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Cryptocurrencies: 2020 and Beyond

Authors: Jonathon Milne, Partner | **Robert Amey,** Barrister

As the global leader in alternative investment funds and one of the most innovative financial centres in the world, it is unsurprising that the Cayman Islands has quickly become a popular destination for cryptocurrency vehicles and initial coin offerings (ICOs).

There are several other reasons why Cayman is an attractive jurisdiction for FinTech business, including the fact that it offers tax neutrality, a stable political system, judicial ties to the United Kingdom and support via sophisticated professional services firms.

There is always a balancing act between adopting a pro-industry approach to exciting new business and maintaining the highest standards of governance. Cayman, like the rest of world, is considering how best to regulate and place controls on the cryptocurrency space.

In this article, we consider recent case law and developments regarding the treatment of this FinTech business and the legal status of this relatively new and evolving asset class, to predict how the Cayman Islands and other jurisdictions may treat crypto assets and deal with disputes as they arise.

Brief history of the development of cryptocurrencies

Almost 12 years ago now, a white paper entitled "Bitcoin: A Peer-to-Peer Electronic Cash System" was published under the moniker Satoshi Nakamoto. Prior to that watershed moment, other Blockchain pioneers had tried to create digital currencies with more limited success.

By 2010, cryptocurrency exchanges were cropping up. Shortly after that, more coins and crypto assets were created under a variety of brand names. The market was relatively sophisticated by 2015, when Ethereum arrived on the scene, and ICOs began taking place. Fast forward to 2020 and there are literally thousands of unique digital currencies.

There is now a wide-ranging investor base for digital assets and many retail stores are accepting cryptocurrencies as a method of payment. With the advent of dedicated ATMs and mainstream use of Blockchain technology, it appears that cryptocurrencies (in one form or another) are here to stay.

Accordingly, as Bitcoin and its competitors become more embedded in our daily lives, there is an increased focus on regulation and a desire to determine the legal status of this relatively new and evolving asset class. However, that focus and desire creates a number of issues from a philosophical standpoint. Many early adopters of Bitcoin and other cryptocurrencies were attracted to the ideology of cryptocurrencies rather than the financial benefits. It is no coincidence that Bitcoin gained traction and support following the Global Financial Crisis, when anger and apathy were at an all-time high.

The Bitcoin white paper contains this statement: *"The root problem with conventional currencies is all the trust that's required to make it work. The central bank must be trusted not to debase the currency, but the history of fiat currencies is full of breaches of that trust."*

It is against that ideological background that the judiciary, regulators, legislature and industry stakeholders must consider how to apply existing principles (if possible) and also develop a satisfactory regulatory regime in respect of cryptocurrencies and related digital assets.

Latest developments: is cryptocurrency property?

An issue which has arisen repeatedly in the recent past and will continue to arise is, whether Bitcoin and other cryptocurrencies should be treated as property in the eyes of the law. The answer to this question has profound consequences, and has been the subject of a number of decisions. For example, how can misappropriated assets be recovered and remedies sought to trace them, if the asset is not property and therefore there is no proprietary interest to protect? As will be seen, the position is not as straightforward as it initially appears.

The spectrum of academic opinion on certain fundamental, threshold questions is broad:

- Is cryptocurrency personal property? If not a form of personal property (as it is neither a chose in possession nor a chose in action), is it a new hybrid category of personal property, a "virtual chose in possession"?
- Is cryptocurrency money? Although it lacks certain of the fundamental characteristics, it may soon become a form of money. Therefore, can it be classed as property in that sense?

It is generally accepted that a bitcoin, to pick a particular type of cryptocurrency, cannot be a chose in action - not least because the holding of a bitcoin gives the holder no rights against any other person. Furthermore, a bitcoin is not a chose in possession because, in the absence of statutory intervention, one cannot take possession of an intangible (such as a block added to a chain on a digital system).

It is settled law, at Court of Appeal level in England, that choses in action and choses in possession are the only two categories of personal property (see *Your Response Ltd v. Datateam Business Media Ltd* [2014] EWCA Civ 281). So this poses quite a problem regarding how bitcoin and other crypto assets should be, and whether they can be, classed as property.

This does not mean that the holding of a bitcoin could not in principle be a type of personal property at common law. It could be viewed as being "other intangible property". Different crypto assets have different fundamental features however, so a further problem is how to define different types of asset under one definition of "crypto assets".

We consider below how the courts have been dealing with the issue of how to treat cryptocurrency.

English Interim Injunction Cases

The issue first arose, in England, on applications for interim injunctions.

In *Vorotyntseva v Money-4 Ltd* [2018] EWHC 2596 (Ch), the claimant alleged that the defendant cryptocurrency exchange had misappropriated her cryptocurrency (in that case, Bitcoin and Ethereum), and sought a proprietary injunction pending trial, preventing the defendant from dissipating the cryptocurrency which had allegedly been misappropriated. The injunction was granted, and continued following an *inter partes* hearing.

Although the decision lends support to the proposition that English law will treat cryptocurrency as property (such that a proprietary injunction may be granted to preserve it pending trial), it appears that the point was not actually argued.

In *AA v Persons Unknown* [2020] 4 WLR 35, hackers had installed ransomware on a victim's computer systems, rendering those systems unusable. The hackers demanded US$1.2 million to reverse the effect of the ransomware, although they subsequently accepted US$950,000 instead. Payment was made in Bitcoin. Subsequently, the victim's insurer (AA), which had funded the ransom payment, instructed investigators to trace the destination of the Bitcoin payment. The payment was traced to an account with the Bitfinex exchange. (As an aside, the facts of the case provide a useful reminder that Bitcoin payments are not, contrary to popular belief, wholly anonymous or untraceable.)

Having identified the destination of the Bitcoin, the insurer sought a proprietary and/or freezing injunction against the hackers (the 'Persons Unknown'). Although the 'Persons Unknown' could not be identified, the benefit of an injunction would be that Bitfinex would be obliged to freeze the relevant account.

The court considered whether Bitcoin could fall within the definition of 'property', such that it was amenable to a proprietary injunction. After considering authorities on the nature of property in English law.[1] Bryan J concluded that "*crypto currencies are a form of property capable of being the subject of a proprietary injunction*".

Although this decision lends considerable support to the proposition that English law will treat cryptocurrency as property, the judgment is subject to two serious limitations:

1. The application was made *ex parte*, and accordingly no contrary argument was considered by the court.

[1] including the decision in Vorotyntseva v Money-4 Ltd, the first instance judgment (although not the appeal judgment) in B2C2 v Quoine (discussed further below) and the UK jurisdiction Task Force Legal statement on crypto assets and smart contracts (discussed further below).

2. The court only needed to be satisfied, at the interim injunction stage, that "*there is at least a serious issue to be tried*" (para.63). Accordingly, even if there had been full argument, it would be dangerous to rely upon this decision as conclusive proof that English law recognises Bitcoin as a form of property.

Singaporean Judgements *B2C2 v. Quoine* [2020] SGCA (I) 2

In *B2C2 v. Quoine* [2020] SGCA (I) 2, Quoine operated a cryptocurrency exchange, on which B2C2 was an investor. Trading occurred automatically through computer algorithms. Due to a coding error, B2C2 sold cryptocurrency to Quoine for 250 times its actual value. Quoine unilaterally reversed the relevant trade and B2C2 sued.

At trial, the High Court allowed B2C2's claim for breach of contract and breach of trust. However, it had apparently been conceded that cryptocurrency was a form of property, and the court heard no argument on the point.

On appeal, the Court of Appeal reversed the trial judge's findings on breach of trust, and declined to determine whether cryptocurrency could be property. Menon CJ referred to the UK Jurisdiction Taskforce Legal statement (discussed below) and concluded:

> *"There may be much to commend the view that cryptocurrencies should be capable of assimilation into the general concepts of property. There are, however, difficult questions as to the type of property that is involved. It is not necessary for us to come to a final position on this question in the present case."*

New Zealand *Cryptopia* [2020] NZHC 728

Cryptopia [2020] NZHC 728 appears to be the only decision anywhere in the common law world where the proprietary status of Bitcoin was fully argued and ruled upon. To understand the judgment, it is necessary to explain how the issue arose.

Cryptopia was a cryptocurrency exchange. It had started as a small-scale operation, but had grown as the price of Bitcoin increased. By the time it entered liquidation, it held cryptocurrency worth NZ$170 million (over US$100 million). Its Terms and Conditions had changed over time, and were expressed in language which was "*not ideal*", but the latest version referred to Cryptopia holding assets "on trust" for investors.

Investors would deposit their own cryptocurrency (eg Bitcoin) into a 'wallet' owned by Cryptopia, and could then exchange their cryptocurrency for another (eg Ethereum). Investors' deposits were pooled by currency (ie, all Bitcoin deposits would be in one wallet, all Ethereum deposits in another wallet etc). Some, but not all, of the wallets were hacked, and Cryptoassets were misappropriated.

Investors in the accounts which had not been hacked argued that they had a proprietary right to receive the full value of their deposits. By contrast, investors in the accounts which had been hacked would be better off if investors were treated as having a purely *personal* right (rather than a proprietary right), because that would result in all the Cryptoassets being pooled and shared among all the investors.

It therefore became necessary to determine whether investors had a proprietary right to the Cryptoassets held in their account.

Having heard full argument, Glendall J considered at para.69:

"I reach the conclusion that the cryptocurrencies here situated in Cryptopia's exchange are a species of intangible personal property and clearly an identifiable thing of value. Without question they are capable of being the subject matter of a trust."

This first instance judgment lends the strongest support yet for the proposition that the common law treats Cryptoassets as a form of intangible property. However, with respect, it is possible to make various criticisms of the reasoning:

1. There does not appear to have been any expert evidence on the nature of the various cryptocurrencies in issue, and the judge appears to have treated them all alike. There were apparently "*several*" different cryptocurrencies misappropriated from Cryptopia (para.13), but the judgment does not tell us what they all were (Bitcoin and Ethereum are mentioned, but there were apparently others). The judgment does not analyse the technical characteristics of these various cryptocurrencies, and how those characteristics might inform the question whether they should be treated as property. The only attempt in the judgment to explain the technical nature of crypto assets is at para.21 of the judgment, where Glendall J quoted from the UK Jurisdiction Taskforce Legal statement. That quotation simply makes clear that there is a wide range of different crypto assets, each with their own peculiar features. This is an important point. However one defines the concept of 'property', the question whether any given crypto-token satisfies that definition will depend on the characteristics of the relevant token. Given the wide range of instruments which carry the label 'crypto asset', it is likely that some will fall within the definition, and some will not. The judgment makes no effort to distinguish between the different categories.
2. Linked to this, part of the judge's reasoning included what he described as "*public policy arguments*" (see paras 129-132). The judge considered that "*honest commercial developments may very well be hindered by a failure of the general law to recognise crypto assets as property*" and that "*Cryptocurrencies have also become popular with honest people as a method of effecting payments and of investing. The traditional banking sector is itself widely reported to be already using block chain technology and to be planning to create trading platforms for cryptocurrencies*." The correctness of this statement (which does not appear to have been based on any expert evidence) is highly doubtful. The sole basis for the finding is an article from Bloomberg which, with respect to the judge, says nothing of the sort. If supposed public policy arguments are to be used as a

justification for developing the law in a novel way, it is desirable that such decisions are made on the basis of proper evidence as to the social and commercial consequences, rather than a single news article.

3. The absence of expert evidence as to how different cryptocurrencies work appears to have led the judge to draw inaccurate comparisons between crypto-tokens and traditional bank deposits. At para.127 of his judgment, the judge considered that crypto-coins are "*comparable to the electronic records of a bank*" and that the private key used to transfer crypto-coins was like "*a PIN on an electronic bank account*". This is, with respect, a misunderstanding of how most cryptocurrencies work. In the case of electronic bank records, the electronic ledger is simply a record of a chose in action that the customer has against the bank (where the account is in credit) or that the bank has against the customer (where the account is overdrawn). It is that chose in action which is the 'property' held by the depositor. It is certainly possible to devise a crypto-token which has 'real-world' legal rights attached to it (a sort of virtual bearer share or bearer bond), and there would be a strong case for treating such a token as an item of property. However, the same reasoning cannot be applied to Bitcoin and other similar crypto-assets, which do not have any 'real-world' legal rights attached.

The UK Jurisdiction Taskforce Legal Statement recognised that the rationale and design of crypto assets may create some practical hurdles to legal intervention but "that does not mean that crypto assets are outside the law". The judiciary, in different parts of the common law world, have followed that line of thinking and the cases summarised above are worthy of deeper analysis.

Other Guidance

Cayman Islands Regulatory Regime

On 25 May 2020, the Cayman Islands legislative assembly passed the Virtual Asset (Service Providers) Law 2020 (the "Law"). The Law provides a licensing regime for providers of a "*virtual asset service*". "*Virtual asset service*" is widely defined, including the issuance, exchange, transfer or custody of virtual assets, as well as "*participation in, and provision of, financial services related to a virtual asset issuance or the sale of a virtual asset*".

Section 4 of the Law provides that any person carrying on or purporting to carry on a "*virtual asset service*" must be registered or licensed (or to have received a waiver from such requirements) in accordance with the Law.

The Law aims to maintain certain standards in respect of licence-holders by requiring the employment of personnel with the necessary skills, appropriate capital adequacy and cybersecurity measures and accounting systems (section 8). Virtual asset service providers must be owned and operated by fit and proper persons, and must comply with anti-money-laundering, data protection and other regulatory requirements (section 9).

Other requirements are imposed on those offering virtual asset custody services (section 10), virtual asset trading platforms (section 11), and issuance of virtual assets on the licence-holder's own behalf (section 12).

Of particular interest is Part 3 of the Law (section 17) onwards, which provides for sandbox licences for a period of up to one year in respect of new and innovative technologies. The Law aims to strike a balance between protecting the public by the imposition of regulatory requirements and encouraging legitimate technological innovation.

The Cayman Islands Monetary Authority is given power to enforce the regime and non-compliance with its requirements can result in a fine and imprisonment. Companies which fail to comply may be wound up (section 34).

The UK Jurisdiction Taskforce Legal Statement

As discussed above, a committee of experts prepared a legal statement in relation to the status of both smart contracts and cryptocurrencies under English law. Despite the fact that it is not legally binding, judges throughout the common law world have already referred to and relied upon it in reaching interlocutory and final decisions. The legal statement carries substantial weight due to the make-up of the UK Jurisdiction Taskforce, which included Sir Geoffrey Vos (Chancellor of the English High Court) and other distinguished lawyers. [2]

In summary, according to the authors:

1. Crypto assets have the legal indicia of property, and should be treated as property, even though such assets are intangible, and may work on a decentralized ledger.
2. The private key grants practical control over the asset, which is one of the indicia of property.
3. Crypto assets are subject to the protection of English law with respect to insolvency, succession, theft and fraud.
4. As there is no physical possession of crypto assets, there can be no "bailment" of crypto assets, or pledge or lien granted over crypto assets. On that note, crypto assets do not constitute documents of title or negotiable instruments.

5. It may be possible that “some types of security” may be applied to crypto assets.

It is worth noting that the statement was produced at the behest of the LawTech Delivery Panel, which is an industry-led group that is tasked with supporting the digital transformation of the UK legal services sector. It is also drafted from a rather partisan starting point (i.e. “Cryptoassets and smart contracts undoubtedly represent the future” and that “perceived legal uncertainty was the reason for some lack of confidence amongst market participants and investors”).

Comment

The combination of legal guidance, regulation and common law judgments handed down to date, suggest that the default position is that Cryptoassets will be treated as property. However, not all Cryptoassets are created equal. Therefore, it will be important for clients and their advisers to analyse the specific nature of the asset and the way it is held/used to determine whether it might fall within the traditional legal definition of property.

Given that Cayman is a world-leader in this space; it is likely that it will be at the forefront of shaping the legal and regulatory regime for crypto assets in the near future. Watch this space.

Conyers Contact:

Jonathon Milne
Partner
jonathon.milne@conyers.com
+1 345 814 7797

South Square Contact:

Robert Amey
Barrister
robertamey@southsquare.com
+44 (0) 7696 9900

[2] The foreword to the legal statement makes clear that it reflects the views of the drafting team (four English barristers in private practice), rather than the members of the Taskforce generally. Nonetheless, Sir Geoffrey’s involvement has conferred a certain degree of respectability on the legal statement.