Freezing crypto-assets in the Cayman Islands: Practical considerations

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In *Philip Smith v Torque Group Holdings*, the courts of the British Virgin Islands adopted the position of the English Court in the 2019 case *AA v Persons Unknown re Bitcoin* when it came to the treatment of cryptocurrency as 'property'.

Having established that crypto assets are capable of amounting to 'property', the courts will now need to grapple with proprietary claims relating to crypto assets, and how they deal with the identification and freezing of such proprietary assets.

Introduction to crypto assets

By their very nature, crypto assets are intangible things, because unlike traditional assets like shares, money or a piece of art, they are not centrally located or easily identifiable and therefore difficult to trace.

Crypto assets, as the name suggests, are 'secret' or 'hidden' assets, which use advanced secure technology to keep a record of the true owner of the assets and which governs how these assets are traded between respective owners. They are held in a decentralised distributed ledger referred to as the 'blockchain', which permanently records crypto transactions. Crypto assets are held in different types of wallets which are software programmes designed to hold public or private keys that allow owners to trade, monitor, track and hold their cryptocurrency.

Due to the nature in which crypto assets are held, they are incredibly susceptible to attack from hackers who specialise in cryptocurrency theft.

More often than not, cryptocurrencies are held on exchanges that are either crypto-to-crypto exchanges, or fiat-to-crypto exchanges, the latter meaning that users can trade cryptocurrency with global currencies such as US Dollars or Euros. Users choose crypto exchanges based on their particular needs and will consider elements like the ease of withdrawal, supported currencies, pricing and security when electing a particular exchange. For example, a new investor in cryptocurrency may choose a fiat-to-crypto exchange in order to purchase cryptocurrency with traditional fiat currency.

Another key consideration in selecting a crypto exchange is the jurisdiction in which the asset would be held. Following the determination in AA v Persons Unknown that cryptocurrency is property, the court further determined that the law of the country in which the crypto assets are located is the law of the country where the person or company who owns the asset is domiciled.

Practically, therefore, an investor might consider choosing a crypto exchange in the country in which he/she is domiciled in the event that a claim as to misappropriation arose in future.

While the above options should be kept in mind at the point of investment to make potential recovery of misappropriated crypto assets easier, they are not essential to ensuring such recovery can be made, particularly as the law on crypto assets is still evolving.

Practical considerations

Given the transient nature of crypto assets, tracing such assets at any given moment in time is much more difficult compared with more traditional assets. While it is a misconception that crypto assets are held anonymously and therefore the perpetrator of a fraud or theft is unknown, it is true that many of these assets are owned by individuals who are trying to conceal their identity. However, users of crypto assets are usually registered with IP addresses on the blockchain which makes it possible for them to be identified.

Because crypto assets are pseudonymous the question becomes what legal remedies are available to recover crypto assets that have been misappropriated by hacking or through fraud.

Two of the key considerations following a misappropriation of crypto assets are time and expertise. The victim must act quickly to locate and secure their crypto assets because of their transient nature.

There are firms that specialise is blockchain forensics and transaction tracing that can de-anonymise users and assist in the analysis of transaction flow and the current location of crypto assets.

In relation to timing, one way in which this issue might be addressed is by issuing urgent ex parte applications for prohibitory injunctions or mandatory orders (as described further below) against the wrongdoers and/or third parties that may hold information relevant to the tracing of the misappropriated crypto assets. Such applications should be made without notice to any other parties and hearings should be held in private in order to make it more difficult for offenders or holders of the tainted assets, or information relating to them, to be tipped off.

Recent caselaw

The above considerations were recently considered by the English court in the recent case of *Fetch.Ai Limited and Fetch.AI Foundation PTE Limited v Persons Unknown & Ors* in which the two claimants, Fetch.Ai Limited and Fetch.Ai Foundation PTE brought applications against (1) three categories of persons unknown, (2) Cayman Islands-registered company Binance Holdings Limited, and (3) UK-incorporated Binance Markets Limited.

The application brought was for a proprietary injunction, a worldwide freezing order and ancillary information disclosure orders against persons unknown; and, a disclosure order in the form of either a Bankers Trust order or Norwich Pharmacal order against Binance.

Fetch.Ai alleged that a fraud had been committed in which persons unknown had obtained access to accounts maintained by Binance, which held various cryptocurrencies and who traded those cryptocurrencies at an undervalue, leading to a loss of US$2.6 million in a short period of time.

The applicants sought two things: a proprietary order designed to freeze either the assets which were removed from Fetch.Ai's accounts and/or to restrain third parties in possession of the traceable proceeds from dealing with them; and a worldwide freezing order against those that were knowingly involved in the fraud to ensure that whatever judgment was obtained by the claimants in the future could have a real tangible effect.

The judge noted that one difficulty with applications of this nature is to ensure that innocent receivers of crypto assets, who have no reasonable grounds for thinking that what has appeared in their account does not belong to them, do not find themselves inadvertently in breach of an order.

Another issue determined by Judge Philip Mark Pelling QC was that Norwich Pharmacal relief could not be obtained against an entity based outside of the jurisdiction in which the application was being brought; whereas a Bankers Trust order could, in principle, be served on respondents based in a jurisdiction outside of the one in which the relief was being sought.

In granting the Bankers Trust order against the Cayman Binance entity, the English court considered that the assets about which the information was being sought belonged to the claimant (by their private keys); that there was a real prospect that the information sought would lead to the location or preservation of the assets; that the information sought was not unnecessarily wide; and that the possible detriment to the respondent did not outweigh the benefit to the claimant.

Norwich Pharmacal relief was also granted against the English Binance entity on the basis that a wrong had been carried out by an ultimate wrongdoer, unless and until the information sought was supplied by the respondent; it would be impossible to identify the wrongdoer and what had become of the assets wrongly taken from the claimant; and (iii) that it was necessary and proportionate to make the order.

Turning back to the critical issue of timing, Judge Pelling QC was content to make an alternative service order against Binance Cayman. In other words, he held that service of the orders could be effected faster compared with the usual channels of service required under English law, which could ordinarily take weeks or months. Judge Pelling QC allowed for alternative service on the basis that by losing time by effecting ordinary service on the respondents, the purpose of making a time-critical order that involves prohibitory injunctions or mandatory orders to preserve the assets or information in question, would ultimately be rendered nugatory.

Finally, the judge granted permission for the hearing of the application to take place in private in order to avoid any tipping off of the wrongdoers.

Conclusion

While the courts in the Cayman Islands have, to date, not had to contend with freezing crypto assets, parallels can be drawn with the position taken by the English Court in Fetch.Ai Limited and Fetch.AI Foundation PTE Limited v Persons Unknown & Ors.

The availability of obtaining proprietary injunctions and freezing orders as against crypto assets should provide global market players with much needed confidence and legal certainty and may well play a part in an increase in crypto-based transactions. And whilst the courts of the Cayman Islands have not yet had to decide a proprietary claim relating to crypto

assets, there is no reason to believe that litigants in the Cayman Islands would not be in a position to avail themselves of traditional injunctive relief and other ancillary orders with regards to these types of assets.

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Case references

Philip Smith v Torque Group Holdings Limited et al (BVIHC (COM) 0031 OF 2021)

AA v Persons Unknown re Bitcoin [2019] EWHC 3556 (Comm)

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