



THE NEW LEGAL FRONTIER: A PRACTITIONER'S GUIDE TO DIGITAL ASSETS

By Jon Farnsworth



Traditionally, lawyers are trained to deal with tangible, fixed assets. These assets are subject to long-standing accepted ownership structures and are easily bought and sold. Recently, intangible digital assets have exploded in popularity and are pushing the boundaries of traditional legal principles. Hard assets, such as real estate and personal property, no longer constitute the bulk of the value of the world's assets. There is evidence to suggest the value of digital assets now outweighs the value of tangible assets, which has sweeping effects for all lawyers.¹ This article highlights the importance of digital assets for all lawyers by giving an overview of what digital assets include and how they impact the modern legal practice.

An Evolving Definition of Digital Assets

There is no exact definition of a digital asset. One suggested definition is "content owned by an individual that is stored in digital form."² A similar definition is an asset "that exist[s] only in digital form."³ Both of these definitions raise questions about the nature of digital assets. When an asset simultaneously exists in both digital and non-digital format, is it still considered a digital asset? Is a digital asset simply a new classification for intellectual property?

Traditionally, digital assets have been associated with various types of intangible assets, such as intellectual property rights.⁴ Intellectual property rights commonly include trademarks, copyrights, patents, and trade secrets. Although

any digital asset can be considered an intangible asset, not every intangible asset, such as the goodwill of a company, is considered a digital asset. In other words, digital assets are only a subset of intangible assets—and a valuable one.

Most people are familiar with contemporary types of digital assets: computer databases, social media accounts, emails, blogs, websites, digital music, e-books, aggregated data, personal photos and videos, electronically stored customer lists, complex Excel spreadsheets, and general information technology infrastructure, among many other things.

The scope of digital assets, however, is much broader and includes other examples that people may not initially consider. For instance, lesser-known digital assets may include algorithms,

digital currencies like bitcoin, video game characters and accounts,⁵ customized electronic business arrangements like online cloud-based storage or software as a service subscription, online payments accounts, online bank accounts, and Internet domain names.

The list of digital assets grows as technology expands. Take Google, for instance. Google started using an artificial intelligence (AI) system called RankBrain to process its search queries.⁶ The more searches RankBrain processes, the more "intelligent" it becomes. RankBrain now outperforms Google's smartest (human) engineers in predicting which web pages rank highest on Google's search results. Regardless of the fear that development of AI is becoming "smarter" than humans, RankBrain is undoubtedly a valuable digital asset.

A Growing Market

Consider the value people place on having continual access to smartphones and the data they hold. One study in the United States found that, on average, people valued their *personal* digital assets at over \$54,000.⁷

While a personal smartphone is a common example of a digital asset, business digital assets are sometimes less evident even though one estimate values digital assets for U.S. companies at over \$8 trillion.⁸

In order to assist clients in understanding the value of digital assets, I often ask new business owner clients to name their most important assets. Clients typically say that they themselves and/or their executive teams are the most valuable assets. Many clients then state that some other type of intangible asset or piece of intellectual property is another major company asset. These interactions highlight that many clients are aware of the value that they, in conjunction with their digital assets, bring to their businesses, even though the clients may not specifically identify the particular asset as a “digital asset.”

Businesses have increasingly started to better leverage the value of their digital assets. For example, some companies strategically purchase digital assets from other companies through mergers and acquisitions (M&A). In 2015 alone, one-third of all M&A transactions occurred for the primary purpose of acquiring another company’s digital assets.⁹

What does this mean for legal practitioners?

For lawyers who focus their practice specifically on M&A, it is important to remember that the practitioner *must* evaluate the value and quality of a company’s digital assets before pursuing an M&A transaction. In a recent example of the value of how quickly digital assets may be impaired, Verizon just slashed the amount it offered to acquire Yahoo. Verizon originally offered \$4.8 billion to purchase Yahoo, but subsequently lowered its offer by \$1 billion because of Yahoo’s massive data breach.¹⁰ While the Verizon/Yahoo transaction has not been finalized as of this writing, and is not limited to exclusively digital assets, the reduced offer price supports the fact that the value of digital assets may be greatly impaired due to expected future liability and a tarnished brand name.

Even for non-M&A lawyers, digital assets are still an important consideration. For example, digital assets may be used to securitize a loan. While many lending institutions will discount the value of digital assets due to liquidity concerns or the difficulty of valuing the assets, the assets may provide a valuable avenue to securitize lending agreements and increase access to crucial capital.

The Ownership Dilemma

One disadvantage of digital assets is the dilemma over ownership. Who owns the asset? Unlike tangible assets where a deed may be of public record or a title may exist, digital assets may lack proof of ownership and/or proof of the current/prior owner(s).

Consider this example: Bob goes to the store and purchases a hardcover book. Bob now owns that physical book (i.e., the book

HOW DIGITAL ASSETS AFFECT YOUR PRACTICE:

FAMILY LAW/TRUSTS & ESTATES

- Valuing digital assets for a marital estate
- Determining who receives digital assets upon death or separation
- Granting access to digital assets to non-owners (e.g., heirs, relatives)

LITIGATION

- Collecting judgments through digital assets. See, e.g., *Office Depot, Inc. v. Zuccarini*, 596 F.3d 696 (9th Cir. 2010) (permitting a creditor to levy domain names of a judgment debtor to satisfy a judgment)
- Resolving ownership disputes of digital assets

BUSINESS LAW

- Using digital assets as collateral for loans
- Protecting intellectual property rights
- Using M&A transactions to leverage digital assets’ value

EMPLOYMENT LAW

- Creating policies/procedures on access to digital assets
- Implementing non-competition provisions to protect digital assets
- Using digital assets as fringe benefits

TAX LAW

- Considering tax implications of purchase/sale of digital assets
- Understanding depreciation of digital assets purchases

BANKRUPTCY LAW

- Assessing digital assets impact on clients’ eligibility for bankruptcy
- Understanding ability to claim digital assets as exempt

CRIMINAL LAW

- Prosecuting/defending theft of digital assets
- Utilizing digital assets to solve crimes

CONSTITUTIONAL LAW

- Understanding search and seizure issues related to digital assets
- Determining Constitutional rights/arguments given to digital assets in the future? (i.e., artificial intelligence)

is now Bob's asset). He can read it, lend it to other people, and use it essentially however he wishes. Now, let us change the example slightly. Instead of a hard copy of the book, Bob decides to purchase an electronic version of that same book, an e-book. Does Bob own the electronic book?

Common sense would say yes, Bob should own the book. He purchased it, so he's the owner, right? Unfortunately, the reality is almost assuredly that Bob does not own the e-book. Rather Bob likely only purchased a contract right, specifically a *license* to use the e-book.¹¹

So if Bob only owns a license to the e-book, what does this mean for him? Practically speaking, Bob still possesses a digital asset, an e-book, but there are limitations imposed on his "ownership" of the license. Such limitations may include who can use the book, how long it can be used, and what type of device it may be used on.

Digital assets, in theory, should always be worth more when the owner truly "owns" the asset—meaning, that the person or entity is the sole owner of the asset, and there are no restrictions placed on that asset by another party or entity. The reality, however, is that many of the digital assets we "own" are not truly "ours." Consider digital music or e-book files, software purchased from a third party, or even online social media and email accounts through third-party providers. In each one of these examples, although we may "own" a digital asset, that ownership right may be restricted and may be subject to traditional contract principles (i.e., you only have a license).

At the risk of oversimplifying the "ownership dilemma," the value of digital assets and tangible assets may widely vary—even for essentially the same product—due to limitations of use that are often placed on digital assets. Thus, this difference needs to be taken into account when valuing digital assets.

The ownership dilemma is further complicated by the fact that the creator (or possessor) of the digital asset (e.g., email, photo, algorithm, lines of code) may not actually own the digital asset. For instance, if an employee creates electronic code for software "within the scope of employment," under copyright law, the employer owns this new digital asset, not the employee.¹² Contrast an independent photographer who is hired by a company for a company event. The photographer is the owner of the photos taken (i.e., the digital assets) and only grants a *license* to the company for its use, unless a written agreement states otherwise.

While these examples are basic, this general principle applies to countless situations. To complicate things further, patent law and

copyright law are not identical, and may both apply to certain digital assets. A situation could potentially arise where under copyright law person A "owns" a digital asset, but under patent law person B "owns" part of the digital asset. Lawyers may be tasked to ensure a client retains ownership of digital assets, whether formally documented on paper or not.

The Legal Challenges of Transferring Digital Assets

Transfer or duplication of digital assets raises other important issues. Digital assets are usually easily duplicated or transferred. The problem with duplication, however, is that "a copied file can be held by multiple users who can use or dispose of it in any way they wish."¹³ Wrongful duplication and distribution of electronic files generally diminishes value for the asset.

As noted, mere possession is not ownership. This highlights the importance of reading the terms of underlying legal contractual relationship for the digital asset (e.g., license agreement; website terms of service, etc.). Additionally, it is important to protect digital assets by maintaining robust security, keeping a written record of ownership, and, if applicable, consummating agreements that govern rights and responsibilities of each owner or user of the digital asset.

Lawyers are well advised to encourage their clients to place limitations, restrictions, and permissions on who can access certain electronic files/digital through metadata, passwords, encryption, and/or use of watermarks. It is important to protect our clients' property, both tangible and digital, from unauthorized use and disclosure. Unfortunately, however, digital assets often are insufficiently protected.

Cybercriminals and Digital Assets

Allowing digital assets to fall into the wrong hands can have disastrous consequences for a firm, company, or practice. The Minnesota Rules of Professional Conduct are clear: we lawyers have an ethical duty to our clients to "make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client." And clients expect that we protect their information as well. By failing to take proactive, preventative steps to protect our clients' information, we only open ourselves up to potential loss, which could also result in discipline that adversely affects our livelihood.

Bottom Line

Our society has transformed. The value of digital assets now exceeds the value of physical assets. There are nearly limitless examples of a digital asset, which can include anything from emails and Excel spreadsheets to complex algorithms and non-traditional forms of currency. The value, complexity, and pervasiveness of digital assets are anticipated to grow. Regardless of your legal practice, digital assets almost assuredly play a larger role than you may think for you and your clients. While legal practitioners are not expected to be experts on digital assets, they need to have a basic understanding of their implications for the legal field. Legal practitioners who advise clients on protecting and fostering digital assets will better leverage the value they provide to clients.

¹ See Roberta D. Anderson, *Legal Considerations for Cybersecurity Insurance*, in NAVIGATING THE DIGITAL AGE: THE DEFINITIVE CYBERSECURITY GUIDE FOR DIRECTORS AND OFFICERS 121, 121 (Matt Rosenquist ed., 2015).

² John Romano, *A Working Definition of Digital Assets*, THE DIGITAL BEYOND (Sept. 1, 2011), <http://www.thedigitalbeyond.com/2011/09/a-working-definition-of-digital-assets/>.

³ Heather Antoine, *Digital Legacies: Who Owns Your Online Life After Death?* 33 THE COMPUTER & INTERNET LAWYER 15, 15 (2016).

⁴ See, e.g., INTERNAL REVENUE SERVICE, PUBLICATION 544: SALES AND OTHER DISPOSITIONS OF ASSETS 25 (2016), <https://www.irs.gov/pub/irs-pdf/p544.pdf>.

⁵ See Antoine, *supra* note 3, at 15 ("Characters and accounts developed on [video] games, such as Word of Warcraft and Second Life, can be sold to other players for a price.").

⁶ Cade Metz, *AI Is Transforming Google Search. The Rest of the Web Is Next*, WIRED (Feb. 4, 2016), <https://www.wired.com/2016/02/ai-is-changing-the-technology-behind-google-searches/>.

⁷ McAfee Reveals Average Internet User Has More Than \$37,000 in Under-protected "Digital Assets," INTEL SECURITY, <http://www.mcafee.com/us/about/news/2011/q3/20110927-01.aspx> (last visited Sept. 26, 2016).

⁸ Vipal Monga, *Accounting's 21st Century Challenge: How to Value Intangible Assets*, WALL STREET JOURNAL (Mar. 21, 2016, 8:05 PM), <http://www.wsj.com/articles/accountings-21st-century-challenge-how-to-value-intangible-assets-1458605126>.

⁹ Joerg Krings et al., *Will You Be Mine in the Digital World?* STRATEGY + BUSINESS (Mar. 1, 2016), <http://www.strategy-business.com/article/Will-You-Be-Mine?gko-fdce3>.

¹⁰ Richard Nieva, *Verizon Reportedly Asks for \$1B Discount on Yahoo Sale*, CNET (Oct. 6, 2016), <https://www.cnet.com/news/verizon-lb-discount-on-yahoo-sale-hack-breach-government-surveillance-email/>.

¹¹ Antoine, *supra* note 3, at 16. This same concept also applies to other forms of digital media such as music files. See *id.*

¹² See 17 U.S.C. § 101 *et seq.* See also Andrew Stockment, *Copyrights and Works Made for Hire*, ABA, http://www.americanbar.org/publications/tyl/topics/intellectual-property/copyrights_and_works_made_for_hire.html.

¹³ Joseph Webster et al., *Protecting Digital Assets: Legal Protections for Practical Security*, 17 IT PROF'L 56, 56 (2015).



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