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Issues in Crypto Currency Fraud Claims – An Update

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Good morning and thank you to the organisers of this conferencing for asking me to speak to you on this topic. As always, the views I express are mine alone and are not those of the Judiciary of England and Wales.

Before turning to the developments over the last 12 months it is worth identifying a few of the themes I referred to last year.

Firstly, I started by noting that for those who were not as familiar with the joys of Smart Contracts, block chain, distributed ledgers, crypto assets and currencies, Public keys and Private keys or wanted a refresher on the fundamentals, there were two publications that were required reading in the field. The first was the Legal Statement on Crypto assets and Smart Contracts published by the UK Jurisdiction Taskforce in November 2019 and the second was Law Commission Paper No 401 entitled "*Smart legal Contracts – Advice to Government*". The first of these publications remains required reading in this field. The second continues to be important but must now be read subject to the most recent report of the Law Commission published this morning. As you will know, the primary focus of Paper No 401 was on claims between parties to smart contracts rather than those who have been the victims of fraud and the primary conclusion

[1] His Honour Judge Pelling KC, Judge in Charge, London Circuit Commercial Court, a constituent court of the Business and Property Courts of England and Wales, a group of specialist courts and lists within the High Court of England and Wales.

of LC Paper 401 was that no legislative reform is necessary and that the common law is well able to facilitate and support these emerging technologies. I expressed the view then that it was improbable that any different approach would be taken in relation to crypto fraud claims whilst noting that state courts in any jurisdiction and those in England and Wales are no different face acute jurisdictional difficulties in relation to information gathering claims by victims of fraud, usually against Exchanges based in foreign jurisdictions, to claims against fraudsters whose identities were unknown at any rate at the start of the litigation operating in a myriad of offshore jurisdictions and to enforcement of judgments, particularly in relation to proprietary claims involving tracing through a network of foreign registered entities.

The final report of the Law Commission entitled "*Digital Assets*" published this morning. It is now the third publication that all who practice in this area should read. The Law Commission's concluded position is to support the common law as the primary means by which crypto claims should be resolved with the law being described as generally "*relatively certain*" whilst describing the remaining areas of uncertainty as "*highly nuanced and complex*". The Commission makes two recommendations for statutory law reform. The first is to ameliorate any difficulties caused by the way English law defines property rights by in effect declaring that various defined crypto assets are or are capable of giving rise to personal property rights. The second proposal focuses on regulation rather than litigation by supporting the creation of " … *a bespoke statutory legal framework that better and more clearly facilitates the entering into, operation and enforcement of (certain) crypto-token and (certain) crypto asset collateral arrangements*…" The Commission recognises that this is not a matter for law reform alone because it involves issues wider policy judgments for government and so suggests that this be carried

forward by as a multi disciplinary project. The first proposed statutory intervention of course does not need to wait for the second to be ready.

The most novel proposal advocated by the Commission concerns support by the industry and those connected with it to the wider judiciary. The basis for this proposal is the underlying theme that the heavy lifting so far as crypto litigation is concerned should be by the common law. This raises a real difficulty however – caused by the proliferation over time of new products, many of which will be complex "*malleable in their functionality*", multi faceted and using different and ever advancing technology. Because of the speed of change that is likely, the Commission concludes that the common law is better able to keep up than statute law reform. To my mind this is both unsurprising and realistic. However, The Commission concludes that the task of staying alive to such developments poses an enormous task for the judiciary and therefore recommends that the Government creates or nominates a panel of industry-specific technical experts (meaning those with expertise in Crypto token markets as well as traditional finance and intermediated security markets), legal practitioners, academics and judges to provide non-binding guidance on the complex and evolving factual and legal issues relating to control involving certain digital assets (and other issues relating to digital asset systems and markets more broadly). The rationale for this novel (indeed in the civil law context I think unique) approach is that it will result in consistent and informed decision making. This is certainly a model for achieving what is on any view a desirable end. However, other models have been and are being considered in different jurisdictions. One solution may be to create a specialist court (as for example the DIFC has done with a single Judge in Charge of it) or list catering specifically for crypto claims. The benefit of such a scheme is that it can be established quickly and at limited cost and concentrates

expertise within a small group of judges who will more easily be able to keep up with the relevant developments by reason of their attachment to a specialist court or list. The likely downside of this solution is that it will perpetuate the need for extensive and very expensive expert evidence in aid in particular of emergency applications whereas the Commission's proposal may reduce at least the scope of such evidence and therefore its cost as well as reducing the amount of time required by a judge to determine such applications.

There are other detailed recommendations concerning the extension of causes of action and remedies that are too detailed for this talk. The report is a valuable and much needed contribution to how the law and courts should respond to a new and developing area of commercial activity and the Commission team led by Professor Sarah Green are to be congratulated for the thoughtful and practical proposals they make.

When I delivered this talk last year, I was able to say with confidence that Cyber currency fraud claims had shown a steady up tick in volume over the previous 12 to 18 months. That was at a time when fiat currency linked cryptocurrency – the most well known of which is Bitcoin – was experiencing meteoric increases in value. At the end of March 2022, 1 bit coin was worth about £36,240. There was thereafter a fairly meteoric fall in value and perhaps unsurprisingly an apparent drop off in claims. Currently I bitcoin is worth about £24,000 and has been strongly rising all year from a low of about £14,000. I anticipate therefore that there will be an uptick in fraud claims as long as the value of these currencies are perceived to be strongly rising. The other anecdotal change that has become apparent in the last year concerns the size of claims and the status of claimants bringing them. As to the

first, the values of the claims being made appear to be increasing and as to the second, claimants seem now to be including commercial entities as opposed to individuals who have been seduced into investing in schemes usually by internet presentations. This points in turn to those responsible for such frauds becoming both more sophisticated and more ambitious in the way they operate.

Last year I drew attention to a specific difficulty that faced any victim seeking information from a third party service provider usually an exchange and a more general problem arising from most of the principles that apply in this area having been decided on applications where only the claimant was represented or in cases that had been decided at first instance without Court of Appeal.

In relation to information gathering, it will usually be vital for a victim of fraud to achieve two things very quickly. The first will be to gather whatever information can be gathered concerning the true identity of the fraudster and secondly to freeze the assets obtained by the fraud or their traceable proceeds to the extent they remain in the hands of the fraudsters. The traditional response of English law in relation to the first of these issues is to make either Norwich Pharmacal[2] or Bankers Trust[3] orders directed to intermediaries used by the fraudsters requiring those entities (usually banks with the NYC information such institutions are required to collect in relation to account holders)) to supply such information as they have concerning the fraudsters. In a domestic litigation context none of this presents

[2] Norwich Pharmacal Co. v. Customs and Excise Commissioners [1974] A.C. 133. The criteria that must be satisfied if an order is to be obtained are those summarised in Mitsui & Co v Nexen Petroleum UK Limited [2005] EWHC 625 (Ch), 3 All ER 511 at paragraph 21 (Lightman J)

[3] Bankers trust Co v. Shapiro [1980] 1 WLR 1275. This form of order is available to assist in locating assets in which a proprietary interest is claimed. The criteria that must be satisfied if an order is to be obtained are those summarised in Kyriakou v Christie's [2017] EWHC 487 (QB) at paragraphs 14 – 15 (Warby J as he then was).

any particular jurisdictional difficulty. However, where the information holder is located outside England and Wales there was a significant jurisdiction problem caused by one first instance decision suggesting that the court had no jurisdiction to make Norwich Pharmacal orders against institution that could only be served with proceedings out of the jurisdiction[4] whilst other first instance decision shad concluded that Bankers Trust order could be sought from foreign based institutions[5]

This problem was corrected by the Civil Procedure Rules Committee amending Practice Direction 6B so as to add an additional gateway facilitating an application for permission to serve proceedings outside England and Wales where the claim is for information regarding the true identity of a defendant or potential defendant or what has become of the property of the claimant. It had ben thought that this would reduce cost of fraud victim by allowing a conventional Part 8 claim for either a Norwich Pharmacal or Bankers trust order without incurring the very substantial cost of commencing a Part 7 claim against the fraudsters as Persons Unknown whilst at the same time seeking information that may not be forthcoming. There is a difficulty about applying for permission to serve such claims against Exchanges based in overseas jurisdictions however. Before permission to serve proceedings out of the jurisdiction can be given an applicant must satisfy three tests – being (i) that there is a serious issue to be tried as between the claimant and the relevant defendant, (ii) that there is a good arguable case that the claim passes through one or more of the jurisdictional gateways set out in in PD6B paragraph 3.1; and (iii) that England and Wales is the most appropriate forum for the dispute to

[4] AB Bank Ltd v Abu Dhabi Commercial Bank PJSC [2016] EWHC 2082 (Comm) (Teare J)

[5] Ion Science Ltd and another v. Persons Unknown [2020] Unreported 21 December at paragraphs 19-21 (Butcher J) and Fetch.AI Limited and another v. Persons Unknown (categories A, B and C) [2021] EWHC 2254 (Comm).

be determined[6]. The third of these requirements might create a problem (which may largely be a problem of perception) in relation to a Part 8 Claim against only the exchange with the relevant KYC information. Bringing Part 7 proceedings which establishes a very strong link with this jurisdiction for the substantive claim helps address that problem. It is probably for that reason that there has been no interest in the opportunity to seek information from overseas institutions ahead of the commencement of substantive proceedings. There is another possible practical reason. It is usual practice to include within both Norwich Pharmacal and Bankers Trust orders to include a limited ante tipping off provision so as to enable a claimant a limited opportunity to commence substantive proceedings. It may be that cautious practitioners have a concern about the efficacy of such orders when made against institutions with no presence in England and Wales and so avoid that risk by starting substantive proceedings against Persons Unknown, seek freezing orders against those defendants in those proceedings whilst at the same time seeking Norwich Pharmacal and Bankers Trust orders against the institutions concerned.

Last year, I speculated about whether foreign based exchanges not amenable to enforcement procedures would comply with such orders. The tentative view I expressed then was that such exchanges were likely to comply with such orders because of the reputational damage that would result in them being seen not to comply with such orders when sought by the victims of fraud. I am pleased to say that appears to have been the result.

The absence of Court of Appeal authority in this area has been corrected in the last 12 months with the handing down by the Court

[6] Altimo Holdings and Investment Ltd v Kyrgyz Mobil Tel Ltd [2011] UKPC 7; [2012] 1 WLR 1804

of Appeal, of their judgments in Tulip v Van der Laan[7]. The claimant company claimed to be the owner of some bitcoin. The private keeps had been probably stolen meaning the victims could not access their assets or move them to new wallets. They alleged that the controllers of the networks concerned owed the claimants fiduciary and tortious duties to take the necessary steps to correct the problem. Permission was sought to serve the proceedings out of the jurisdiction which was dismissed by the judge on the basis that the alleged duties were not owed as a matter of law. The Court of Appeal allowed the appeal holding that t5he tripartite test I mentioned a moment ago should be applied and that applying that test there was a sufficiently arguable case for permitting service of the proceedings out of the jurisdiction. Although not central to the issues decided by the Court of Appeal Birss LJ recorded:

1. There was no dispute that the cryptocurrency in issue (Bitcoin) was property as the Judge had concluded. This issue should I think now be regarded as determined as a matter of English law. The Judge had followed the earlier first instance decisions in AA v Persons Unknown[8], Ion Science Limited & Anor v Persons Unknown (ibid); and Fetch.AI Limited v Persons Unknown (ibid.) and Birss LJ did not suggest she was wrong to do so. This approach has also been followed both by me and then Lavender J in Osbourne v. Persons Unknown [2023] EWHC 39 (KB) in relation to a claim relating to two NFTs.

2. There was a good arguable case that (a) the claimant was resident in the jurisdiction notwithstanding that it was a Seychelles registered company; and (b) the property (Bitcoin) was located here. This varied slightly the existing law because the conclusion in the earlier first instance cases had been that the *lex situs* of a

[7] [2023] EWCA Civ 83; [2023] 4 WLR 16
[8] [2019] EWHC 3556 (Comm); [2020] 4 WLR 35

crypto asset is the place where the person or company who owns it is domiciled – see Ion Science Limited & Anor v Persons Unknown (ibid); and Fetch.AI Limited v Persons Unknown (ibid.). As the Judge had observed the distinction between domicile and residence was not material in either of those cases but was in Tulip. The judge adopted the residence test rather than the domicile test. Again Birss LJ did not suggest this conclusion was wrong and in my view this issue can now be regarded as decided.

Other developments in the last year concern the availability of the litigation process in relation to what amounts to the theft of NFTs; the liability that Exchanges may have in relation to proprietary claims by victims seeking to trace into mixed funds created by exchanges and service by alternative means, all of which help further to settle the approach to be adopted in crypto claims.

First in relation to NFTs, Osbourne v. PU (ibid.) concerned four wallets included in an account opened by the claimant with MetaMask. The claimant was given two NFTs representing digital works of art said to have a value of between £3,000 and £5,000. They were deposited in the wallet but about four months later were transferred out by an unidentified person or persons.

The key point to emerge from this case is that it is at least realistically arguable that a Non Fungible Token should be treated as property as a matter of English law. It also demonstrates that the most potent cause of action in most crypto cases will be a proprietary claim as a result because the NFTs were property belonging to a claimant resident in England that were removed by fraud so as thereby to become impressed with a constructive truest which was then

breached by the alleged fraudsters transferring the assets away in breach of that trust. Service out of the jurisdiction was an issue in that case. The most straight forward of the gateways will in most cases be Gateway 15 because it relates to claims against a defendant as constructive trustee arising out of acts committed in the jurisdiction. Given that NFTs were property and the lex situs of the property was England (the place of residence of the claimant), there was a strongly arguable case enabling the claimant to rely on that gateway as Lavender J held.

The focus of what I have been saying in relation to exchanges and other intermediaries has been on information gathering. The question that remains is whether an exchange can have any substantive liability for losses suffered by a victim of fraud.

This was the issue considered at a contested hearing before Trower J in Piroozzadeh v. PU[9] which concerned the fraudulent transfer of some Tether ultimately to wallets at the defendant exchanges used by the exchanges own account holders. No allegations of fraud were made against the exchanges. The claimant sought to trace what had been taken to the exchanges' wallets. The key point for present purposes is that the uncontested evidence was that the users of the wallets did not retain property in the Tether deposited, which was swept into central unsegregated "Hot wallet" where they are treated as part of the assets of the exchange concerned and operated as a central pool. The evidence was that there have been hundreds of transactions an hour passing through each of the hot wallets. The question was whether a proprietary injunction granted against the exchange concerned should be continued.

[9] [2023] EWHC 1024 (Ch)

The fundamental point was that this particular exchange operated this part of its business much as clearing banks do. Once the Tether had been swept from the user accounts into the pool, the users were then granted credit in the amount of the value swept which it was submitted would then constitute the exchange a purchaser and no longer susceptible to any remedy at the suit of the claimant so long as it acted *bona fide*. The evidence that the cryptocurrency had been pooled as I have described was what enabled the exchange to assert a bona fide purchaser defence. The judge acceded to the exchanges submission.

Aside from this case demonstrating the engagement of an exchange with no connection to this jurisdiction engaging with the litigation process, the outcome also reflected the acknowledgement in the Law Commission report I referred to at the outset of this talk that the majority of the consultees made strong submissions " … *in favour of the recognition and development of a common law special defence of good faith purchaser for value without notice applicable to crypto-tokens* …". Piroozzadeh suggests that as predicted by the Commission the common law has responded to this requirement in an appropriate case and thus that the Commission was correct to anticipate that:

> "We conclude that a special defence of good faith purchaser for value without notice applicable to crypto-tokens can be recognised and developed by the courts through incremental development of the common law."

The final development I wanted to mention concerns service by an alternative means applying CPR r 6.15. Traditionally such service has been ordered to be my email and by service on the exchange for onward transmission to the wallet holder. However it is now recognised that service by NFT will be authorised in an appropriate

case – see D'Aloia v Persons Unknown [2022] EWHC 1723 (Ch) and Osbourne v. PU (ibid.) where a process that protects confidences potentially threatened by the public visibility of document served in this way whilst ensuring the defendants' get full access to unredacted documentation is set out.

The cases referred to above shows the incremental development of English law in response to a novel and developing form of commercial activity. I am confident that most industry players will continue to engage with the English jurisdiction because it provides responses that are fair, proportionate and predictable. What uncertainty remains will be eliminated if the statutory law proposals of the Law Commission concerning what constitutes property are adopted. More generally, the working out of the applicable principles will I hope reduce the cost of litigation in this area, improve access to the legal system for victims of fraud whilst enabling intermediaries to arrange their business affairs in reliance upon that level of predictability.