

The key to cryptocurrency

Scott Barker, Luke Sizer

25 September 2020

Buddle Findlay, acting on instructions from leading Singapore firm Rajah & Tann for a British Virgin Islands incorporated investment and advisory firm, recently obtained freezing orders and a proprietary injunction in the Court of Appeal over various cryptocurrencies, while also successfully arguing for the use of cryptocurrency as security for any damages that might be suffered by the respondents. While the case is legally novel, it is consistent with the courts' increasing readiness to adapt traditional remedies to respond to the complexities of modern asset recovery.

What is cryptocurrency?

In short, cryptocurrencies are digital currencies.

A unit of cryptocurrency, sometimes referred to as a token or coin, is created from an encrypted series of data blocks known as a blockchain. The blockchain is a digital ledger, which keeps a reliable history of transactions, and which is verified across a distributed network. The distributed network prevents inconsistent transfers of the same unit of cryptocurrency, by requiring each transaction to be validated across the distributed network, thereby reducing the risk of fraud or loss. The distributed network is designed to give cryptocurrencies exclusivity and stability, much like a traditional Bank would do in recording deposits and withdrawals of money from accounts of its customers. Although unlike a traditional Bank, the use of cryptographic processes to provide exclusivity and stability is not dependent on the reliability of that Bank (or these days, the servers and computer systems controlled by that Bank), but instead depends on the validation of transactions across the distributed network.

In addition to the blockchain, which provides for public verification of dealings in cryptocurrencies, each unit of cryptocurrency has a second set of private data parameters, known as the 'private key'. The private key is what permits a user to transfer and use cryptocurrencies. Control of the private key gives control over the unit of cryptocurrency concerned.

Cryptocurrencies can be bought and traded in the same way as fiat currencies can, through online cryptocurrency exchanges. The values of cryptocurrencies increase and decrease with often a high degree of volatility.

Recent legal developments on cryptocurrencies

Cryptocurrencies generally, and bitcoin in particular, enjoyed a significant boom in 2017, trading at almost US\$20k per bitcoin (which is the most prominent type of cryptocurrency) in December 2017, before a significant crash in 2018, which reduced trading to about US\$5,5k per bitcoin by November 2018. The crash was preceded by high profile warnings from the likes of Warren Buffet, who warned in April 2018 that purchasing cryptocurrency amounted to speculation, not investment. Since the cryptocurrency crash of 2018, bitcoin has recovered some of its previous value, having averaged a value of about US\$7,5k per bitcoin from mid-2019, with a present value of approximately US\$11k and a total market capitalisation of approximately US\$200b.

The significant increase in value of cryptocurrencies, their highly transferable nature, and the relative anonymity afforded by the blockchain ledgers, meant that it was inevitable that cryptocurrencies would eventually be the subject of high value actions before the courts, as occurred in several cases brought in England, and as has now occurred here. A central issue in many of those cases has been whether cryptocurrency is a form of "property", which can significantly affect the relief available. If cryptocurrency is not property, for instance, it would be impossible to obtain a freezing order over cryptocurrency (although other forms of relief may be available).

Putting the issues in context, late last year, a Canadian insurance company applied for a proprietary injunction and various disclosure orders in connection with a ransomware attack of which it was the victim. A ransomware attack typically involves the use of malware, which encrypts the data on the victim's computer systems rendering it inaccessible, and which requires the payment of a sum – in many cases, cryptocurrency – for the data to be decrypted. Without payment of the ransom, it is virtually impossible to access or restore the victim's affected computer systems. The insurance company paid the ransom, and then sought orders against the bitcoin exchange through which it traded the ransom, requiring disclosure of the identity of the ultimate recipients of the ransom, as well as a proprietary injunction against the ultimate recipients requiring the return of the ransom. The High Court found that the bitcoin paid as the ransom were property, capable of being the subject of an injunction, and granted the relief sought.

More recently, the English High Court issued and continued a freezing order in connection with a purportedly fraudulent

cryptocurrency platform, which was inceptioned in about 2016, with the stated aim of enabling fans, traders and investors to buy and sell tokens giving them a chance indirectly to acquire interests in football clubs through special cryptocurrency tokens created for that purpose by the defendants. While cryptocurrency was not the subject of the freezing order, the case is notable for its observations on the nature of cryptocurrency investment. In particular, while Court observed that cryptocurrencies and similar offerings have attracted their "fair share of fraud", it said that many "honest start-ups are small operations with unsophisticated operators" and that many who invest in these ventures "do so as risk capital" and that those considerations should be taken into account when considering allegations of fraud by disappointed investors in start-ups.

Meanwhile, in New Zealand, the concept of cryptocurrency as being valuable property was explored fully by the New Zealand High Court in a recent and precedent setting decision. In *Rusco v Cryptopia Ltd (In liq)*, the High Court was asked to determine whether approximately NZ\$170m worth of cryptocurrencies, held by a New Zealand based cryptocurrency exchange on behalf of various account holders, were "property" under the Companies Act 1993 and whether those cryptocurrencies were held on trust. The Court answered "yes" to both questions, which meant that the account holders would be entitled to return of those cryptocurrencies, to the detriment of the company's unsecured creditors.

The Court of Appeal's decision on cryptocurrency

Cryptopia set the scene for the Court of Appeal's recent decision.

In this appeal, the Court of Appeal heard an urgent without notice appeal against a decision of the High Court, which had declined to grant a British Virgin Islands advisory and investment firm a freezing order and proprietary injunction over various cryptocurrencies held by a Singaporean firm and two New Zealand parties, on the basis that the appellant's cryptocurrency, held on trust by its solicitors, was not sufficient security to satisfy any award of damages that the court might make, if it turned out that the freezing order and injunction should not have been granted.

On appeal, the Court of Appeal accepted that the cryptocurrency held on trust by the appellant's solicitors in New Zealand could be used as security for those damages. To protect against volatility in the price of the cryptocurrency, it required the appellant to maintain the value of the cryptocurrency held by its solicitors at or above at least NZ\$200k. The Court reserved leave to the respondents to apply to have that order varied or discharged if the appellant failed to adhere to its terms.

The Court also granted, consistent with the English authorities, a freezing order and proprietary injunction over cryptocurrencies that the appellant alleged the respondents had misappropriated from it, at the then value of approximately US\$3.6m.

The Court of Appeal's orders reflect and affirm the view of the High Court in *Cryptopia*, that cryptocurrency is a form of valuable property, and also reinforce that the courts remain willing to adapt traditional remedies to respond to novel and complex issues of asset misappropriation and recovery. It is also legally novel, in that it is to the authors' knowledge, the first time an appellate court has affirmed that cryptocurrency can be used as security for damages.

Scott Barker of Buddle Findlay was instructed by Grant Thornton in the *Cryptopia* litigation and also appeared in the appeal the subject of this article, on instructions from Rajah & Tann.

This article was written by [Scott Barker](#) and [Luke Sizer](#) for NBR (September 2020).

Auckland

**188 Quay Street
Auckland 1010**

**PO Box 1433
Auckland 1140
New Zealand**

**P: +64 9 358 2555
F: +64 9 358 2055**

Wellington

**Aon Centre
1 Willis Street
Wellington 6011**

**PO Box 2694
Wellington 6140
New Zealand**

**P: +64 4 499 4242
F: +64 4 499 4141**

Christchurch

**83 Victoria Street
Christchurch 8013**

**PO Box 322
Christchurch 8140
New Zealand**

**P: +64 3 379 1747
F: +64 3 379 5659**