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WHITE PAPER

September 2021

Crypto and the Reach of Unclaimed Property Laws: Is New Illinois Legislation the Future?

Cryptocurrencies are quickly becoming part of the financial mainstream, with institutional and retail investors alike adding them to their portfolios in record numbers. State legislatures are trying to keep up with this growth by modifying abandoned and unclaimed property laws. Illinois Senate Bill 338, signed into law by Governor J.B. Pritzker (D) as P.A. 102-288 on August 6, 2021, exemplifies this trend. As amended by P.A. 102-288, the Illinois Revised Uniform Unclaimed Property Act will require holders to escheat dormant crypto and liquidate crypto into U.S. dollars in order to escheat. This both represents an administrative burden for crypto custodians and may be unwelcome by long-term crypto investors.

DEFINING AND UNDERSTANDING VIRTUAL CURRENCY

In 2017, Illinois adopted the definition of virtual currency that was developed for the Illinois Revised Uniform Unclaimed Property Act ("RUUPA" or "Act," 765 ILCS 1026/15-101 *et seq.*):

> a digital representation of value used as a medium of exchange, unit of account, or store of value, that does not have legal tender status recognized by the United States. The term does not include (A) the software or protocols governing the transfer of the digital representation of value; (B) game-related digital content; or (C) a loyalty card [or gift card]. 765 ILCS 1026/15-102(32).

The amended Act expands that definition to include "*any type of* digital unit, including cryptocurrency, used as a medium of exchange, unit of account, or a form of digitally stored value, which does not have legal tender status recognized by the United States."

Unlike many other financial assets, cryptocurrencies and other blockchain-based digital assets were designed so they could be held directly by the owner, without a central repository. Many people hold custody of their cryptocurrencies in this way, using wallet software that they alone control. This can be technologically challenging for some because it requires them to manage unwieldly hexadecimal codes known as private keys, and it places a burden on them to not lose those private keys. Because of these difficulties, many people prefer to have a third party hold custody of their cryptocurrency. Numerous hosted wallet service providers offer custodial services.

DORMANCY HOLDERS AND THE ABILITY TO ESCHEAT

One core component of abandoned and unclaimed property ("AUP") laws is the tracking period for determining when a property has become "dormant." Most common property types become dormant within one to five years. Once property becomes dormant, the holder of the property must contact owners to remind them that a debt is owed to them. The amended Illinois Act establishes a five-year dormancy period for virtual currency based on the last contact with the holder. Such contact, when it is sufficient to defer dormancy, is referred to in the Illinois statute as an owner's "indication of interest" in the property.

The amended Act, however, does not specify types of owner-to-holder contacts for crypto that would constitute an indication of interest that defers dormancy. Using existing AUP frameworks as a guide, one might compare crypto to securities, where an indication of interest can be in the form of a vote, phone call, or email to the transfer agent to update the owner's personal information, and in some states, direct deposit of dividends. The analogy has limitations, though, because securities have a welter of requirements and reporting obligations placed upon those issuing, owning, and dealing in them.

A comparable regulatory framework unique to crypto transactions has not yet developed for escheat purposes. All or most crypto custodians likely have the electronic monitoring capacity to track when users log into the account, buy or sell crypto, or transfer crypto from one wallet to another. It is reasonable to anticipate that logging into one's account is a sufficient indication of interest to stave off dormancy, but are passive actions that affect an owner's wallet similar? As an example, if another party deposits crypto into the owner's wallet, will that toll dormancy? In many states, direct deposit of a securities dividend is no longer sufficient as an indication of interest. Will it be similar for crypto?

What such a framework may require becomes even more complicated as different types of crypto platforms are evaluated from an escheat-compliance perspective. Cryptocurrency exchanges in the United States are required under various applicable know-your-customer ("KYC") laws and regulations to implement policies that allow them to know the identity and addresses of their customers. The states, and their unclaimed property audit agents, are likely to deem such businesses the holder of property, and therefore hold them responsible for monitoring its dormancy and escheat.

Decentralized finance—DeFi—transactions are, however, different from transactions on an exchange. In DeFi transactions, there is no intermediary business or individual, such as a bank or an exchange that holds funds and reconciles accounts. DeFi protocols are built with open source code and rely on

smart contracts, meaning there is no central organization or individual that directs or controls them. Smart contracts have written contract or loan provisions associated with them. If certain instructions are sent to a smart contract, and the conditions are met, then the code will execute automatically.

For example, DeFi liquidity pools allow lenders to deposit funds in a lending pool contract, for which a borrower can call on that contract and request to borrow funds. If all coded conditions are met, the loan will go through. Likewise, decentralized apps ("Dapps") beyond the DeFi space contain a series of smart contracts that interact with one another and execute functions based on instructions they receive.

Any assets held at noncustodial smart contract addresses have the potential to become dormant. Monitoring contacts with such addresses and demanding escheat from ostensible holders may prove difficult, if not impossible, to enforce given their noncustodial nature.

Further, because there is no central administrator and no legal requirement or mechanism to collect owner names and addresses, in many cases, the only known information about the transacting parties will be their public keys. To which jurisdiction would a holder escheat dormant crypto when there is no owner name or physical address, or when there may be no state of incorporation or legal domicile for the holder to use? Further, the purported holder may not be located in the United States, raising the question of whether these transactions are subject to U.S. jurisdiction.

Gary Gensler, chair of the Securities and Exchange Commission ("SEC"), recently vowed to "take our authorities as far as they go" and also asked for additional tools to regulate the crypto and DeFi industries. As the SEC continues to develop its regulatory structure, anticipate escheat laws to follow.

ESCHEATING CRYPTO

Once a crypto asset becomes dormant, the amended Act mandates the holder liquidate the crypto within 30 days prior to the compliance filing and remit the proceeds to the appropriate government authority. The term "escheat" refers to taking ownership of property. That term is inexactly but commonly used to describe the process of remitting abandoned property to a state that will hold the property in custody for the owner. Illinois holds remitted abandoned property solely as a custodian, as stated in Section 15-804 of its Act, and is responsible for the safekeeping of the property.

The price of crypto fluctuates in dollar terms. It is not fixed like a paycheck or a receivable credit on account denominated in U.S. dollars. While there are a few crypto products with stable values, for instance stablecoins linked to a national currency like the U.S. dollar, the majority of cryptos see their values fluctuate as determined by the economic trends and vagaries that influence supply and demand. Crypto is often purchased with the expectation that the value will increase exponentially. Crypto values have fluctuated wildly, with prompts ranging from a reaction to a tweet to the economy to rumors. When liquidating dormant crypto, the holder would be locking in the value of the asset on the day of liquidation. The states have expressed their limitations with their ability to take custodial possession of the multitude of crypto products. However, the Commissioner's Prefatory Note in the 1972 Uniform Unclaimed Property Act described the following policy behind the uniform act:

> The Uniform Act is custodial in nature—that is to say, it does not result in the loss of the owner's property rights. The state takes custody and remains the custodian in perpetuity. Although the actual possibility of his presenting a claim in the distant future is not great, the owner retains his right of presenting his claim at any time, no matter how remote. State records will have to be kept on a permanent basis. In this respect the measure differs from the escheat type of statute, pursuant to which the right of the owner is foreclosed and the title to the property passes to the state. Not only does the custodial type of statute more adequately preserve the owner's interests, but, in addition, it makes possible a substantial simplification of procedure. 8 Uniform Laws Annotated 74 (1972).

The solution of requiring liquidation undermines that custodial nature. While owners can still collect their value, that value is now fixed and finite, unable to ride the ebbs and flows of the market.

Further, contracts with crypto custodians may contain provisions that limit the ability of a "holder" to liquidate and escheat crypto. Crypto holders may not have the legal right to use the owner's private key to direct a transaction on the blockchain to liquidate their value. While there is case law, such as *People v. Marshall Field & Co.*, 404 N.E. 2d 368 (Ill. App. 1980) that set forth anti-limitation provisions on "private escheat," there are notable differences from the crypto holder scenario. In the *Marshall Field* case, the holder created contract provisions for its gift cards that would terminate the card value just shy of the period for which it would become escheatable (a five-year termination to undermine a seven-year dormancy period). *Marshall Field,* 404 N.E. 2d at 373. The court found that the anti-limitation provisions addressed contract terms that would be in "fundamental conflict with public policy." *Id.* In comparison, the crypto exchanges hold private keys that control crypto. Is requiring an exchange or an online wallet provider to take an action beyond its contractual terms in fundamental alignment with public policy?

The true intent of the Illinois RUUPA is to safely hold crypto until the owner claims it. In this regard, the state has implemented protections for securities that could be emulated for crypto. Section 15-703 of the Act provides that the state must hold escheated shares for three years after delivery; if the shares are sold prior to that time, the owner is entitled to claim the value of the shares at the time of the claim, plus dividends and interest. The amended Act lacks a comparable safeguard for crypto. The state is limited in infrastructure that would allow crypto to be transferred to the state in a custodial manner. However, there are viable alternatives, such as implementing a longer mandatory holding period (e.g., 10 years), developing strategic alliances with viable third-party providers to act as a holding mechanism for crypto, or directing the holder to segregate and hold the crypto until the state may give direction for the sale.

OWNER RECOURSE

The amended RUUPA states that "the owner shall not have recourse against the holder or the administrator to recover any gain in value that occurs after the liquidation of the virtual currency under this subsection." It is unlikely that this limitation will dissuade legal action by the angry owner of crypto that increased tenfold since the date of liquidation for escheat compliance.

If the historical litigation trend by owners of escheated securities provides any guidance, owners will not stand by as docile observers when a holder liquidates his or her crypto for escheatment. When finding the value of crypto increased significantly after his wallet was liquidated, a crypto owner will likely go after everyone involved in what he views as an unlawful seizure and taking. States notoriously have not stepped up to shield duly compliant holders in the past, even in the face of a statutory obligation to do so. Query why they would behave differently with crypto.

Crypto is the new unclaimed property frontier. In fact, Delaware passed identical language to that of Illinois and mandates the liquidation and escheat of crypto, whereas New York and D.C. introduced bills that do not require liquidation of cryptocurrencies prior to escheat. Do P.A. 102-299 and similar proposals embody an appropriate balance for the states to safeguard the rights of owners of crypto, or do such state laws evoke the pickaxes and pans wielded by gold prospectors of old? We will likely find the answers in court.

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