Snapshot: Crypto recovery

Insights - 04/12/2020

The uncertainties of 2020 and the increasing acceptance of Bitcoin (soon to be available in PayPal accounts) has led Bitcoin to boom to nearly 2017 levels. Interest in other cryptocurrencies is also high. A high tide for any asset class can leave holders vulnerable to fraudsters, scammers and simple theft.

Those new to the asset class should familiarise themselves with key issues:

1. Cryptocurrencies are digital currencies secured by cryptography often based on decentralised networks using blockchain technology, a public distributed ledger with no central authority.
2. Unlike traditional fiat currency, Initial Coin Offerings or Securitized Token Offerings, cryptocurrency is not backed by Governments or assets. Value is derived from the strength of the network and what the market is willing to pay. As such, they are highly susceptible to market trends and events.
3. Every transaction involves public and private keys. Public keys are the public address used to facilitate transactions. Private keys are the authorisation code that approves transactions - never reveal your private key.
4. Cryptocurrencies can be stored on a variety of "wallets". "Hot" wallets are connected to the internet and susceptible to hacking. "Cold" wallets are not connected to the internet but once lost cannot be recovered. Use wallets with secure two-factor encryption for extra security.
5. Exchanges can hold cryptocurrency pending exchange, but never keep large volumes on exchanges. Many instances of crypto loss have been through exchange failures following hacks, poor management and liquidity issues. The larger exchanges maintain a reserve and insurance against hacks, but why take the liquidity risk?
6. Beware of the "next Bitcoin". CoinMarketCap lists 7,846 cryptocurrencies. Bitcoin currently has a market share of over 60%. In 2017 this market share fell to below 40%, but many other

cryptocurrencies launch with hype only to fail to achieve any traction.

7. While proponents touted the anonymity of cryptocurrencies, the coins are technically traceable as the public ledger preserves an immutable record of all transactions.

What if I am the victim of a crypto hack, scam or fraud?

There is a growing body of judicial authority that would be persuasive in the Cayman Islands that recognise crypto-currencies as an asset. The forensic ability to trace transactions on the public ledger and the increasing number of on-ramps to identify the use of cryptocurrency means that common law remedies may be available to a victim. *Norwich Pharmacal* orders (requiring disclosure of information necessary to bring a claim) and freezing injunctions (preserving assets including those held by third parties such as exchanges) may enable a victim to identify and pursue the perpetrators.

Although these tools are not cheap, quick initial steps are necessary given the ease with which transactions may cross-borders and that the use of coin mixers may frustrate effective recovery of crypto. In Cayman, joint actions are permissible where there is a common question of law or fact which would arise in the actions and where the rights to relief are in respect of or arise out of the same transaction (which would arguably include a broad-based hack). Alternatively, the facts may justify the appointment of a liquidator to take collective action on behalf of creditors for the recovery of assets, which may make actions more cost-effective.

If a victim obtains a judgment, the nature of cryptocurrency means that enforcement may require more creativity than is usually the case as there is no central authority to return stolen assets or hand over the private key. Depending upon the legal personality of the defendant contempt or sequestration proceedings may be appropriate, or the appointment of liquidators or receivers to seize real-world assets and halt operations to compel compliance. The inclusion of a mechanism for implementing Court ordered returns of assets is anathema to the ideals of crypto-currency, but the inclusion of such a mechanism in future digital currencies may give the wider public more comfort in their use, enabling wider acceptance and the achievement of the other purposes of a more easily available digital economy.

In terms of a scam, any promises (oral or written) will need to be considered and contractual and tortious claims pursued against the promoters and issuers of the coin, which may lead to damages awards enforceable against real-world assets purchased with the proceeds of the scam. *Norwich Pharmacal* and freezing orders may similarly be sought to aid in proceedings.

Although many of the remedies and tools that are available for recovery of cryptocurrency are the application of well-established legal principles, experience and knowledge of the crypto and blockchain ecosystem is crucial in avoiding missteps in recovery actions. Ogier is one of the leading Offshore firms working in Blockchain and has lawyers experienced in fraud, asset recovery and financial claims.

About Ogier

Ogier is a professional services firm with the knowledge and expertise to handle the most demanding and complex transactions and provide expert, efficient and cost-effective services to all our clients. We regularly win awards for the quality of our client service, our work and our people.

Disclaimer

Meet the Author

Jennifer Fox

Partner

Cayman Islands

E: jennifer.fox@ogier.com

T: +1 345 815 1879

Key Contacts

Jeremy Snead

Partner

London

Cayman Islands

British Virgin Islands

E: jeremy.snead@ogier.com

T: +44 20 3835 9470

Related Services

Dispute Resolution

Crypto Disputes

Related Sectors

Restructuring and Insolvency

Technology and Web3