

Blockchain Law

The fork not taken

Robert A. Schwinger, *New York Law Journal* — November 24, 2020

I shall be telling this with a sigh
Somewhere ages and ages hence:
Two roads diverged in a wood, and I—
I took the one less traveled by,
And that has made all the difference.
— Robert Frost

Is the token holder — often the holder of some form of digital currency — always free to choose which branch of the fork to take?

A blockchain is often envisioned as a record of a single continuous sequential series of transactions, like the links of the metaphorical chain from which the term “blockchain” derives. But sometimes the chain turns out to be not so single or continuous. Sometimes situations can arise where a portion of the chain can branch off into a new direction from the original chain, while the original chain also continues to move forward separately. This presents a choice for the current holders of the digital tokens on that blockchain about which direction they wish to follow going forward. In the world of blockchain, this scenario is termed a “fork.”

But is the tokenholder—often the holder of some form of digital currency—always free to choose which branch of the fork to take? Two recent decisions, one from Georgia and one from California, hold that owners of tokens whose holdings are kept on third-party exchanges rather than in digital wallets to which the owners themselves hold the private keys may be at the mercy of those exchanges in determining which direction they can take in response to an upcoming fork, despite a variety of creative claims raised on tort, contract and statutory grounds.

Background: ‘Two roads diverged in a yellow wood’

A blockchain fork occurs when someone seeks to divide a blockchain into two branches by changing its source code, which is possible to do because the code is open. For those users who choose to upgrade their software, the software then “rejects all transactions from older software, effectively creating a new branch of the blockchain. However, those users who retain the old software continue to process transactions, meaning that there is a parallel set of transactions taking place across two different chains.” See generally N. Reiff, [“A History of Bitcoin Hard Forks”](#) (Investopedia June 25, 2019).

The original and most famous cryptocurrency, Bitcoin, has undergone a number of forks over the years. Some of these forks have continued on while others have essentially died out. Among the more well-known Bitcoin forks are the creation of Bitcoin XT, Bitcoin Classic, Bitcoin Cash, Bitcoin Gold and Bitcoin Private. Id.

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These new currencies thus borrow from the initial Bitcoin software but alter it to create new functions or make it more suited to a specific market. In some instances, individuals have modified Bitcoin or other digital currencies in the hopes of improving them, such as by allowing more transactions into a single block of blockchain.

The Need To Make a Choice: ‘And sorry I could not travel both’

When a fork is initiated, the proponents of the new blockchain variant create the fork by separating a blockchain and presenting its users with two potential paths forward. In other words, when new forked digital currencies are created, the then-existing underlying blockchain is divided into two distinct, but identical, copies consisting of (1) the “original” chain and (2) the new “forked” chain. A user who decides to follow the fork will then switch to owning an identical amount of the new forked currency.

For digital currency owners who own private keys to their digital wallets, supporting a new forked currency requires only that they download the new software applicable to the forked coins. But users who rely on digital exchange platforms can potentially find that their individual choice of which path to pursue may be limited by their exchange platform’s decision. That is, those users’ ability to move forward with the new forked coins may be subject to the exchange platform’s decision as to whether to download the software required to support the forked currency.

A number of such forks occurred in 2017-18, when Bitcoin Cash, Bitcoin Gold and Bitcoin Private were created. These forks led to lawsuits when cryptocurrency holders found themselves unable to fork to the new currencies because the digital exchanges on which they kept their holdings refused to support the new currencies’ software.

Questions of First Impression: ‘In leaves no step had trodden black’

BDI Capital v. Bulbul Investments, 446 F. Supp. 3d 1127 (N.D. Ga. 2020), involved a suit by a cryptocurrency owner against a digital currency exchange and related parties that operated it, alleging that the exchange unlawfully retained the plaintiff’s forked digital currency when it refused to support the Bitcoin Gold fork. The plaintiff asserted a claim for conversion under Georgia law as well as violations of the federal Commodity Exchange Act, 7 U.S.C. §1 et seq.

In *BDI Capital*, the defendants in 2011 began to develop code for a Bitcoin trading platform that would allow users to buy and sell Bitcoins against U.S. Dollars. The plaintiff set up an account with the defendants’ exchange. In 2017, the plaintiff attempted to make a withdrawal of all of its Bitcoins stored on the exchange but allegedly was unable to complete the transaction. Plaintiff subsequently learned that the defendants decided to shut down the exchange. Plaintiff filed suit against the defendants seeking to recover the amount held in its account with the exchange.

The parties subsequently entered into a consent order, and the exchange returned both cash and Bitcoin holdings to the plaintiff. Despite the return of the Bitcoin, however, the plaintiff pointed to the creation of Bitcoin Cash, Bitcoin Gold and Bitcoin Private and contended that the exchange was unlawfully retaining the plaintiff’s Bitcoin “forks” and should be held liable for conversion by “failing to return them upon demand.”

In assessing the plaintiff’s conversion claim, the court first addressed the threshold question of “whether bitcoins, as virtual intangible cryptocurrency, may be the subject of a conversion action at all.” It concluded that bitcoins are “sufficiently identifiable” to be considered “specific intangible property” subject to a conversion claim under Georgia law. (See generally R. Schwinger, “[Property and Contract in the Digital World](#)” (N.Y.L.J. March 16, 2020), surveying the treatment of digital assets as “property.”) The court then considered whether a conversion claim was applicable to the set of facts at hand.

Recognizing that a “bitcoin exchange’s duties with respect to a bitcoin fork presents a case of first impression in the truest sense of the word,” the court began by analyzing the nature of forked currency. In so doing, the court noted that forked currency “does not simply appear” in a holder’s bitcoin wallet; rather, to access the forked coins the bitcoin holder must download software supporting the new forked currency. With respect to bitcoin owners who hold their virtual currency in an exchange, however, “to access the forked currency, the exchange must take some affirmative action.” The court concluded that if it were to find that the exchange was obligated to provide the plaintiff access to forked currency, it would necessarily be “imposing a major new duty on all cryptocurrency exchanges operating in Georgia to affirmatively honor every single bitcoin fork.”

In declining to impose such a duty on cryptocurrency exchanges, the court found that the onus of ensuring access to new forked virtual currency was more appropriately placed on the cryptocurrency holders themselves, explaining:

Bitcoin investors are aware they are operating in an unregulated market, and therefore it seems more reasonable to place the burden to ensure access to forked currency on the investors themselves. There is no requirement that investors keep their coins in exchanges; they can always withdraw the coins to their own private wallets. In the unregulated cryptocurrency market, potential investors are well advised to ensure that the terms of service of the exchange they are using clearly spell out what the exchange's obligations are with respect to forked cryptocurrency, if any.

Accordingly, the court concluded that the exchange was not obligated to provide the plaintiff access to any of the cryptocurrencies forked out of Bitcoin that had been created by third parties.

The court also rejected the plaintiff's argument that, even if the defendants were not required to provide access to forked currency, they nevertheless had a "duty to warn" its users about the impending fork. The court was unpersuaded that Georgia law would require such notice and therefore held that the defendants "were not under any affirmative obligation to warn" the plaintiff in advance that it would not be supporting forked cryptocurrency.

The court also granted defendants summary judgment on plaintiff's claim for relief under the Commodity Exchange Act, which provides federal regulation of all futures trading activities. The court agreed with the defendants that because the plaintiff sought damages arising from "the spot sale of a commodity," rather than a contract of sale of a commodity for "future delivery" (i.e., a "futures contract"), it could not maintain a private right of action under that act.

Forced to have 'kept the first for another day'

A subsequent California state court decision, *Archer v. Coinbase*, 53 Cal. App. 5th 266, 267 Cal. Rptr. 3d 510 (2020), arose from somewhat similar facts but sought relief on some additional theories. In *Archer*, the plaintiff Bitcoin holder Darrell Archer brought suit against the online digital currency platform Coinbase, alleging that Coinbase's "failure and refusal" to provide access to forked Bitcoin Gold constituted breach of contract, conversion and negligence.

Archer alleged that when Bitcoin Gold was created in October 2017, Coinbase decided it would not support the new currency on its platform, citing security concerns about its software. Thereafter, Archer, who held 350 Bitcoin on Coinbase at the time of the Bitcoin Gold fork, filed a lawsuit against Coinbase. The trial court granted Coinbase summary judgment on all claims, holding that the fact that the parties' user agreement contained no provision requiring Coinbase to provide services related to any particular digital currency created by a third party was dispositive.

On appeal, the California Court of Appeals for the First District affirmed. On the breach of contract claim, it agreed with the trial court that Coinbase's user agreement created no obligation to provide Archer access to Bitcoin Gold, or any other type of particular currency that may be created by a third party, following a fork. In the absence of such a provision in the user agreement, it held, there was no breach of contract claim.

The appellate court also rejected Archer's argument that Coinbase was "able" to transfer the Bitcoin Gold to him because it had the necessary software. The court explained that whether Coinbase "could" provide plaintiff with access to the forked currency was not dispositive to Archer's breach of contract claim. Rather, the relevant question was whether Coinbase "had a contractual obligation to do so," and the evidence submitted on the summary judgment motion showed that it did not.

The appellate court also affirmed the dismissal of a conversion claim, declining to impose an absolute tort duty on digital currency exchanges to honor forked currencies. Under California law, conversion requires that the defendant "take some affirmative action" to exercise control over or deprive a plaintiff of his or her property. The court found that the plaintiff failed to establish Coinbase took any such action. The California appellate court pointed to the Georgia federal district court's analysis in *BDI Capital* and found it persuasive and equally applicable to the facts in *Archer*. Adopting the reasoning of *BDI Capital*, the California appellate court likewise "decline[d] to impose a major new absolute tort duty on digital currency exchanges to honor forked currencies."

For the same reasons, the appellate court also affirmed the dismissal of Archer's negligence claim. It concluded that Archer failed to identify any independent duty of care that Coinbase owed to him to allow him to "acquire" all cryptocurrency created by third parties.

Conclusion: ‘I shall be telling this with a sigh’

In both *BDI Capital* and *Archer*, the courts were not persuaded by arguments that exchanges have an obligation to provide their users access to new forked currencies on their platforms. Instead, the courts declined to impose a new tort duty on digital currency exchanges to honor forked currencies, or any contractual or statutory duties to do so, instead placing the burden on cryptocurrency holders to ensure their own access to forked currency created by third parties.

More such lawsuits may continue to arise, however. Notably, the Bitcoin Cash blockchain is set to undergo a hard fork on November 15, 2020. The controversial upgrade is expected to result in two separate chains, “Bitcoin Cash Node” and “Bitcoin ABC,” with Bitcoin Cash Node appearing to be the favored chain. See S. Haig, [“Fork in the node: Bitcoin Cash Node on track to oust Bitcoin ABC”](#) (CoinTelegraph Nov. 4, 2020). Exchanges themselves are taking positions. Cryptocurrency exchange Kraken, for example, has stated that it “will support Bitcoin Cash ABC ONLY IF the hashpower on the ABC network is at least 10% of the hashpower on the Bitcoin Cash Node network.” See [“Bitcoin Cash Hard Fork on November 15: What Kraken Clients Need to Know”](#) (Kraken blog Nov. 6, 2020). As Bitcoin Cash holders await the upcoming creation of the new token, they should appreciate the risk that third-party exchanges may take positions about which path of the fork they will support, potentially hindering access on their platforms to the currency they disfavor.

As these and other forks continue to occur, courts may be inclined to adopt the reasoning of *BDI Capital* and *Archer* and conclude that exchanges have wide discretion as to which forked digital currencies, if any, they will make available to their users. Accordingly, owners of digital currencies who rely on cryptocurrency exchanges should beware that it may be up to the exchange’s discretion whether to give their users access to forked currencies on their platform.

Ultimately what may matter most for cryptocurrency holders when it comes to cryptocurrency forks may be the non-software fork in the road that preceded all of them—the decision the holder originally made between the options of holding digital currency on an exchange versus in the holder’s personal wallet. As the poet might say, for the courts who have examined this issue to date, “that has made all the difference.”



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