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UK Courts Continue To Struggle With Crypto-Asset Cases - Emily Saunderson and Sam Mitchell

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Cryptocurrency is garnering an increasing level of institutional acceptance as the price of bitcoin surged to record highs in March after the Financial Conduct Authority signaled its approval of crypto-backed exchange traded notes.[1] Furthermore, in January, the U.S. Securities and Exchange Commission approved 11 bitcoin-based exchange traded funds.[2]

These developments may suggest that crypto is finally coming of age. Crypto-assets have been regarded as an exciting new area of development in the law for, at least, the last 10 years. But, the reality is somewhat different.

Most of the crypto-asset cases before the courts involve fraud and are overwhelmingly brought against persons unknown.[3] And while the legal status of cryptocurrency is now relatively well-established, the issues of whom to sue and where they are remain the same as they have always been.

The relatively small sums usually at stake combined with the uncertainty of achieving any meaningful recovery and the front-loading of costs in seeking disclosure and freezing orders, mean that — despite all the noise — relatively few crypto cases make it to court.

Furthermore, when they do, there is usually no one on the other side, which means that difficult legal points are usually not argued fully or at all.

While few people doubt the capacity of the English common law to adapt to this now not-so-new asset class, it seems that the nature of the cases means that any meaningful development in the law concerning crypto-assets is likely to come from legislation and regulation.

This article will address the issues inherent to crypto claims, why those issues make it difficult for the common law to progress, and why the resolution of those issues is beyond the courts' ambit.

What are crypto-assets?

It is now widely recognized that crypto-assets are property, and therefore can be the subject of proprietary injunctions and asset preservation orders.

For example, on Feb. 3, 2023, in the Court of Appeal of England and Wales' judgment in ***Tulip Trading Ltd. v. Bitcoin Association for BSV***,[4] Justice Colin Birss endorsed the view that bitcoin was property.[5]

This followed the consideration set out in the U.K. Jurisdiction Taskforce's report "Legal statement on cryptoassets and smart contracts," published in November 2019, and the adoption of that analysis by the High Court of Justice of England and Wales in its decision on Dec. 13, 2019, in ***AA v. Persons Unknown*** in the context of an application for a proprietary injunction.[6]

But it is worth bearing in mind that this is not a straightforward issue. Crypto-assets are usually represented by two elements: a public key, which identifies the address, or wallet, in which the crypto-asset is held, and a private key with which its owners may authorize transactions into or out of the wallet.

Each transaction is broadcast to a public network, where it is verified — often grouped in a block with other transactions — with a unique code, or hash, and recorded in a public ledger. Ledgers are often distributed and decentralized, meaning that no single entity has the right or obligation to maintain them, and that any attempt to alter transactions within a ledger would also alter the hash and thereby be noticed and rejected by other participants.

Therefore, ledgers, at least in principle, maintain an accurate and unalterable record of transactions between wallets, without needing to identify the owners, and without reliance on a single third party. Despite this, it is not easy to discern the nature of a crypto-asset from the various descriptions of them that are available.

In its final report on digital assets, published in June 2023, the Law Commission concluded that digital assets were neither things in possession nor things in action, but a "Third Category of Thing," which gives some indication of the complexity of the issue.

Meanwhile, opinions continue to differ. Robert Stevens, professor of private law at the University of Oxford, stated in his 2023 article "Crypto is not Property," that despite "widespread" support for the treatment of crypto-assets as property, "the case for the legislature recognising cryptoassets as 'property' generally for legal purposes was extremely weak, and that for the courts taking such a step non-existent."[7]

As the Court of Appeal has endorsed the view that bitcoin is property, concerns as to the nature of crypto-assets may be considered academic. But, so far, this issue has not been the subject of serious, or any, challenge in the courts in the U.K., despite the classification as "property" being what might be thought a fairly fundamental point when it comes to a new asset class.

Who do you sue?

The High Court's decision in ***Tuppawan Boonyaem v. Persons Unknown*** on Dec. 14, 2023, provides an example of the problems that can arise in suing persons unknown.[8]

Tuppawan Boonyaem was contacted by an individual, referred to as SC, through Facebook and was persuaded, by the promise of lucrative returns, to invest in crypto-assets. Boonyaem purchased USDT — a cryptocurrency tethered to the value of the U.S. dollar — and transferred them from her wallet to wallets controlled by SC and/or an entity known as INGFX on the understanding that SC or INGFX would use the USDT to purchase other crypto-assets as an investment on her behalf.

Boonyaem was led to believe that her investments were successful, but when she tried to withdraw the sums, she was compelled to pay 8% tax, 5% withdrawal fees and 4% insurance. After paying those sums, SC and INGFX stopped all contact with Boonyaem, and no USDT was ever returned. However, Boonyaem was able to trace some of her USDT to other wallets, of which the addresses but not the owners could be identified.

Boonyaem brought the claim against three categories of defendants:

- Persons Unknown A, who were, broadly, the people associated with INGFX, the person who used the name SC, or people who were associated with the telephone numbers used to contact Boonyaem;
- Persons Unknown B, who were the owners of the wallets to which the USDT could be traced; and
- INGFX Ltd., which is an English company.

None of the defendants responded to the claim, and summary judgment was sought.

The court gave summary judgment against Persons Unknown B on the basis that:

- The USDT constituted property for the purposes of the English rule that property acquired by fraud gives rise to a constructive trust;
- The required level of coordination between depletion and acquisition of the assets was established between Boonyaem's wallet and the identified wallets; and
- That the defendants could be adequately identified as owners of the wallets.

However, the court refused to give summary judgment against Persons Unknown A because Boonyaem was unable to identify SC or the persons involved with INGFX. The individuals could not be identified by reference to an act they were alleged to have committed. Therefore, a final judgment, as opposed to interim remedies, could not be granted.

But you do not always need to identify the fraudster: The key to any recovery is to find some assets.

It is challenging to locate crypto-assets and determine jurisdiction.

The very nature of crypto-asset transactions means that they can be carried out virtually without any indication of the identity or location of the receiving party, save for a wallet address. The courts have some tools that can be used to uncover information concerning the potential defendants and the whereabouts of assets, such as Norwich Pharmacal and Bankers Trust orders, but these are not guaranteed to be fruitful.

For example, in Boonyaem, 10% of the USDT could not be traced, and the identity of Persons Unknown A were never discovered. In those circumstances, final judgment could not be entered against them.

But even if fraudsters can be identified or assets can be traced to particular wallets, there is a difficulty in identifying the appropriate place of service, which is how English courts assume jurisdiction. Claimants, defendants and exchanges are unlikely to be in the same place, and there is the added difficulty of determining the place of the crypto-assets.

Unlike a physical or tangible asset, a crypto-asset exists only in software, which is not tied to any single computer or location. Furthermore, as ledgers are often distributed and decentralized, there is no singular or primary server to which crypto-assets can be tied.

The courts are developing methods to deal with these issues, such as treating the residence or domicile of a crypto-asset's owner as the situs of that asset, or permitting service by creative means, such as by delivering a nonfungible token to a particular wallet, but these methods are far from well established.

The appeal judgment in ***Tulip Trading v. Bitcoin Association for BSV***[9] is notable because it is the only case, so far, to make it to the Court of Appeal where the nature of crypto-assets has been considered, and because it concerned a jurisdiction challenge.

The defendants in Tulip were various entities outside the jurisdiction, alleged to be the developers of four bitcoin exchanges. The claimant, Tulip, alleged that the private keys to its wallets on the exchange, which held a substantial amount of bitcoin, had been stolen.

Tulip sought an order compelling the developers of the exchange to update its software, so that the bitcoin in the wallets could be safely transferred to wallets controlled by Tulip without the private keys, on the basis that the developers owed it a fiduciary duty to do so.

Many of the defendants challenged the English court's jurisdiction.

The first instance judge found that there was no real prospect of establishing a fiduciary duty decision, and so service on the defendants should be set aside.

The Court of Appeal reversed that decision. It said that for the Tulip's case to succeed, there would have to be a significant development of the law concerning fiduciary duty, but that there was a real prospect of successfully establishing such a duty, and so there was a serious issue to be tried on the basis that:

» The parties accepted that crypto-assets constituted "property."

» It was arguable that the developers had the power and decision-making authority to update the exchange's software, such as fixing bugs.

» There was arguably an entrustment of property to the developers, because the owners of the bitcoin could not update the exchange's software themselves.

Thus, it was arguable the developers owed a fiduciary duty to update the exchange to permit Tulip to recover its crypto-assets.

It remains to be seen to what extent those defendants participate in the proceedings now that their jurisdiction challenge has been dismissed. But the decision is further evidence of the adaptability of the common law to the challenges raised in relation to crypto-assets.

What is next?

Claimants must understand — particularly in cases involving fraud, overseas defendants, and the inherent anonymity associated with crypto-assets — that there is a risk that remedies will likely be limited to the recovery of traceable assets, not money. That makes the cost exposure of these claims particularly high with a two-fold effect, namely that:

Parties are less interested in pursuing academic points or points on appeal, with Tulip being the only Court of Appeal authority on the nature of crypto-assets.

Parties are incentivized to have their claims resolved by way of summary disposal, whether that is a default judgment, summary judgment or challenges to jurisdiction, rather than progressing to a full trial.

Those factors together make for limited opportunities for the common law to develop principles concerning crypto-assets. The common law has demonstrated that it is capable of flexibility and of applying established principles to the new technologies of crypto-assets, including:

- By the use of third-party disclosure orders to identify fraudsters and owners of wallets;
- By the treatment of crypto-assets as property;
- By the identification of a crypto-asset's situs by reference to its owner's place of residence;
- By permitting service on wallets through the use of nonfungible tokens; and
- By recognizing at least the possibility of fiduciary duties owed by exchanges.

However, those developments have happened in spite of the limited opportunities given to the courts, not because of them.

The factors limiting the courts' opportunities to progress the common law in relation to crypto-assets are not easily rectified, and it may be time for statutory regulation to intervene and supplement the principles that the courts might once have been expected to develop.

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[1]https://www.reuters.com/technology/uk-financial-watchdog-will-not-block-requests-crypto-exchange-traded-notes-2024-03-11/.

[2] https://www.sec.gov/news/statement/gensler-statement-spot-bitcoin-011023.

[3] Where the claimant does not know the defendants' names or identities, it may sue "persons unknown" who meet a certain description. A recent example, the High Court case of ***Tuppawan Boonyaem v Persons Unknown*** dated 14 December 2023, is discussed below.

[4] ***Tulip Trading Ltd v Bitcoin Association for BSV*** [2023] EWCA Civ 83.

[5] ***Tulip Trading Ltd v Bitcoin Association for BSV*** [2023] EWCA Civ 83, para. 25.

[6] ***AA v Persons Unknown and others*** [2019] EWHC 3556 (Comm).

[7] (2023) 139 LQR 695.

[8] ***Tuppawan Boonyaem v Persons Unknown*** [2023] EWHC 3180 (Comm).

[9] ***Tulip Trading Ltd v Bitcoin Association for BSV***[9] [2023] EWCA Civ 83.

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