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Fighting Cryptocurrency Fraud: What's in the English Lawyer's Toolkit?

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Synopsis

Cyber criminals reportedly have taken advantage of the COVID-19 pandemic (and lapses in cybersecurity) on a significant scale. We anticipate that knowledge of the developing English and Commonwealth jurisprudence concerning cryptocurrency will become increasingly essential in combatting such fraud. This article: (1) highlights some of the occasions when a litigator may come across cryptocurrency, (2) outlines some of the interim remedies potentially available where cryptocurrency is concerned; and (3) addresses some of the recent authorities in England and some other Commonwealth jurisdictions dealing with the issue of whether cryptoassets can be considered property, and thus subject to a proprietary claim – a question of particular importance in fraud claims within an insolvency context.

When might a lawyer come across cryptocurrency?

Whilst the paradigm case would be one where cryptocurrency has been misappropriated from a client, there are other examples which may be less obvious. For example, an asset may be sold and the proceeds converted into cryptocurrency, or a client may have made a ransom payment in cryptocurrency and want to recover the payment. It is also possible that a client could have innocently purchased cryptocurrency from a fraudster and be caught up in a dispute with the victim/initial owner of the cryptocurrency. Whichever example, it is essential that the modern commercial lawyer dealing with the matter has at least some knowledge of how cryptocurrency is treated as a matter of English law.

What remedies are available to restrain or control the proceeds of fraud?

As practitioners will be aware, a litigator has a wide range of interim remedies available to him or her in fraud cases under CPR 25.1(1) as well as at common

law and in equity. These remedies include: (1) the Freezing Order; (2) the Search Order; (3) the Asset Preservation Order; (4) the Proprietary or Tracing Injunction; (5) orders directing a party to provide information about the location of assets; and (6) Norwich Pharmacal/‘Bankers Trust’ orders. These interim remedies are varied, and often hinge on a particular asset being classed as ‘property.’ When deployed at the right time, a challenging case can be completely resolved in a client’s / victim’s favour by the use of such interim remedies. However, the balance is a fine one: when used incorrectly an interim remedy can become a new battleground (and lead to a diversion of time and resource).

In addition, there are powers in criminal proceedings in the form of (among other things): (1) confiscation orders (under the Proceeds of Crime Act 2002), (2) account freezing and forfeiture orders, (3) unexplained wealth orders (both (2) and (3) under the Criminal Finances Act 2017); and (4) freezing orders (under the Criminal Justice Act 1988). The substance of these powers is beyond the scope of the article. However, one of the main purposes of these remedies is to deprive someone of the benefit of criminal conduct and/or to prevent the dissipation of assets pending trial. For those reasons, they may also have a role to play in cryptocurrency related litigation. We expect that the battle against cryptocurrency related fraud will require the use of multiple remedies (the nature of which will turn on the circumstances of the particular case).

The authorities on cryptocurrencies

The UK Jurisdiction Task Force’s legal statement on the status of cryptoassets and smart contracts of November 2019 (the ‘UKJT Statement’) addressed, among other things, the extent to which cryptocurrency could be considered to be property. The Task Force concluded (among other things) that cryptoassets could be considered ‘property’ within the meaning of section 436 of the Insolvency Act 1986. We set out below short summaries of some of the recent cases in England and certain other Commonwealth jurisdictions that

have addressed this issue and the related question of the remedies available to the victim of cryptocurrency fraud.

1. Vorotyntseva v Money-4 Ltd (T/A Nebus.com) and others [2018] EWHC 2596 (Ch)

Vorotyntseva transferred approximately £1.5m of Ethereum and Bitcoin to Money-4 and its directors (who were also defendants), for the purposes of Money-4 dealing with that cryptocurrency on its new trading platform (on behalf of Vorotyntseva). Vorotyntseva became concerned that those funds had been dissipated and applied for a proprietary and freezing injunction (which was subsequently granted). The defendants were represented at the hearing. The decision indicated that cryptocurrency could be a form of property and be subject to an injunction.

2. Robertson v Persons Unknown (unreported – 2019)

Robertson was the victim of a 'spear phishing attack' which resulted in him transferring 100 Bitcoin (worth approximately £1.2 million at the time) to a fraudster's cryptocurrency wallet. By tracing the transfer on the public Bitcoin blockchain, it became apparent that the fraudster had then transferred 80 of those Bitcoin to another wallet which was operated by Coinbase (a well-known cryptocurrency exchange).

The Commercial Court acknowledged that there was a serious issue to be tried in respect of whether or not the 80 Bitcoin were Robertson's personal property and granted an Asset Preservation Order in respect of those Bitcoin. The Commercial Court also granted a Bankers Trust order, which required Coinbase to disclose certain information about the wallet holder.

3. AA v Persons Unknown [2019] EWHC 3556 (Comm)

A hacker gained unlawful access to the IT system of a Canadian Insurance company and deployed ransomware. The hacker demanded \$1.2m in Bitcoin, as the ransom payment, in exchange for the decryption software and keys.

The Canadian Insurance company was itself insured by an insurer in England. The English insurer appointed a specialist negotiator who agreed a reduction of the ransom directly with the hacker to \$950,000 (in Bitcoin) and facilitated the transfer to the hacker's proposed Bitcoin wallet. Once the Bitcoin had been transferred, the decryption keys were provided so as to 'unlock' the encrypted files and systems.

The English insurer then worked with specialist blockchain tracing experts to 'follow' the transfer of

the Bitcoin. A substantial amount (96 Bitcoin) had been transferred to a wallet operated by the cryptocurrency exchange, Bitfinex (which is itself the trading name of two BVI entities). The English insurer applied for a proprietary injunction against persons unknown and sought disclosure orders against Bitfinex to obtain the relevant KYC documentation provided to Bitfinex by the true controller of the wallet.

The Commercial Court adopted the rationale as set out in the UKJT Statement and confirmed that cryptocurrencies are capable of being subject to an interim proprietary injunction. The Commercial Court ordered that Bitfinex provide information in relation to the potential 'persons unknown' in order to police the injunction.

4. B2C2 Ltd v Quoine Pte Ltd [2020] SGCA(I) 2 (a Singapore case)

B2C2 entered into a contract with Quoine (an automated cryptocurrency exchange) so as to allow it to make trades on their platform. Due to an error, the platform executed a trade (Ethereum to Bitcoin) in favour of B2C2 at 250 times the market rate. The proceeds were credited to B2C2's account on the platform. Quoine reversed the trade (notwithstanding the fact that the underlying contract stated that trades were 'irreversible') because of the error. B2C2 sued Quoine for breach of contract and breach of trust. B2C2 and Quoine both accepted during the course of the proceedings that cryptocurrencies were a species of property. Judgment was given in the High Court on liability in favour of B2C2's claims for breach of contract and breach of trust, with damages to be assessed (at a later hearing) if not agreed.

Quoine appealed against the decision. The Court of Appeal upheld the breach of contract claim, but held that there was no trust over the Bitcoin in B2C2's account. The High Court had considered that a decisive factor in the breach of trust determination was the fact that Quoine segregated and held the cryptocurrency separately (rather than as part of its trading assets). The Court of Appeal considered that the segregation of assets from its customers cannot, of itself, lead to that conclusion. The Court of Appeal did not determine that Bitcoin was 'property,' but acknowledged that 'cryptocurrencies should be capable of assimilation in the general concepts of property.'

5. Ruscoe and Moore v. Cryptopia Limited (in liquidation) [2020] NZHC 728 (a New Zealand case)

Cryptopia was a New Zealand-based cryptocurrency exchange that provided an online platform or exchange to allow users to trade pairs of cryptocurrencies between themselves, with Cryptopia charging fees for trades,

deposits and withdrawals. Its servers were hacked in January 2019 and some NZD 30 million of cryptocurrency stolen. Soon after, its shareholders placed Cryptopia into liquidation by special resolution. The liquidators applied to the Court for directions in order to resolve a dispute between, respectively, Cryptopia's creditors on the one hand, and its account holders on the other. The dispute concerned whether the remaining cryptoassets were 'property' within the meaning of section 2 of the NZ Companies Act 1993; and if so, whether such cryptoassets were held on trust by Cryptopia for the benefit of the account holders or whether they fell to be part of Cryptopia's assets available for distribution to the general body of creditors. The Judge held that the remaining cryptoassets were 'property' within the meaning of the NZ Companies Act 1993 both on the authorities and as a matter of statutory construction. The Judge also found that as a matter of principle the cryptoassets could be held by Cryptopia on trust for the account holders; and found as a matter

of fact that they were so held on trust since each of the three certainties necessary for a trust (intention; subject matter and objects) were met in the case.

Conclusion

Our provisional conclusion is that there will be a continuing trend for the English Courts to find no conceptual problem in treating cryptoassets as property where the facts and circumstances allow. As such, we anticipate that the English Courts will have no problem in providing, and developing, appropriate interim remedies for victims of cryptocurrency related fraud. We also anticipate in light of the recent case law that tracing or following of cryptoassets (or its proceeds) will present no conceptual difficulty for the English Courts in appropriate cases.

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