

Bit by bit – the future direction of English insolvency law and cryptocurrency

KEY POINTS

- Cryptocurrency has now been recognised as property under English law.
- It is therefore capable of falling within the insolvent estate of companies and individuals.
- This opens the door to potential actions by insolvency officeholders in relation to cryptocurrency transactions, including transactions at an undervalue, preferences and misfeasance.

INTRODUCTION

This article considers how insolvency law may develop in response to the increasing frequency of cryptocurrency transactions. It focuses on how the courts may classify cryptocurrencies as a matter of English property law, and the implications of this for insolvency law. Drawing on a developing body of case law in the context of cryptocurrency fraud, we suggest that the courts will take a similarly proactive approach in the area of insolvency law and, in particular, considerations of antecedent transactions and directors' liability in a cryptocurrency context.

WHAT IS CRYPTOCURRENCY?

Cryptocurrency is a virtual form of money traded online in a decentralised, immutable and anonymous form, independent of the traditional banking system.

Cryptocurrency predominantly uses distributed ledger technology ("DLT"). A distributed ledger is a record of transactions that is shared across the cryptocurrency network. Control of the ledger is *decentralised* (with no one person able to make unilateral changes) and *distributed* (as all changes of the ledger are made simultaneously and by consensus of the users).

Users access the cryptocurrency network using a private key – a unique, anonymous combination of letters and

numbers. This private key allows users to permit transfers or other dealings in the relevant cryptocurrency. In addition, each user possesses a public key which contains or references information about the cryptocurrency asset eg its ownership, value and transaction history.

DLT commonly utilises blockchain technology – blockchain, simply put, is a series of transactions (each transaction being a block) linked together sequentially on the ledger. Every new transaction of cryptocurrency within the network is, once verified by the consensus of the users, added as a new 'block' to the 'chain'.

These technologies give cryptocurrency three distinctive traits:

- **Decentralisation:** The system is completely decentralised, as control of the network is not held by any single entity.
- **Immutability:** Once a change or record is made in the ledger, it cannot be altered unless the majority of participants agree to make the changes.
- **Anonymity:** Transactions are anonymous as the only information recorded on the DLT is the public key of each user – a unique and randomised set of numbers linked to a user's private key. Each user's private key is used to unlock and transfer their own cryptocurrency and remains anonymous.

THE CATEGORISATION OF CRYPTOCURRENCIES UNDER ENGLISH LAW

The conceptual challenge

One challenge with classifying cryptocurrencies is that they do not easily fit into the two traditional categories of property recognised under English law – a chose in possession, or a chose in action. A chose in possession is something that a person can have by physical possession. Cryptocurrencies evidently do not fit into this category since they are intangible and exist in the digital realm. A chose in action is an asset that can only be claimed or enforced by action of law or equity, rather than by taking physical possession. The term is generally used to mean a right of property capable of being enforced by court litigation or action eg a debt, and cryptocurrencies do not fit neatly into that definition either. Whilst a cryptocurrency may be linked to legal rights external to the system, it does not itself embody any right capable of being enforced by action.

Nonetheless, the UK Jurisdiction Taskforce (UKJT) – comprised of legal and technical experts in blockchain – has argued in its Joint Statement that cryptocurrencies should be categorised as property under English law. The UKJT argued that cryptocurrencies meet the four criteria set out in Lord Wilberforce's classic definition of property in *National Provincial Bank v Ainsworth* [1965] 1 AC 1175, ie being (i) definable, (ii) identifiable by third parties, (iii) capable in their nature of assumption by third parties and (iv) having some degree of permanence.

Case law

The UKJT Statement is not a judicial

Feature

statement but its reasoning on the classification of cryptocurrencies has, mostly, been adopted in English courts.

In *AA v Persons Unknown* [2019] EWHC 3556 (Comm), a hacker gained access to the IT system of an insurance company and demanded US\$1.2m in Bitcoin as a ransom payment. The Applicant paid a ransom in Bitcoin to the hacker and subsequently traced the Bitcoin to a wallet operated by the cryptocurrency exchange, Bitfinex. It successfully applied for a proprietary injunction against the Defendant, requiring the Respondents to preserve cryptocurrency assets so that they could be turned over to the Applicant if successful in their subsequent action.

Bryan J cited and adopted the UKJT's argument that the traditional dichotomy between choses in possession and choses in action was not a rigid one. He noted the UKJT's point that the courts in other cases had had no difficulty in treating novel kinds of intangible assets as property. He concluded that the bitcoins in question could be classified as a form of property capable of being the subject of a proprietary injunction.

In *Fetch.ai Ltd v Persons Unknown* [2021] EWHC 2254 (Comm), the defendant fraudsters accessed the trading accounts of the Applicants and misappropriated their cryptocurrencies. The Applicants successfully applied for Bankers Trust and Norwich Pharmacal orders against the fraudsters and the companies that maintained their accounts. Pelling J in his judgment noted that he was entirely satisfied that the cryptocurrencies were to be regarded as property for the purposes of English law. However, unlike *AA v Persons Unknown*, Pelling J considered that the cryptocurrencies should be considered a chose in action, although he did not elaborate further on this conclusion.

Furthermore, in *DPP v Briedis* [2021] EWHC 3155 (Admin), McGowan J held that the cryptocurrencies concerned could be considered 'property' within the meaning of s 316(4)(c) of the Proceeds of Crime Act 2002 capable of being the subject of a freezing order.

IMPLICATIONS FOR INSOLVENCY LAW

The recognition of cryptocurrencies as a form of property by the English courts, together with their proactive approach to interim relief and tracing, has a number of implications for the development of insolvency law.

Cryptocurrencies within the insolvent estate

The recognition of cryptocurrencies as a form of property by the English courts has clear implications for their classification within an insolvent estate. Cryptocurrency could be construed as 'property' within the meaning of s 436 of the Insolvency Act 1986 ('Insolvency Act'), falling within the insolvent estate of bankrupt companies and individuals.

This point was made by the UKJT in its Joint Statement but has not yet been considered by the English courts. However, the question was considered in New Zealand in the case of *Ruscoe and Moore v Cryptopia Ltd (in liquidation)* [2020] NZHC 728. The Respondent cryptocurrency exchange's servers were hacked and some NZD 30 million of cryptocurrency stolen. It was later placed into liquidation. The liquidators applied to the court for directions as to whether the remaining cryptocurrencies were 'property' within the meaning of s 2 of the New Zealand Companies Act 1993 ('NZ Companies Act').

The New Zealand High Court ruled that the cryptocurrencies were 'property' within the meaning of the NZ Companies Act, drawing on precedent from England in *AA v Persons Unknown* and the UKJT Statement. However, the court ruled that the cryptocurrencies were, on the facts, held on trust by Cryptopia Ltd on behalf of its accountholders. Therefore, the cryptocurrencies were to be transferred to the accountholders rather than forming part of the insolvent estate of Cryptopia Ltd.

The location of cryptocurrency will also be a key consideration for officeholders. Pelling J addressed this issue in *Fetch.ai Ltd v Persons Unknown*, ruling that the proper question was where the owner of the

cryptocurrency was domiciled.

Cryptocurrency transactions as reviewable transactions

It is likely that there will be future cases where insolvency practitioners may wish to challenge and undo transactions involving cryptocurrency.

The following scenarios are plausible:

- Insolvency practitioners ('IPs') may seek to challenge cryptocurrency transactions as transactions at an undervalue under s 238 of the Insolvency Act.
- IPs may seek to challenge a transaction as one designed to defraud creditors under s 423 of the Insolvency Act. One such scenario may arise where a company has converted fiat currency into cryptocurrency at a discount and concealed the private key in an attempt to place the assets beyond the reach of creditors.

Now that the English courts have recognised cryptocurrency as a form of property, it is likely that transfers of cryptocurrency by a company would constitute 'transactions' within the definitions of s 238 and s 423 of the Insolvency Act, respectively. This significantly increases the chances that such future applications by IPs may succeed.

However, the anonymous nature of the distributed ledger presents significant challenges to IPs in tracing and recovering cryptocurrency, even if their court applications succeed.

Nonetheless, the case law in the context of cryptocurrency fraud indicates that practical solutions will be available in some cases. Where the cryptocurrency can be traced to an established exchange, the exchange will usually be required to hold personal information of accountholders (eg, in the form of KYC ('know your customer') documentation). IPs, following the precedent in the fraud cases, could apply for orders under s 236 of the Insolvency Act against these exchanges, requiring them to provide information and allowing the IP to identify the relevant persons against whom

Biog box

Jonathan Sears is a senior associate in Dentons' London office. He is a member of the Restructuring, Insolvency and Bankruptcy team with particular sector experience in the energy and banking sectors. Julian Ng is a trainee at Dentons and completed his first seat with the Restructuring, Insolvency and Bankruptcy team. Email: jonathan.sears@dentons.com; julian.ng@dentons.com

to seek further relief.

Additionally, where there is a transaction at an undervalue, the court does not need to order that the original property be restored, as it has discretion to order other forms of relief such as requiring a person who has gained a benefit from the transaction to pay over any sums received to the IP in monetary terms. This discretion means an IP may be able to seek relief even if they are unable to obtain control over the private key.

Directors' liabilities for wrongful and fraudulent trading involving cryptocurrencies

A similar analysis applies when considering the possibility of claims for wrongful and fraudulent trading against company directors. Directors face potential liability under both headings:

- **For wrongful trading under s 214/246ZB of the Insolvency Act:** where a director, having concluded that there is no reasonable prospect of the company avoiding insolvency, continues with a transaction involving cryptocurrency against the best interests of creditors.
- **For fraudulent trading under s 213/246ZA of the Insolvency Act:** where a director carries out a cryptocurrency transaction during the course of the winding-up or administration of the company with the intent to defraud creditors of the company.

In the case of fraudulent trading, a director faces potential criminal liability. In the case of wrongful trading, the courts have the power to order a director to contribute to the company's assets as it thinks proper. As in the case of transactions at an undervalue, the nature of the available relief mitigates issues that IPs may face over control of the private key for the cryptocurrency. In light of the tracing solutions adopted by the courts in the context of fraud, we may see future cases where the court grants similar relief to an IP in order to trace and recover assets from a director's accounts/personal assets.

CONCLUSION

The recognition of cryptocurrency as a form of property under English law has significant implications for insolvency law. Drawing from the case law in cryptocurrency fraud, we have argued that the courts will take a similarly proactive approach in the context of insolvency law and the review of transactions and directors' personal liability in particular. Creditors, insolvency practitioners and law firms should therefore be alive to the possibility that insolvent companies may have assets in the form of claims in respect of cryptocurrency, which can be realised for the benefit of creditors. ■

Further reading

- Dealing with crypto-assets in a downturn: lessons from London and other jurisdictions (2020) 3 CRI 90
- LexisPSL Restructuring & Insolvency; Industry/sector guides for R&I lawyers; Finance, insurance and professional services; Crypto-assets in insolvency
- LexisPSL Banking & Finance; Regulation for Banking Lawyers; Fintech-United Kingdom – A Q&A Guide