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Cryptoassets—Obtaining English Freezing and Proprietary Injunctions in Relation to Civil Fraud

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The English High Court has ruled that cryptoassets are property under English law. Cryptoassets are not things in possession nor things in action, but a third category of property which English law recognises. Worldwide injunctive relief may be granted by the English High Court in relation to Cryptoassets—either proprietary or freezing injunctions. The English courts' objective is to provide much needed market confidence and a degree of legal certainty as regards English common law in an area that is critical to the successful development and use of cryptoassets and smart contracts in the global financial services industry and beyond.

Keywords: Crypto currency, UK freezing orders

Introduction

The theft and misappropriation of cryptoassets, typically Bitcoin, Ethereum, and other virtual cryptocurrencies, by fraudsters is becoming increasingly common, and thus the subject-matter of civil fraud litigation. This article considers how parties can obtain the "nuclear weapon" of the worldwide proprietary or freezing order against cryptoassets.

English law does not provide a statutory definition of a cryptoasset or cryptocurrency but essentially considers it to be a form of decentralised digital currency, providing through cryptography a secure means of transacting, with a verification of asset transfer, and creation of new units of currency. Cryptocurrencies have a unique identity and cannot therefore be directly compared to any other form of investment activity or payment mechanism.

Legal Status of Cryptoassets in English Law

In obtaining injunctive or other relief in respect of cryptoassets, the first hurdle is to prove that they are "property" in English law.

In *Vorotyntseva v Money-4 Ltd* [2018] EWHC 2596 (Ch), Mr. Justice Birss granted a freezing injunction against a cryptocurrency trading company and its directors. In that case, it was not argued that cryptocurrency was not "property".

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In *Robertson v Persons unknown* CL-2019-000444, on 16 July 2019, Mrs. Justice Moulder granted an asset preservation order (but not the requested freezing order) in respect of cryptocurrency, holding that there was a serious issue to be tried concerning a proprietary claim.

In *AA v Persons Unknown* [2019] EWHC 3556 (Comm), on 19 January 2020, Mr. Justice Bryan specifically held, on a without notice application, that cryptoassets were "property" for the purposes of granting proprietary or freezing injunctive relief.

The facts in that case were as follows. In October 2019, hackers, the First and Second Defendants, infiltrated the IT system of a Canadian insurance company, which was itself insured against cyber-crime attacks by the Applicant, the Insured, and installed malware called BitPaymer, which caused all of the Insured's data and IT systems to become encrypted. The First and Second Defendants subsequently demanded the equivalent of US$950,000 in Bitcoin in return for the decryption software that would allow the Insured to decrypt and regain access to their IT systems.

There was a period of negotiation, conducted on behalf of the Applicant by a specialist intermediary known as an Incident Response Company. Then, in light of the importance of the Insured being able to gain access to its systems, the Applicant arranged for the Bitcoin ransom to be paid, to an electronic address (also known as a "wallet") provided by the First and Second Defendants. Shortly after the payment was made, the Insured received the necessary decryption tools and over a period of several days, was able to regain access to its IT systems.

The Applicant subsequently engaged a third party company, Chainalysis, Inc., a blockchain investigations company specialising in cryptoasset investigations, to trace the Bitcoin that had been paid to the First and Second Defendants. The investigation revealed that, of the 109.25 Bitcoins that had been transferred as the ransom payment, 13.25 Bitcoins (worth approximately US$120,000 at the time) had been converted into an untraceable paper currency, while the remaining 96 Bitcoins had been transferred to a specific, traceable, wallet, which was found to be linked to an exchange known as Bitfinex, operated by the Third and Fourth Defendants (both registered in the British Virgin Islands).

The Applicant sought a proprietary injunction against the First to Fourth Defendants, as well as ancillary disclosure orders against the Third and Fourth defendants, to require them to verify the identities of the customers who held the Bitcoin wallets in question (i.e., the First and Second Defendants). For the purpose of the application, which Mr. Justice Bryan agreed should be heard in private and on a without notice basis (insofar as the First and Second Defendants were concerned), an anonymity order was sought and granted to protect the identities of both the Insured and the Applicant. The Judge granted the Orders as sought, and permitted alternative service of the order, by email, on the Third and Fourth Defendants in the British Virgin Islands.

Shortly before the decision in *AA v Persons Unknown* (above), in November 2019 the UK Jurisdiction Taskforce (UKJT) had produced a Legal Statement on Cryptoassets and Smart Contracts. The UKJT is chaired by the most senior Chancery Judge, Sir Geoffrey Vos, Chancellor. The Legal Statement was, however, drafted by a team of counsel, and Sir Geoffrey Vos noted that "it is not in my role as judge, nor that of the UKJT or its parent, the UK's LawTech Delivery Panel, to endorse the contents of the Legal Statement" (Vos, 2019). It follows that the Legal Statement provides an authoritative, albeit not binding, analysis. Nonetheless, Mr. Justice Bryan referred to the Legal Statement as being an accurate exposition of English law in *AA v Persons Unknown* (above) and said that he considered that crypto assets such as Bitcoin are "property". They meet the four criteria set out

in Lord Wilberforce's classic definition of "property" in *National Provincial Bank v Ainsworth* [1965] AC 1175 as being definable, identifiable by third parties, capable in their nature of assumption by third parties, and having some degree of permanence.

That too, was the conclusion of the Singapore International Commercial Court in *B2C2 Ltd v Quoine PTC Ltd* [2019] SGHC (I) 03, in which it was held that that cryptocurrencies fulfilled Lord Wilberforce's classic definition, so as to amount to "property".

For present purposes, we therefore consider that the first hurdle can readily be vaulted, in establishing that cryptoassets are "property" for the purposes of seeking worldwide freezing or proprietary injunctions.

Seeking an Injunction Respect of a Cryptoasset

As cryptocurrency accounts are wholly different from ordinary bank accounts, because they are decentralised i.e. not located in one place but held across a distributive ledger, there is no obvious party on whom to serve proceedings. The question therefore arises as to who should be served. The thief or wrongdoer is the obvious first choice; however, what of other enablers or associates? In *Robertson v Persons Unknown* (above), Mrs. Justice Moulder relied upon an analysis provided by a specialist company which is a provider of software to track payment of crypto currency. That analysis tracked 80 Bitcoin to a wallet/account/address held by a crypto currency or coin exchange called "Coinbase".

Practical questions arise as to the form of disclosure that should be sought from a wrongdoing respondent. The standard form worldwide freezing injunction order requires a respondent to give the "value, location and details of all such assets", but the question arises as to how this applies to cryptocurrencies. As stated above, the defining nature of a distributive ledger is that cryptocurrencies are not located in one place. Issues will arise as to ascertaining which parties have a private key to the coins and as to whether the coins are held in an exchange or through a third party. It will be necessary to discover the transaction code or hash by which the coins were wrongfully acquired.

How to Locate Cryptocurrencies

In theory, the tracing of cryptoassets ought to be possible, given that the apparently transparent nature of the blockchain system means that anyone can obtain a copy of every transaction of that particular cryptocurrency by downloading the blockchain. To assist the application for injunctive relief in court, there are "block explorers" by which an applicant can obtain information about cryptocurrency addresses and transactions. This means that an applicant should be able to trace cryptocurrencies from one address to another in permissionless systems, although the position will of course be different in permissioned ones[1].

Governing Law

The traditional property rules of private international law, given a natural historical focus on tangible goods, dictate that a question as to rights or entitlement should be governed by the law of the place in which the property or claim to property is situated; the lex situs.

[1] Permissionless systems are open to the public, and members of the public may affect and verify changes to the ledger. By contrast, in permissioned systems only authorised participants are able to create records and verify changes to the ledger (and different participants may have different authorisations).

The very concept of a single situs for the asset becomes difficult to apply in the case, first, of intangibles, secondly, of digitised assets and, thirdly, of assets constituted on a distributed network or platform.

The question arises as to which law governs the exercise of seeking to trace and recover the cryptoasset. It may be difficult to use the *lex situs*, because cryptocurrencies are maintained on the decentralised ledger. Perhaps it would be the *lex fori*, on the basis that tracing is a process. Alternatively, it could be the law of the underlying transaction, or the law governing the underlying fiduciary relation that allows an applicant to trace.

It may be that the elective situs should be the starting point for any analysis of a conflicts of law approach to virtual tokens. The elective situs is the system of law chosen by network participants of the distributed ledger technology (DLT) system[2], provision for which could be included in the terms and conditions of joining the system.

The lex situs does not, however, translate well when applied to a DLT system. The situs of an asset constituted on a DLT ledger, which is by definition distributed, is not immediately obvious. A network can span several jurisdictions and, in the case of a ledger which is fully decentralised, there is no central authority or validation point. Yet the conflict of laws analysis in respect of a DLT system need not necessarily be radically different just because there is new technology underpinning a transaction. Indeed, in some contexts, a traditional conflict of laws analysis may be the most appropriate route to the answer.

The authors of the Legal Statement suggest that the following factors might be particularly relevant in determining whether English law governs the proprietary aspects of dealings in cryptoassets:

(a) Whether any relevant off-chain asset is located in England;

(b) Whether there is any centralised control in England;

(c) Whether a particular cryptoasset is controlled by particular participant in England (because, for example, a private key is stored there);

(d) Whether the law applicable to the relevant transfer (perhaps by reason of the parties' choice) is English law.

English Law's Worldwide Reach

Originally, a freezing order was only obtainable in support of litigation brought within England and Wales. These days, a freezing order is often obtained in support of foreign litigation, even in cases where the primary court where the litigation is proceeding would not have a similar power to grant a freezing order, e.g. Switzerland (*Credit Suisse Fides Trust SA v Cuoghi* [1997] 3 All ER, p. 724) and the USA (see *Motorola Credit Corp v Uzan (No 2)* [2003] 1 All ER, p. 150, where the Court of Appeal adopted the memorable phrase, coined by Sir Sydney Kentridge QC in the late 1990s, as the jurisdiction enables the English Court to act as an "*international policeman*"). More recently, the Court of Appeal supported this idea, of "*long arm*" jurisdiction (*United States of America v Abacha and others* [2014] EWCA Civ 1291, [2015] 1 WLR 1917, p. 57).

[2] The European Securities Markets Authority (ESMA) has observed that DLT systems can be characterised as:
(a) records of electronic transactions which are maintained by a shared or "distributed" network of participants (known as "nodes"), thereby forming a distributed validation system;
(b) make extensive use of cryptography i.e. computer-based encryption techniques such as public/private keys and hash functions which are used to store assets and validate transactions on distributed ledgers.

Section 25 of the Civil Jurisdiction and Judgments Act 1982 (CJJA), as extended by the Civil Jurisdiction and Judgments Act 1982 (Interim Relief) Order 1997, gives an English court power to grant interim relief in proceedings that have been, or are about to be, commenced in a foreign state. The proceedings authorised by the CJJA are free-standing proceedings brought solely for the purpose of obtaining the interim relief. In such cases, the merits will not be decided in England and Wales. Historically, at common law, the English court had had to be properly seised of an action (*Siskina v Distos Cia Naviera SA (the Siskina)* [1979] AC 210).

By s.25 of CJJA, the High Court has power to grant interim relief in aid of substantive proceedings elsewhere of whatever kind and wherever taking place (*Credit Suisse Trust S.A. v Cuoghi* [1998] Q.B. 818, p. 825, per Millett LJ).

In *Ras al Khaimah Investment Authority v Bestfort Developments LLP* [2015] EWHC 3383 (Ch), Rose J held that the first consideration is whether the facts would warrant the relief sought had the substantive proceedings been brought in England. In the case of an application for a freezing order, that requires the applicant to show that he has a good arguable claim against the defendants in the overseas proceedings. In that case, the applicants could not point to any assets (let alone assets of sufficient value to render the costs involved proportionate) held by the defendants anywhere in the world. On the applicant's appeal in this case (allowed in part), the Court of Appeal clarified that it is not enough for the respondent to be apparently wealthy or for the applicant to claim that the respondent must "*have assets somewhere in the world*". The Court held that there must be "*grounds for belief*" that there are assets on which the judgment will bite, which normally means assets within the jurisdiction whether the freezing injunction sought is "*domestic*" or "*worldwide*" ([2016] 1 WLR 1099, pp. 36-39).

Where the cause of action is not one which will be adjudicated upon in England and Wales, careful attention must be paid to the basis upon which it is claimed that the court has jurisdiction (*Banco Nacional de Comercio Exterior SNC v Empresa de Telecomunicationes de Cuba SA* [2008] 1 W.L.R. 1936). It would rarely, if ever, be appropriate or expedient for the English court to assume jurisdiction under Sention 25 where the relevant defendant had no connection with the jurisdiction and the relevant assets were not located in England (*Belletti v Morici* [2009] EWHC 2316 (Comm); [2009] I.L.Pr. 57 per Flaux J).

In *Royal Bank of Scotland Plc. v FAL Oil Co Ltd* [2012] EWHC 3628 (Comm), [2013] 1 Lloyd's Rep. 327, however, Gloster J granted a worldwide asset freezing injunction and worldwide disclosure order under s.25 against a defendant in the United Arab Emirates, notwithstanding the absence of assets within England and Wales. The Judge there found that it was reasonable to infer the existence of assets in other jurisdictions, that there was other evidence of links with England, and that the identification and location of assets would assist the enforcement of any judgments of the UAE courts.

Under CJJA s.25(2), the court may refuse relief if the fact that the court has no jurisdiction apart from under s.25 of the CJJA "makes it inexpedient for the court to grant it".

The Court of Appeal gave guidance on the approach to take in deciding this issue in *Motorola Credit Corp v Uzan (No. 2)* [2004] 1 WLR 113 where it held that there are five considerations which the court should bear in mind when considering the question whether it is "*inexpedient*" to make an order under s.25 CJJA:

(i) Whether the making of the order will interfere with the management of the case in the primary court: e.g., where the order is inconsistent with an order in the primary court or overlaps with it.

(ii) Whether it is the policy in the primary jurisdiction not itself to make worldwide freezing orders.

(iii) Whether there is a danger that the orders made will give rise to disharmony or confusion and/or risk of conflicting inconsistent or overlapping orders in other jurisdictions, in particular the courts of the state where the person enjoined resides, or where the assets affected are located. If so, then respect for the territorial jurisdiction of that state should discourage the English court from using its unusually wide powers against a foreign defendant.

(iv) Whether at the time the order is sought there is likely to be a potential conflict as to jurisdiction rendering it inappropriate and inexpedient to make a worldwide order.

(v) Whether, in a case where jurisdiction is resisted and disobedience to be expected, the court will make an order which it cannot enforce.

In *Mobil Cerro Negro Ltd v Petroleos de Venezuela SA* [2008] 1 Lloyd's Rep. 684, the Venezuelan national oil producer sought unilaterally to "*repatriate*" the oil enterprises owned by Mobil to companies that were 60% owned by Venezuela. Mobil sought ICC arbitration in New York and was granted an ex parte worldwide freezing injunction order by Mr. Justice Teare under s.44 Arbitration Act 1996. Mr. Justice Walker, however, on the return hearing held that where an award can be easily enforced under ICC Rules, a freezing order is unlikely to be just and reasonable. The recipient of the order must be shown to have a sufficient connection to the jurisdiction of England and Wales, or there must be some other relevant reason to justify an order. Strong justification is required to counter the principle of comity with other jurisdictions. In this case, there was no sufficient link with the jurisdiction in the form of substantial assets within the jurisdiction, and the fact that the seat of the arbitration was abroad made it inappropriate to grant an order. There was no justification for an order since *Petroleos* had neither assets nor presence nor any dispute in the England and Wales jurisdiction.

ETI Euro Telecom v Bolivia [2009] 1 W.L.R. 665 was a case involving Bolivian decrees unilaterally nationalising shareholdings in ETI's subsidiary company. Arbitration proceedings were commenced, and ETI sought a worldwide freezing order against the Bolivian Government. In this instance, there were assets in London. The Court of Appeal held that s.25 CJJA did not apply, since the New York order sought was for an attachment in aid of arbitration *only* for assets held in New York. On any view, the English proceedings were not in aid of, or related to, any substantive proceedings in New York, however liberally those expressions were interpreted. The New York attachment proceedings constituted interim relief to protect assets pending the outcome of the ICSID arbitration. They were directed solely at assets in New York, and proceedings in England directed at assets in England could not be ancillary to the New York attachment.

Freezing orders can also be obtained as an ancillary aid to the enforcement of foreign judgments, which are registered in the High Court pursuant to CPR Part 74 under the Administration of Justice Act 1920, the Foreign Judgments (Reciprocal Enforcement) Act 1933, Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of December 12, 2012, commonly known as the "recast" Judgments Regulation, and the CJJA. The Brexit process, when completed, will cause English law to revert to its pre-accession (to the EEC, latterly EU) provisions and will not directly affect any claims regarding assets or persons in the PRC or the USA.

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