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Demystifying jurisdiction and ownership of crypto assets

Insights - 30/10/2023

With the rise of digital asset fraud and liquidations in the crypto industry globally, the courts have shown a continued willingness to assist litigants in overcoming the nuanced issues that crypto assets present, by repurposing well known legal investigative and asset tracing tools. In this article, we examine digital assets, insolvency and asset tracing in the Cayman Islands and British Virgin Islands.

The BVI Court is one of the frontrunners in this developing jurisprudence, having considered the issues in two recent important decisions (*Philip Smith v Torque Group Holdings Limited et al BVIHC (COM) 0031 of 2021* and *Chainswap Limited v Persons Unknown & Ors BVIHC (COM) 2022/0031*) and it is expected that, when faced with the same questions, the Courts of the Cayman Islands will follow suit.

In a previous article we provided a broad overview on the issue of whether crypto assets should be treated as "property" and outlined the broadly forming consensus in recent judicial decisions that it was capable of being property. This article considers two more complicated and uncertain issues which flow from that characterisation, both of which arise from the unique and decentralised nature of crypto assets: where are crypto assets located and who owns them?

How crypto assets are held

Each owner of crypto assets holds them in a "wallet" which has a unique address and is associated with two distinct keys: a public key (akin to a bank account) and a private key (akin to a PIN). It is the private key which is used to transfer cryptocurrency from one user's wallet to another and thus confers practical control over the asset.

There are various types of wallets but the most relevant dichotomy in the context of asset tracing and insolvency is whether the wallets are maintained online by a third-party exchange or trading platform (a "hot wallet") or whether they are held offline on separate software or a secure drive (a "cold wallet"). The benefit of holding digital assets in a hot wallet on an online platform is convenience as it facilitates easy trading. However, hot wallets are at greater risk of hacking, mismanagement by the exchange and may be vulnerable in cases where the exchange or platform becomes insolvent.

These distinct means by which crypto assets are held raises two legal questions for litigants and insolvency practitioners appointed over companies holding crypto assets: where are the crypto assets located and who is the "owner" of those assets?

Identifying the jurisdiction in which crypto assets are held

In order to determine the appropriate jurisdiction for enforcement action, a claimant or liquidator must identify where the crypto assets are located and thus the governing law of the property (or "*lex situs*"). However, it is a design feature of many types of crypto asset technology that the ledger has no single identifiable location which makes it more secure and resistant to state or centralised corporate control.

In *Ion Science v Persons Unknown* (Unreported, 21 December 2020), the English High Court determined on a summary basis, that the *lex situs* of cryptocurrency is the domicile of its (rightful) owner [1]. The view was reaffirmed by Trower J in *D'Aloia v Persons Unknown* [2022] EWHC 1723 which concerned an application for (amongst other relief) an interim freezing injunction to prevent the defendants from disposing of crypto assets.

However, uncertainties may arise in identification of the domicile in more difficult cases, such as where a company owning the assets acts as agent for another, or where digital assets are held on an exchange domiciled elsewhere. Where digital assets have been misappropriated, there is also a divergence of views as to whether the Court ought to look at the location of the asset *before* the misappropriation. Indeed, in *Tulip Trading Ltd v Bitcoin Association BSV* [2022] EWHC 667*,* Falk J having considered *Ion Science* questioned whether "domicile" was the sole relevant test and opined that the "residence" of the owner was a possible determining factor.

While residence is likely to refer to "inhabitance" (as opposed to casual visits) and requires an evaluation of all the circumstances and may comprise multiple locations, domicile is likely to require the coincidence of both residence and the intention to reside indefinitely. As it concerns individuals there may not be a difference between one's domicile and residence, however, the difference between inhabitance and residence is more relevant to companies, whose residence is arguably where its central management and control is located, which may not always be its place of incorporation (its domicile). It remains to be seen how the court will determine this issue in relation to a company's ownership of crypto assets if the day-to-day business of the company does not occur in the place of incorporation.

Falk J in *Tulip Trading Ltd* opined that the location of *control* of a digital asset, including by the storage of a private key, was of relevance. The judge referred to paragraph 99 of the *Legal statement on cryptoassets and smart contracts* authored by the UK Jurisdiction Taskforce which identifies a few factors relevant to determining whether the proprietary aspects of dealings in digital assets are governed by English law. These factors are likely to be relevant to similar considerations in BVI and Cayman law and include:

- Where any relevant off-chain asset is located
- Where (if any) centralised control is located
- Whether a particular cryptoasset is controlled by particular participant in the jurisdiction (because, for example, a private key is stored here)
- What is chosen law applicable to the relevant transfer (if any, for example perhaps by reason of the parties' choice)

That said, the concept of "control" as it applies to crypto assets is far from straightforward. The June 2023 discussion by the UK Law Commission in its report - *Digital Assets*, opted to describe "control" as a factual concept (as opposed to defining it) involving both the ability to exclude or to permit access to the thing, and put the thing to the uses of which it is capable. Factual control in this context will largely be determined by the way in which the particular technology facilitates the imposition of varying degrees of technical encumbrances. That said, the Law Commission considered that the concept requires refinement and should be coupled with the legal consequences of control as well, which too varies with the asset.

There is also a question about when the question of jurisdiction should be determined. In *Fetch.ai Ltd v Persons Unknown* [2021] EWHC 2254 (Comm), Justice Pelling indicated that "*the test for whether assets are within the jurisdiction, for the purposes of deciding whether a claim relates to such asset, must focus on where the assets were located before the justiciable act occurred*" [2]. However, in *Osbourne v Persons Unknown* [2023] EWHC 39 (KB), while he ultimately was not required to determine the question, Justice Lavender considered that "there is room for doubt whether HHJ Pelling KC's proposition is correct", suggesting that the question of jurisdiction ought to be determined as at the date of any application for relief (therefore after the assets have been relocated), rather than the date when the cause of action accrued [3].

Until final determination of this issue, it is prudent to adopt the domicile of the owner as the *lex situs* of cryptocurrency, as a leading English legal textbook has found that while the law as to the *lex situs* of crypto assets remains undeveloped, this approach and its "*ascertainability and control justifications*" is based on sound principles.[4]

Ownership of crypto assets

For insolvency practitioners appointed over companies that facilitate the trading of crypto assets, such as crypto assets exchange platforms, an important initial question is whether those assets which remain in the wallets held by the platforms belong to the insolvent company (and are therefore distributable to the general body of unsecured creditors of that company) or whether they are held on trust for the accountholders. Two recent cases, which involved liquidators seeking directions as to the ownership of crypto assets contained in hot wallets held online and controlled by the company, provide an illustration of these two different scenarios and underline the importance of considering the specific legal arrangements governing the insolvent company's retention of accountholders' crypto assets on a case-by-case basis.

In the New Zealand High Court case of *Ruscoe v Cryptopia (in liquidation)* [2020] NZHC 728 accountholders of a cryptocurrency exchange in liquidation [5] asserted a proprietary interest in the cryptocurrency held by the exchange (in both hot and cold wallets), arguing that it was held on express trust on their behalf.

The *Cryptopia* exchange maintained one hot wallet per cryptocurrency (although it had various "cold wallets" which were used for topping up the hot wallets) [6] and a detailed database which recorded all transactions carried out on the exchange on behalf of accountholders and the coin balances of each accountholder [7]. It also exclusively held the private keys for the wallets and the accountholders did not have access to the private keys [8], although the exchange did not trade with or use any of the accountholder's cryptocurrency in its own right [9]. The *Cryptopia* terms and conditions confirmed that the ownership of the cryptocurrency held on the exchange remained vested in the accountholders [10].

In those circumstances, Justice Gendall found that:

- an express trust existed on the facts, given that the three certainties (certainty of subject matter, object and intention) were all present [11] . In particular, a single trust was created for each relevant type of cryptocurrency with each accountholder who held that currency sharing beneficial co-ownership with all other accountholders holding that currency in proportion to the numbers of coins they had contributed [12]

- Even though the terms and conditions were only introduced in 2018, as there was no material change to the business that resulted from the introduction of the terms and conditions, the analysis as to the existence of the trust was the same regardless of the dates on which individuals invested [13]

- The lack of documentation was not fatal to the existence of a trust and in particular, although there would be some difficulties in identifying all of the accountholders, this evidential uncertainty does not defeat the existence of a trust [14]

Conversely, in the decision of the Hong Kong Court of First Instance in *Re Gatecoin Limited* [2023] HKCFI 914, which also involved a cryptocurrency exchange in liquidation in which accountholders asserted a proprietary interest over the assets in the wallets held by the exchange, the Court found that by virtue of the terms and conditions of the exchange, no trust existed in that instance.

The *Gatecoin* exchange's internal ledger recorded details of deposits made onto the exchange and withdrawals off the exchange [15] and once a customer deposited cryptocurrency onto the platform, it was transferred into a wallet where it was co-mingled with cryptocurrencies held by other accountholders [16]. The exchange applied any cryptocurrencies held in that wallet without regard to which accountholder deposited them including for the purpose of withdrawal requests. There were three separate terms and conditions in effect over the relevant period but only one version specifically referred to the fact that the cryptocurrency was held on trust in favour of the accountholders [17]. This version came into effect in November 2016 but was superseded by new terms and conditions in March 2018, which expressly provided that the exchange was not acting in a fiduciary capacity.

Accordingly, Justice Chan found that:

- although the funds had been comingled,[18] she would have been inclined to find that the cryptocurrency was held on trust if the November 2016 terms and conditions had remained in effect, as the amounts deposited could be determined by reviewing the ledger [19] .
- The fact that the March 2018 terms and conditions excluded a fiduciary relationship meant that there was no certainty of intention to create a trust. The evidence showed that all customers who re-accessed the platform after March 2018 were required to agree to those new terms and conditions [20] . Although Justice Chan acknowledged there may be some accountholders who had not accessed the platform since March 2018 and may not have agreed to the new terms and conditions, none were identified at the hearing [21] .

Justice Chan therefore concluded that, unless such individuals came forward, none of the accountholders had a proprietary interest in the cryptocurrency held in the exchange's wallet and had to prove in the liquidation as ordinary unsecured creditors.

Conclusion

The intangible and decentralised nature of crypto assets present unique and challenging jurisdictional and ownership questions for courts, litigants and insolvency practitioners. Whilst the laws governing crypto assets are still in their infancy, it is expected that the BVI and Cayman courts will be at the forefront of legal developments and will be grappling with and resolving these difficult questions in the coming years.

A version of this article was originally published in IFLR, 17 October 2023.

[1] *Ion Science* at [13].

[2] *Fetch.ai* at [23].

[3] *Osbourne* at [36].

[4] Collins et al, *Dicey, Morris & Collins on the Conflict of Laws* (16th edition, 2022, Sweet & Maxwell) at [23-050].

[5] The exchange was the victim of a hack which resulted in the misappropriation of approximately NZ$30million in cryptocurrency and the shareholders voted by resolution to wind up the company.

[6] *Cryptopia* at [22(g)].

[7] *Cryptopia* at [34].

[8] *Cryptopia* at [22(k)].

[9] *Cryptopia* at [154].

[10] *Cryptopia* at [26]-[27].

[11] *Cryptopia* at [140]-[187].

[12] *Cryptopia* at [183]-[187].

[13] *Cryptopia* at [155].

[14] *Cryptopia* at [149] citing *Re Baden's Deed Trusts (No 2)* [1973] 1 Ch 9 (CA) at 19-20.

[15] *Gatecoin* at [22].

[16] *Gatecoin* at [22]-[23].

[17] *Gatecoin* at [24]-[27].

[18] However, see the BVI decision of *Torque* where, in a sanction application, the liquidators drew a distinction between "User Trading Wallets" which included co-mingled funds and for which the exchange had the private key and "User Personal Wallets" which the accountholders maintained control of. The Court agreed with the liquidators that the former were assets of the company solely on this basis, although no evidence was heard from any accountholders at the hearing: *Smith v Torque Group Holdings Limited (in liquidation)* BVIHC (COM) 0031 of 2021 at [29]-[30].

[19] *Gatecoin* at [64], [68], [70].

[20] *Gatecoin* at [34]-[35].

[21] *Gatecoin* at [39]-[40].

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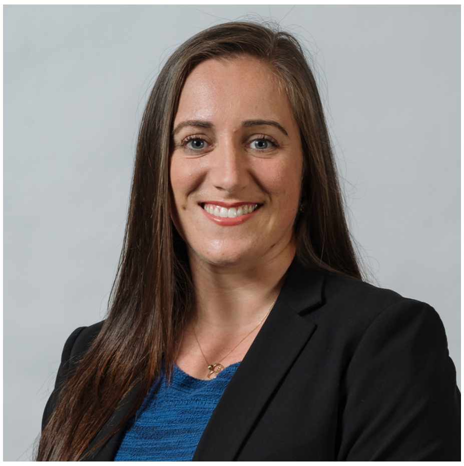

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