

Cryptocurrency Presents Puzzle For Unclaimed Property Laws

By Brooke Condran, Marc Musyl and Steven Felsenstein (August 27, 2019)

As the use and acceptance of blockchain technology continue to grow, state legislators and unclaimed property administrators are starting to recognize and capitalize on the potential revenue generation associated with the widespread use — and misuse and abandonment — of virtual currencies.

On June 13, New York became the most recent state to propose amendments to its abandoned property law providing for escheatment of unclaimed virtual currencies. This proposed legislation is consistent with the ongoing trend among the states to expand the scope of their unclaimed or abandoned property laws, resulting in increased revenues to the states as unclaimed property, more often than not, remains unclaimed by its rightful owner.

The memorandum in support of New York's proposed legislation suggests the new coverage for virtual currency under the state's abandoned property law would increase receipts by an estimated \$2 to \$5 million annually. If the bill is passed, New York would be the sixth state to add virtual currency as a type of property subject to escheatment under state unclaimed or abandoned property laws.

The use of blockchain technology and the issuance of cryptocurrencies have expanded considerably in recent years, inviting heightened scrutiny and regulation. While federal securities, tax and other financial services regulatory agencies — such as the U.S. Securities and Exchange Commission, the Internal Revenue Service, state securities commissioners and others — have begun applying their rules and regulations to cryptocurrency businesses, the cryptocurrency industry has not yet faced significant enforcement from state unclaimed property administrators.

This article considers the application of state unclaimed property laws to cryptocurrencies, and the potential implications and challenges of such application for both industry participants and state unclaimed property administrators.

Overview of Unclaimed Property Laws

Each state has adopted its own unclaimed property laws. These laws require a holder to report and remit, or escheat, unclaimed property to the state. Unclaimed property consists of a wide range of tangible and intangible property, defined differently by the states, due or owing to another person, in the possession of a holder.

State unclaimed property laws generally define "holder" as any person in possession of property — which is subject to state unclaimed property laws — belonging to another person. Typical examples of types of property subject to state unclaimed property laws include uncashed money orders and travelers checks, uncashed rebate checks, customer overpayments or credits, unclaimed royalty payments, unused gift certificates and gift cards, uncashed employee payroll checks, uncashed vendor or accounts payable checks,



Brooke Condran



Marc Musyl



Steven Felsenstein

uncashed dividend checks, amounts due and payable under insurance policies or annuities, unclaimed bank account balances, contents of safe deposit boxes, securities, amounts distributable from employee benefit plans, and certain prepayments, deposits and layaway items.

A holder is required to report and remit unclaimed property to the appropriate state when the property has been unclaimed by the owner for the applicable statutorily mandated holding, or dormancy, period set by the jurisdiction, which is typically three to five years, depending on the type of property.

General priority rules require a holder to report and remit the property to the state of the owner's last known address, as shown on the holder's records, or, if the holder does not have a last known address for the owner in its records, then to the state of the holder's domicile or incorporation. Generally, a lawful owner can later contact the state seeking return of escheated property.

Can Cryptocurrencies Constitute Unclaimed Property Subject to Escheatment?

Unclaimed property laws vary by state, but generally apply to a wide range of intangible assets, including money, financial accounts and securities. The 2016 revised Uniform Unclaimed Property Act specifically includes virtual currency in its definition of property subject to escheatment. Under the Uniform Act, virtual currency is defined as a "digital representation of value used as a medium of exchange, unit of account, or store of value, which does not have legal tender status recognized by the United States," but specifically excludes the software or protocols governing the transfer of the digital representation of value, game-related digital content, loyalty cards or gift cards.

To date, Illinois, Colorado, Kentucky, Tennessee and Utah have adopted the Uniform Act's definition of virtual currency as property subject to escheatment in their unclaimed property laws. It is expected that more states will follow in adopting the same or similar provisions.

In addition, most states have a catchall provision for miscellaneous intangible personal property that may make an intangible asset subject to escheatment. Accordingly, even if a state does not have a specific statutory provision covering the escheatment of virtual currencies, the state may take the position that cryptocurrencies fall within the catchall provision for miscellaneous intangible property subject to escheatment.

Potential Implications and Considerations

In analyzing the applicability of unclaimed property laws to cryptocurrencies, it will first be necessary to determine what type of property the cryptocurrency is under applicable state law. Is the cryptocurrency comparable to money? Is it a commodity or security? Is it redeemable for cash? These are important considerations because different dormancy periods may apply depending on the characterization of the property.

One factor that may become increasingly complicated is whether there is even a holder of some cryptocurrencies. While certain types of cryptocurrencies classified as tokens may have a specific party controlling the token — such as when a token is issued for the purchase of specific goods or services — in a classic blockchain structure, the existence of a cryptocurrency may be validated by a network of otherwise unrelated computers located in multiple and unknown state or national jurisdictions.

A further complication is that the existence of a cryptocurrency may be governed by

contractual terms established at the creation of the cryptocurrency, and those terms can vary, with set terms and conditions affecting both the nature and location of the asset, including who can control the asset.

Even when a cryptocurrency is deposited into an online entity, that does not necessarily resolve the issue of who the holder is with respect to the cryptocurrency. Is the holder the cryptocurrency exchange, the online wallet provider or another form of financial intermediary? In general, a holder is defined as an entity in possession of unclaimed property belonging to another person or entity. In the context of cryptocurrencies, whether a business will be deemed a holder may depend on the business's ability to access and transfer the cryptocurrency to a third party.

What happens when the holder's ability to access and/or transfer the cryptocurrency is restricted? More often than not, the owner has a private key or password needed to transfer the cryptocurrency, in which case a cryptocurrency exchange or wallet provider likely would not be able to transfer the property to the state, and the state likely could not assert the right to take custody of the property. In such cases, the exchange or wallet provider may be deemed not to have possession and control of the property, and thus not be subject to reporting obligations under state unclaimed property laws.

Another complicating factor is the states' ability or inability to accept and hold escheated cryptocurrencies. Even if a cryptocurrency exchange or wallet provider has the technological ability to transfer a customer's cryptocurrency to a third party, state unclaimed property administrators may not be technologically equipped to accept and hold cryptocurrencies on behalf of owners, which could make an in-kind transfer impossible.

Additionally, states do not typically hold noncash assets reported and remitted pursuant to unclaimed property laws. Rather, commodities and tangible items (e.g., jewelry, stock, art, etc.) are generally liquidated upon receipt. Importantly, should the owner later contact the state to recover such property, the owner will receive only the liquidated value of the asset, not its potential appreciated value. If the state were to require the holder to liquidate the cryptocurrency and remit cash to the state, or if the state were to accept the cryptocurrency and liquidate the property upon receipt, any subsequent appreciation value to the owner could be lost.

This liquidation process could harm the cryptocurrency industry and market participants, and would arguably fail to serve the legislative purpose of state unclaimed property laws, which is to return unclaimed property to its rightful owner. Liquidation may also invite litigation against holders for negligent escheatment, or against the states for unlawful takings.

In many instances it also may be hard to track ownership of a liquidated cryptocurrency. For example, when a state does not take in the escheated cryptocurrency, but requires the holder to liquidate it and deposit the resulting funds, how would a claimant later prove ownership to the state when claiming the proceeds? Ownership is generally validated by the network on which the cryptocurrency resides, and the liquidated cryptocurrency would no longer reside on the network.

Industry participants should be aware of the potential for regulatory enforcement actions, audits or litigation based on purported violations of state unclaimed property laws. In March 2018, a class action was filed in California by cryptocurrency owners against Coinbase Inc., a popular cryptocurrency exchange, alleging Coinbase unlawfully retained cryptocurrencies that were not delivered to or claimed by the owners/plaintiffs.

The plaintiffs claimed, among other things, that Coinbase violated California's Unclaimed Property Law by failing to report and remit the unclaimed cryptocurrencies to the state of California. The complaint alleged that Coinbase is a banking organization, business association and/or financial organization subject to California's Unclaimed Property Law; that the plaintiffs are the owners of the cryptocurrencies; that the cryptocurrencies are property subject to escheatment under the Unclaimed Property Law; and that Coinbase, as the holder of the cryptocurrencies, failed to satisfy its notice and reporting obligations under the Unclaimed Property Law.

Coinbase filed a motion to dismiss, arguing California's Unclaimed Property Law does not create a private right of action. The plaintiffs subsequently amended their complaint, removing their claim based on violation of the Unclaimed Property Law, but retaining their claim that Coinbase engaged in unfair and unlawful business practices under California's Unfair Competition Law. The case was dismissed upon the filing of a joint stipulation of voluntary dismissal on May 30, 2019.

While this case sets no precedent with respect to the treatment of cryptocurrencies under state unclaimed property laws, it highlights the fact that market participants may be subject to administrative and legal proceedings brought by both public authorities and private parties.

As cryptocurrency use and acceptance becomes increasingly widespread, industry participants — including cryptocurrency exchanges, online wallet providers and others — should be aware of their potential reporting obligations under state unclaimed property laws. Businesses can take proactive steps to determine their rights and obligations, minimize their liabilities, and streamline their accounting and reporting processes with respect to unclaimed property.

It also will be important for users of cryptocurrencies to remain alert as to their obligations to protect their assets from escheatment, not only in the jurisdiction where the owner is located, but in other jurisdictions that may claim dominion over the assets. Counsel can assist in determining your respective rights, obligations and potential liabilities, and in navigating the holder reporting requirements and procedures in each state where you maintain business operations or otherwise may be required to report unclaimed property.

Brooke E. Condran is an associate, and Marc J. Musyl and Steven M. Felsenstein are shareholders at Greenberg Traurig LLP.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.