PAUL HASTINGS

Stay Current

February 2022

Follow @Paul_Hastings

Has English Law Jumped on the Crypto Bandwagon?

By Alex Leitch, Harry Denlegh-Maxwell & Jonathan Robb

Introduction

In April 2021, Sotheby's realised $17 million at auction for a non-fungible token created by the artist Pak; that same month, Bitcoin reached an all-time high price of $64,863; in August 2021, Lionel Messi received crypto 'fan tokens' as part of his big-money transfer to Paris St. Germain; and, in its 2021/2022 business plan, the U.K.'s Financial Conduct Authority ("FCA") estimated that the number of U.K. consumers holding cryptoassets had risen to 2.3 million.

Against that backdrop, the Right Honourable Sir Geoffrey Vos (the most senior civil judge in England and Wales) can rightly feel comfortable with his 17 September 2021 prophecy that the "*commercial disputes that will need to be resolved in the coming years will be quite different from those we are used to*". As Master of the Rolls, Sir Geoffrey has been leading the charge for the evolution and adaptation of English common law to cryptoassets and other new technologies, most notably through his stewardship of the U.K. Jurisdiction Taskforce ("UKJT"). On 18 November 2019, the UKJT published its "*Legal Statement on Cryptoassets and Smart Contracts*" (the "UKJT Statement"), which, whilst not a binding statement of law, offered essential and accessible guidance as to the legal classification of cryptoassets.

In this article we look at: (i) what cryptoassets are; (ii) what their legal status is; (iii) the key crypto-cases before the English Courts; and (iv) relevant litigation issues and tools that can be deployed in recovery of lost cryptoassets.

Keeping abreast of this quickly evolving legal landscape is vital for anyone concerned about their crypto rights and how such rights can be enforced. Cryptoasset owners, investors, platforms, businesses, advisers, and onlookers alike should read on to get up to speed, or use the following hyperlinks to jump to the section of most interest to you:

In a 'cryptographically-authenticated nutshell', what are cryptoassets?

Cryptoassets are electronically stored and secured data existing on a peer-to-peer network chain: those with access to the blockchain can trade their cryptoassets without the need for a centralised banking intermediary. As explained in the UKJT Statement, a cryptoasset is usually represented by one public data parameter (which is the relevant section of the public blockchain with encoded information as to ownership, value, and transaction history) and one private data parameter (that is the private key unique to each cryptoasset, which private key attaches to the public blockchain, and is cryptographically authenticated).

Without wanting to overstay our welcome in this particular arena of technological complexity, it is worth briefly noting the difference between a non-fungible token ("NFT") on the one hand, and cryptocurrencies on the other. An NFT is, as the name suggests, non-fungible; it is a unique code secured on a blockchain that represents, for example, a unique work of art, a video clip, a song, or even a tweet.[1] Whilst virtual representations of the item conveyed by the NFT can be copied and reproduced, the original NFT itself cannot. By way of analogy, you can purchase various prints of Van Gogh's "Starry Night", but you (or indeed someone with sufficient wealth) could only purchase, or try to purchase, one of the original. Whilst this article looks more at cryptocurrency, NFTs are continually increasing in prominence and the litigation landscape will likely bear witness to increasing 'new-era fine art litigation'.

Cryptocurrencies (such as Bitcoin or Ethereum) are fungible, that is to say they are defined by their value and are therefore mutually tradeable, much like state-backed (or "fiat") currency. Just as one £10 note derives the same value as another £10 note, even though they are physically different, one Bitcoin derives the same value at any one point in time as another Bitcoin, even though their private coding is different.

What is the legal status of cryptoassets and why is this relevant?

Being defined as 'property' (or not) dictates, perhaps obviously, whether (or not) proprietary rights can subsist in a given item, and therefore whether proprietary claims can be made in that item.

Whilst the boundaries have grown more malleable over time, English law remains astute to the detection of property rights, and still truly only recognises two types of property: things in possession (that is objects that can be physically possessed); and, things in action (being a right capable of enforcement, for example the right to enforce a debt). It is reasonably beyond doubt that cryptoassets, for their lack of tangibility, cannot constitute a 'thing in possession', but they similarly do not fit neatly into the second type of property. However, as the UKJT Statement concludes, whilst a cryptoasset might not satisfy the narrow definition of a 'thing in action' (i.e. an enforceable right) that should not preclude cryptoassets from constituting property.

In *AA v Persons Unknown*,[2] the High Court commented that "*there is a difficulty in treating Bitcoins and other crypto currencies as a form of property: they are neither chose in possession nor are they chose in action*". Nevertheless, the Court was drawn to the "*compelling*" analysis of the UKJT Statement, in determining that, because a cryptoasset does not neatly constitute a 'thing in action', does not mean it cannot be property. That analysis is supported by the four criteria of 'property' set out by Lord Wilberforce in the seminal case of *National Provincial Bank v Ainsworth*,[3] being: definable; identifiable by third parties; capable in their nature of assumption by third parties; and having some degree of permanence or stability. In *Fairstar Heavy Transport NV v Adkins*[4] the requirements for property were explained as being: certainty, exclusivity, control, and assignability. Breaking down these criteria of 'property':

1. the public data parameter of a cryptoasset renders that asset definable, certain, and identifiable by third parties with access to the relevant blockchain ledger;

2. the private data parameter, that is the private key, provides exclusivity and control to the asset;

3. each cryptoasset is capable, in principle, of being assumed by (or assigned to) third parties, indeed cryptocurrency in particular was designed with transfer in mind; and

4. a cryptoasset is as much permanent as any other financial asset.

AA v Persons Unknown was more recently cited in the November 2021 case of *Director of Public Prosecutions v Briedis and Reskajs*,[5] in which Justice Fordham remarked that cryptoassets fall within the wide definition of property ascribed by Section 316(4)(c) of the Proceeds of Crime Act 2002: "*things in action and other intangible or incorporeal property*". Both the UKJT Statement and *AA v Persons Unknown* conclude that cryptoassets should be treated, in principle, as possessing all the "*indicia of property*". The owner of that property will be the person who possesses the private data parameter, i.e. the private key.

Key crypto-cases to date

The courts—as with the regulators—are still finding their feet when it comes to cryptoassets. In keeping with its intent to keep pace with society more generally, the English court system has demonstrated willingness to assist cryptoasset owners and to give effect to their rights. We look at some of the key cases below.

AA v Persons Unknown

The key point of law arising out of *AA v Persons Unknown,* as referred to above, was the categorisation of cryptoassets as property. However, the case also identifies other key considerations and tools to bear in mind in the conduct of litigation.

A Canadian insurance company was subjected to a malware attack disabling its IT systems. As a ransom, the hackers demanded that $950,000 worth of Bitcoin be transferred to an anonymous account. The insurance company was itself insured against such a cyberattack, and the insuring entity traced the Bitcoin with the use of specialists to an account with Bitfinex (a cryptoasset exchange). Thereafter, the insurance company sought a proprietary injunction over the Bitcoins as well as certain disclosure orders, including Bankers Trust and/or Norwich Pharmacal orders against Bitfinex. The English High Court, in determining that Bitcoin constituted property (and that the other requirements for a proprietary injunction were met), granted the relief sought, thereby freezing the Bitcoins. The Court further ordered all four respondents to disclose information about the identity and location of the first two respondents (i.e. the persons unknown).

In addition, the Court was satisfied that the hearing engaged various limbs under Part 39.2 (*General rule – hearing to be in public*) of the Civil Procedure Rules ("CPR"), with the result that the hearing should be held in private. The Court considered that if the hearing went ahead in public (as in the ordinary course): it could tip off the persons unknown to enable them to dissipate more of the Bitcoins; it might cause further cyberattacks on the insurer and/or the insured company as well as copycat attacks; confidential information could be revealed; and, as the application was made without notice, it would be unjust to any respondent for there to be a public hearing. The Court also gave orders for service out of the jurisdiction (given that the domicile of the persons unknown was, naturally, unknown), and alternative service.

Fetch.ai Ltd and another v Persons Unknown Category A and others[6]

This case provided further confirmation of the *lex situs* (legal place) of cryptoassets, and identified that claims for the recovery of cryptoassets may be based on a variety of causes of action.

The applicants in *Fetch* alleged that persons unknown had fraudulently gained access to accounts held with Binance (another cryptocurrency exchange), and sold the claimant's assets at a reduced price resulting in a loss of value to the claimants of $2.6 million. In July 2021, the High Court awarded proprietary injunctive relief to freeze its unlawfully transferred assets (to the extent they could be traced), worldwide freezing orders against those knowingly involved in the fraud, and third party disclosure orders. Permission was also granted for the claimants to serve their claim form out of the jurisdiction.

In addition to the wide-reaching awards that were made, the case identifies two points of particular note. First, applying the unreported case of *Ion Science v Persons Unknown* (21 December 2020), the *lex situs* of cryptoassets should be construed as the domicile of the person or entity who owns the cryptoasset, which, as noted above, is likely to be the person or entity who possesses the private key. Secondly, the application was based on a number of causes of action, including breach of confidence on the basis that the private key to access the cryptoassets constituted pure information (i.e. not property) that was confidential. In respect of that tortious cause of action, for the purpose of the Rome II regulation[7] in respect of non-contractual obligations, the governing law was deemed to be England on the basis that the *lex situs* of the assets was England as that was where the damage had occurred. The English Court was also satisfied that England was the appropriate forum.

Digital Capital Ltd v Genesis Mining Iceland EHF[8]

In September 2021, *Digital Capital* offers an example of a more 'vanilla' litigation, reminding us that cryptocurrency cases are not, and will not be, limited to fraud, persons unknown, and asset tracing.

One of the challenges of cryptocurrency, certainly in its nascent years, was its use in day-to-day commercial transactions, which typically require the rapid exchange of the digital currency into regular fiat currency. That process requires a licensed e-money institution as well as the technical infrastructure to perform the exchange.

In this case the claimant, Digital Capital Ltd, agreed to create that exchange infrastructure for the defendant, Genesis Mining Iceland, and by its claim sought payment of various unpaid invoices. The defendant counterclaimed that the relevant services had not been produced as contractually agreed. Aside from providing a useful examination of the interplay between contractual and common law termination rights,[9] we see in *Digital Capital* that crypto litigation has the scope to encompass various fields, including (amongst many others) intellectual property, technology, commercial contracts, financial services, and regulatory disputes.

Tulip Trading Ltd (a Seychelles company) v Bitcoin Association for BSV (a Swiss verein) and others[10]

More recently in January 2022, the English High Court has determined that cryptocurrency, for the time being at least, does not constitute adequate security for the purpose of satisfying an order for security of costs, on account of Bitcoin's volatility. This case more generally is one to watch as it develops further.

In this case, the claimant claims to own US$4.5 billion worth of Bitcoin (the "Assets"), which were accessed by its UBO Dr Wright (who claims to have created the Bitcoin cryptocurrency system under the pseudonym "Satoshi Nakamoto") from his computer in England using secure private keys. The 16 defendants are open-source software developers who developed or improved the Bitcoin software on a non-commercial basis. Following a hack into Dr Wright's computer in February 2020, the private keys were deleted meaning that the Assets could no longer be accessed. The claimant alleges that the defendants owe fiduciary and/or tortious duties to it to rewrite or amend the underlying software such that the Assets can be recovered.

Fifteen of the sixteen defendants have contested the jurisdiction of the English Courts to hear the dispute, with the hearing due to take place at the end of February 2022. In respect of that hearing those fifteen defendants were awarded security for their costs under CPR 25.13(2)(c), being that there was reason to believe that the claimant will be unable to pay the defendants' costs if ordered to do so. The two January judgments from this case are of more general interest in the context of security for costs applications. However, of particular note for this article was the Court's view that cryptocurrency does not "*result in protection for the defendants that equal to payment into court, or first class guarantee*" and therefore will not be adequate security.

Litigation issues and tools

Consistent with the technological complexity of cryptoassets themselves, the cases referred to above highlight the litigation quagmires generated in seeking recovery of cryptoassets. We briefly note below some of the key considerations and tools that practitioners will have to consider in the context of crypto litigation.

Jurisdiction and governing law

It will often be the case with crypto-fraud that the bad actors are 'persons unknown'. Where there is no contract to look at or in the absence of a contractual exclusive jurisdiction clause, whether an English court will accept jurisdiction to hear a dispute where the defendant is not domiciled in England or Wales (or it is not known where they are domiciled), will be determined by the test set out in Part 6 of the CPR:

1. Is there a serious issue to be tried in respect of which the claimant has a reasonable prospect of success?

2. Is there is a good arguable case that the claim falls within one of the 'jurisdictional gateways' set out in Practice Direction 6B of the CPR?

3. Is England and Wales the proper place to bring the claim in all the circumstances?

As regards the applicable governing law, in the case of *Ion Science v Persons Unknown* (unreported) (21 December 2020), Butcher J referred to the textbook "*Cryptocurrencies in Public and Private Law*" by Professor Andrew Dickinson, which states that "*the benefits accruing to a person who is a participant in a cryptocurrency system such as Bitcoin [… are] appropriately governed by the laws of the place of residence or business of that participant with which that participation is most closely connected*". England is where you own and operate your cryptoassets, therefore English law should be the applicable law for any claim related to that property.

Service

In a claim against 'persons unknown' permission from the court will be required to serve the claim form and any injunction application out of the jurisdiction. For known entities, the method of service must comply with local rules (in respect of which local advice should be sought); however, how do you serve unknown people? As demonstrated in the seminal 'persons unknown' case of *CMOC v Persons Unknown*,[11] the English court is willing and able to adopt novel approaches to service, particularly in cases of fraud. Above all, the options for effecting service will have to be discussed upfront with the Court, and technical IT experts may be a useful resource for establishing creative and, more importantly, credible means of effective alternative service.

Freezing injunctions

Particularly in cases concerning the fraudulent loss of cryptoassets, the key applications will be for: (i) an interim proprietary injunction freezing the relevant cryptoassets and/or the traceable proceeds of those assets; and (ii) an *in personam* freezing injunction attaching to the parties who have perpetrated the wrong, which will have the effect of freezing their assets (ideally on a worldwide level).

Both injunctions will follow the principles set out in *American Cyanamid Co (No 1) v Ethicon Ltd*:[12] (i) is there a serious issue to be tried?; and, if so, (ii) where does the balance of convenience lie? On the second limb of that test, a fundamental question will be whether damages would be an adequate remedy, in which case, an injunction would not be appropriate. In *Toma v Murray*,[13] the High Court declined to continue previously granted interim injunctions in respect of a Bitcoin fraud. The claimants were only concerned about the loss of the value that the Bitcoins represented (therefore damages were adequate), and, more to the point, the defendant was known to have an unencumbered asset that would have satisfied any award of damages.

Disclosure orders

E-wallets on cryptocurrency platforms (as with bank accounts in respect of regular fiat currency) will inevitably be a target for fraudsters. Therefore, victims might seek the following court orders compelling the relevant platform to disclose details of the fraudsters and where they sent the cryptoassets:

1. **Norwich Pharmacal Orders**: where a party has been involved or mixed-up in wrongdoing, and is unlikely to become a party to the main proceedings, then a court can order that third party (e.g. the cryptocurrency platform) to disclose relevant information where such disclosure is necessary in the interests of justice.

2. **Banker's Trust Order**: a bank (or entity performing services akin to a bank) can be ordered to disclose documents relevant to a customer account, where there is cogent evidence of fraud and confidential information is sought from the bank that would assist in the recovery of dissipated property. In both the cases of *Fetch* and *Ion Science*, free standing Banker's Trust orders were ordered against cryptocurrency exchanges based outside of the jurisdiction.

Conclusion

In the preface to his eponymous report, Sir Ron Kalifa OBE noted that fintech "*is a permanent, technological revolution that is changing the way we do finance*" and under that umbrella, the U.K. "*has the potential to be a leading global centre for the issuance, clearing, settlement, trading and exchange of crypto and digital assets*". Litigation and regulation alike will have to continue to adapt to the new challenges that technology generally is creating every day. As case law evolves and expands into other legal areas (trusts, insolvency, etc.), practitioners will have to keep abreast of that evolution, both as to how the issues raised above are changing as well as how the courts are responding to new challenges.

In the actual conduct of litigation, it is clear that speed (above all in cases of fraud) will be vital if a claimant is to have more than meretricious success. Practically speaking, litigators and judges alike are still getting to grips with the technology underpinning cryptoassets, which demands consideration particularly when drafting witness statements such that those documents can be as easy to understand as possible. E-disclosure will equally have to adapt to the new types of data being captured for review—most notably coding documents—which will also have to be explained in digestible language to the court. Experts will invariably be a vital component of a well-orchestrated case.

✧ ✧ ✧

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings London lawyers:

Alex Leitch
44.020.3023.5188
alexleitch@paulhastings.com

Harry Denlegh-Maxwell
44.020.3321.1008
harrydenlegh-maxwell@paulhastings.com

Jonathan Robb
44.020.3023.5110
jonathanrobb@paulhastings.com

[1] Joe Dorsey, the founder of Twitter, sold the NFT of his first tweet for $2,915,835.47 in March 2021.

[2] *Persons Unknown who demanded Bitcoin on 10th and 11th October 2019 and others* [2019] EWHC 3556 (Comm)

[3] [1965] 1 AC 1175

[4] [2013] EWCA Civ 886

[5] [2021] EWHC 3155 (Admin)

[6] [2021] EWHC 2254 (Comm)

[7] Article 4(1)

[8] [2021] EWHC 2462 (Comm)

[9] Such examination is beyond the scope of this article, but please see our case summary at this link.

[10] [2022] EWHC 2 (Ch)and [2022] EWHC 141 (Ch)

[11] [2018] EWHC 2230 (Comm)

[12] [1975] UKHL 1

[13] [2020] EWHC 2295 (Ch)

Paul Hastings LLP

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2022 Paul Hastings LLP.