distribute it or administer it if you cannot find it.

6

It's here to stay: maybe not in its present form, but it's not going away.

- While “everyone” has been saying crypto and digital assets are on their way out, we are seeing increased regulation of the space in response to demand from BANKERS.
- Note the LIGHTNING network alone can handle orders of magnitudes more transactions per second than standard banking applications on Web 2.0. Banks are onto this now.

7

Large banks – the nation's largest and oldest banks – have continued to invest massive amounts of money in Web 3.0 and the digital assets space, particularly with regard to cryptocurrencies.

- JP Morgan Chase 2021-2022 – over \$1.1 billion (CNBC TV)
- Goldman Sachs same period - \$698 million
- Fidelity is offering ability to trade “crypto and stocks” in their service and on their app.
<https://fidelity.com/crypto/trading>>

8

BNY Mellon, the nation's oldest bank, in 2022-2023, \$690 million – buying in during “crypto winter” of 2021-2022.

- BNY Mellon conducted a survey in 2022. Results:
- 41% of institutional investors – institutions, not private people – held cryptocurrency in their portfolio already
- Another 15% of institutional investors intend to add digital assets over the next 2-5 years. We are in that window now.
- We have a handout of this press release in your materials.

9

Blackrock, one of the world's largest asset managers, has applied to be an Exchange Traded Fund in the crypto space.

- Clarification: Blackrock has a lot of ETFs. They applied for one that tracks the value of Bitcoin. This would be an available fund of theirs that you can invest in; not something available on crypto space. This was at first denied for the inability to stabilize on “spot” trades, has been revised and resubmitted.
- Large credit companies – VISA is the first in the space – are partnering with digital currencies. (Coinbase publication, 2019)
- And the list goes on and on and on

10

CBDCs are already offered or in development in 81 nations.

- The US Federal Reserve Bank is developing its own CBDC and is expected to launch under a program called “FedNow” that’s been under construction for some time.
- Britain is launching BritCoin. CNN, February 2023
- Australia is launching its own according to the Australian Reserve Bank. www.rba.gov.au/payments_and_infrastructure/central-bank-digital-currency/
- China has a digital yuan, E-CNY, and is using that to pay workers. CNBC, March 2021.
- Bahamas launched one called the Sand Dollar. www.sanddollar.bs

11

We are seeing a regulatory structure forming worldwide in the crypto space.

- The EU has put together a regulatory structure for digital assets
- Indonesia has begun putting together such a framework and intends to open the space to some 300 million of its citizens
- China, which had tried to shut down cryptocurrency altogether by banning it, is moving back into the space with new regulations and opening up the trading center in Hong Kong for crypto. That makes it available to a couple billion people.

12

Some states are even moving to regulate the crypto industry:

- Uniform Regulation of Virtual Currency Businesses Act.
- Enacted in Rhode Island 2019
- Introduced in 2023 in:
 - California
 - Illinois
 - Nevada

13

Status of U.S. Regulation and Case Authority is Evolving

- First, we have some competition between various agencies as to what cryptocurrency is, and who gets to regulate it:
- Other Federal Regulators have taken this on, including:
 - Commodity Futures Trading Commission
 - US Treasury's FinCEN (Financial Crimes Enforcement Network)
 - Office of Foreign Assets Control
 - Comptroller of the Currency
 - They are all moving in their respective areas. See <https://www.reuters.com/legal/transactional/us-crypto-framework-begins-evolve-special-report-update.> October 22, 2021.

14

Are we going to see conflicting rules?

- IRS says... The determination by the IRS that cryptocurrency is treated as property for tax purposes, rather than currency, can be found in IRS Notice 2014-21, issued March 25, 2014.
- SEC says... *SEC v. Ripple Labs Inc. et al.* (2020): The U.S. Securities and Exchange Commission (SEC) filed a lawsuit against Ripple Labs, the creator of the cryptocurrency XRP, alleging that the company conducted an unregistered securities offering.
- California says... enforce SEC ruling from *In re Coinseed* (2021) which found the company was selling unregistered securities and conducting fraudulent activities.

15

Why is it reasonable to treat cryptocurrencies as securities?

- Think back to the Web 3.0 discussion, above; a lot of these cryptocurrencies are being treated as stocks, issued and used to raise capital for buildout of Web 3.0 infrastructure. Payoff is when they go active and acquire volume.
- Staking: “Staking” is available for certain cryptos. This is when the buyer/owner of the crypto currency commits to not sell the crypto for a set period of time and in turn, the buyer/owner earns interest on the crypto being held... in addition to gains in the value of the cryptocurrency itself. Very similar to dividends.

16

Litigation not yet resulting in rulings:

- SEC vs Kraken: Crypto exchange Kraken shuttered its U.S. cryptocurrency staking operation and agreed to pay a \$30 million fine to settle an enforcement action alleging it sold unregistered securities, the Securities and Exchange Commission. So – no law coming out of that, but we are seeing increasing governmental interest.
- SEC brought similar charges against exchanges Coinbase and Binance, and these are being litigated. Right now the exchanges have made deals with the SEC to permit them to continue to operate.
- Coinbase has made preparations to go offshore; that will cost US a lot of tax dollars if they are pushed that far.

17

Lobbying Money, Changing Attitudes

- We are seeing a lot of lobbying money come into this space and a lot of changing attitudes:
- Jaime Dimon of Chase Bank – years ago, said crypto was a fraud; now his bank is one of largest institutional investors, and Chase is developing its own token.
- Larry Fink, Blackrock's CEO, has done a similar about-face.
- Jerome Powell has gone from saying cryptocurrency is a fraud to saying it is a viable but volatile asset
- I cannot get precise numbers on lobbying money at this point, but in 2021 it was \$30 million – was expected to double annually

18

How to Find Cryptocurrency:

- The common perception is that this is a landscape where dirty deeds can be accomplished in complete secrecy.
- That is increasingly unlikely as we see more regulation.
- The huge selling points of crypto are its decentralization and its transparency. The blockchain is constructed the inability to erase or alter what's there.
- So is it “findable”? Yes.

19

You Cannot “Read” the Blockchain

- But it can be accessed.
- The blockchain is a public ledger and can be searched through various engines called “blockchain explorers”.
- The most popular explorers for Bitcoin are: Blockstream and Blockchain.com.
- The most popular explorers for Ethereum are Etherscan & Ethplorer.

20

What Information is Needed to Employ a Blockchain Explorer?

- If you know the address, public key, or hash, you can find all transactions received from those items.
- Why not just a username and password? Two-step verification ensures that passwords will only get you to the first step; you need the second step which will be transmitted to the owner's mobile or secure device.
- What is the address? That's the destination to which funds are sent, and is usually a 256-bit combination of characters.

21

Private versus Public Key

- What is public key cryptography?
- Public key cryptography is a method of signing data with two different keys, making one available for anyone to use; the other is the private key.
- To employ a blockchain explorer, the public key is ideal, as addresses are created from the public key, but not traceable back unless you know the public key.
- Limitations on public key: If you want to know outgoing transactions, you need to have the private key.
- Are we going to have to have experts to find these assets? Maybe – but let's discuss steps you can take before reverting to an expert.

22

Before Hiring An Expert...

- For the most part, money going into the blockchain, or into a cryptocurrency, has to come from a government-licensed monetary institution.
- That's going to be a bank or a credit card, though some businesses are paying employees in Bitcoin or Ethereum, but it all sources somewhere with a US dollar (at least in California).
- Start with examining bank and credit records looking for a line item going into one of the major exchanges or wallets.
- For that you need a list of exchanges and/or wallets.

23

5 Largest Exchanges by Amount Held:

- Binance (over 17.7 Billion \$\$ worth on exchange)
- Coinbase (over 2.3 Billion \$\$ on exchange)
- OKX (over 2.7 Billion \$\$ worth on exchange)
- Bybit (over 1.5 Billion \$\$ worth on exchange)
- Kraken (over 1 Billion \$\$ worth on exchange)

For a more complete list of common exchanges, see your materials.

24

Know your Client laws are increasingly applicable to the crypto space.

- FINRA Rule 2090: Know Your Customer. This is also referred to in some places as “Know Your Client” or “Know Your Investor.”
- KYC is not yet a requirement in the crypto space, but...
- The more reputable exchanges have been adopting or have adopted KYC practices especially if making offerings within the United States.

25

KYC in action on Compliant Crypto Platforms

- Two examples: Coinbase and MyEtherWallet
- Both require a prospective investor to provide identifying information, including a photo ID, front and back, using the scanning function in their respective platforms.
- Both require a prospective investor to link either a bank account or a credit card
- This means that the exchange or the wallet has the party’s identifying information.

26

Starting with Conventional Discovery Tools

- Get the bank/credit card statements via Demand for Production.
- Transfers into a major exchange or wallet are reflected on bank statements as into that exchange/wallet
- If you see an exchange/wallet, you've determined that a party is invested the space.
- From there, special interrogatories requesting the key, holdings, or requests for admissions can issue.
- If interparty discovery doesn't suffice, subpoenas can issue to the exchange. (Remember KYC means exchange has ID info)

27

Some Major exchanges are *presently* registered with California Secretary of State.

- Binance Holdings, LTD
- Coinbase Global Inc.
- Payward, Inc., DBA Kraken
- Others are registered in other states; look to the terms of the state for how to subpoena in those states.

28

If INTERPARTY discovery doesn't suffice, and subpoenas don't suffice...?

- So now you need to do the e-discovery and get an expert who can copy the device and employ a blockchain explorer.
- I would say start with the expert, but... that means accessing electronic devices - and our courts here are not fond of that as a first step.
- The expert will be looking for custodial wallets, non-custodial wallets, as well as exchanges – he will need the public key for that.
- Now we are back to the issue of private and public keys. More on that under attorney liability, below.

29

How do you value the crypto?

- If you have access to the account statements through any of the above discovery methods, that should give you daily values
- If you only know a certain amount of money went into an exchange and then disappeared... How about Requests for Admission? Either opposing party admits, and you can ask for the Bitcoins, or opposing party denies and the burden is on him to produce all that evidence.
- Note: Aim the RFA at the coin that's increased in value most since the date the fiat money went into the crypto system. "Admit you purchased 25 Bitcoins at \$5,000 per Bitcoin."
- Don't forget to serve General Form Interrogatories – Check Box 17 – when serving RFAs.

30

What are Digital Securities?

- Digital Securities are digital representations of financial securities, such as stocks, bonds, or derivatives.
- As discussed above, there's some question as to whether cryptos are in fact securities.
- Technically, your Schwab or TD Ameritrade account, if administered on line, can be classified as a digital security... but we all know about finding those. No one is looking through a bank account and seeing money going into TD Ameritrade without knowing what that is.
- So here we are going to discuss private equities.

31

What are private equities?

- Private equities are investment partnerships that buy and manage companies before selling them. Private equity firms operate these funds on behalf of accredited investors.
- KYC absolutely applies here. It's not being "optionally" enforced as on some of the DEFI exchanges.
- When investing in many private equity funds today, you are obtaining shares that will be held in digital format by the private equity fund.
- Common private equity funds: Republic (www.republic.co), Wefunder.com, Equifund.com AngelList (www.angel.co), SeedInvest (www.seedinvest.com), CircleUp (www.circleup.com) SharesPost (www.sharespost.com), Fundable (www.fundable.com), OurCrowd (www.ourcrowd.com), StartEngine (www.startengine.com), EquityZen (www.equityzen.com), MicroVentures (www.microventures.com)
- These are pre-IPO (initial public offering) companies.

32

Is there a chance of good payoff?

- The “bet” is that the company will go public. That’s the payoff.
- Tax benefits – 26 US 1202: non-taxability of gains from start-ups if you hold start-up shares for five years.
- Can you buy private securities outside of the private equity exchanges? Yes.
- Some firms just offer investment directly through their own portal. See Brazil Potash.
- Locating the investment: it is going to be either in bank records, or in credit card statements, at this point. I am unaware of any private equity firm taking cryptocurrency in payment for shares as of the date of this presentation.

33

Attorney Liability: Private Keys to Crypto Wallets

- With a public key to a crypto wallet, the holder of the key cannot view all transactions, but can view the balances. The holder of the public key cannot move the value – cannot spend, or transfer the value into a different wallet.
- If you take responsibility for having the private key to a crypto wallet in your office, you have basically decided to keep a bunch of cash in an unsecured office drawer. That key can be accessed if you are hacked, by any employee, or if anyone leaves it out on the desk, by the janitor.
- Be aware. My position is I don’t want the private key; and I don’t know what would have to happen for the Court to order the disclosure of a private key.

34

Attorney Liability: Volatility of the Asset

- Why is this an attorney concern? Buyer's remorse.
- Example: The community has 100 Ethereum valued at \$2,000 apiece on the day of settlement.
- Example: The community has \$1,000 shares of Robot Cache purchased at \$2.50 per share.
- What does the client do? Take it equally in kind, or trade it for something else?
- What happens 12 months from entry of judgment?
- Does the client blame you for "advising" him/her to take or pass by the volatile asset?

35

Attorney Liability: Disclosure of the Assets/Liabilities/Risks

- A copy of the Mt. Gox case is attached in your materials.
- My takeaway, here, is that the duty to disclose with these volatile assets isn't JUST that you have them; I think the husband got in trouble in that case because when he realized he was losing a big chunk of the investment to a failed exchange, he never informed Wife and entered into a settlement as though the assets were still available to him for distribution. They weren't.
- If these volatile assets are at issue in any case, advise your client that you not only have to disclose the existence of the asset but, should the client obtain information these assets are in deeper trouble than mere volatility would imply – have to tell opposing counsel about that too.

36

Attorney Liability: Duty to Advise/Investigate

- At this point there's no stated "duty to investigate" in family law proceeding in California. There is a duty to advise.
- These digital assets aren't on Schedule of Assets and Debts, and not requested in most discovery demands.
- First: find out if your client has an interest.
- We've attached a sample questionnaire that goes to the client shortly after engagement, which asks about various asset classes and whether or not they are potentially at issue in the proceeding. We have the clients respond and sign the document under penalty of perjury. A sample is in your materials.
- Second: advise of duty to disclose (see prior slide)