DENTONS

Re Gatecoin: its implications and the future of cryptocurrency in the context of insolvency law in Hong Kong

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In the landmark judgment by Linda Chan J in *Re Gatecoin Ltd (in liquidation)* [2023] HKCFI 914, the Court of First Instance held that cryptocurrencies were property under Hong Kong law capable of being held for distribution to creditors (or beneficiaries if they were trust assets) for the purposes of administrating an insolvent estate. In this article, the authors consider the court's ruling and its wider implications for the insolvency regime in Hong Kong, focusing on fraud claims and reviewable transactions in the cryptocurrency context.

The *Re Gatecoin* judgment

Gatecoin Limited was incorporated under the laws of Hong Kong and operated an online cryptocurrency exchange platform from January 2015. Accountholders who registered an account with Gatecoin were able to deposit and trade more than 45 types of cryptocurrencies, together with fiat currencies, on the platform. In addition, Gatecoin also traded cryptocurrencies in its own right, including by trading with its customers.

Gatecoin became the target of a cyberattack in May 2016 with some US$2 million lost as a result. The company was wound up and Jocelyn Chi and Anson Li were appointed as liquidators on 20 March 2019. The liquidators, faced with uncertainty over the nature of cryptocurrencies, the relationship between Gatecoin and its customers, and how they should be dealt with, subsequently applied to the court seeking directions concerning the legal characterisation of cryptocurrencies held by Gatecoin and, as a secondary issue, whether Gatecoin held the cryptocurrencies on trust on behalf of its accountholders.

The characterisation of cryptocurrencies as property under Hong Kong law

It was necessary for the court to consider whether the cryptocurrencies fell within the definition of "*property*" under s197 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) (**Cap 32**), which imposes an obligation on a liquidator to take into custody all "*property*" upon a winding-up order.

The court engaged in a detailed consideration of precedents in other common law jurisdictions. It placed particular emphasis on the influential New Zealand decision of *Ruscoe v. Cryptopia Ltd* [2020] NZHC 728. In *Ruscoe*, the New Zealand court concluded that cryptocurrencies under the control of the insolvent cryptocurrency exchange were "*property*" within the meaning of domestic legislation capable of forming the subject matter of a trust in favour of the accountholders.

The court in *Ruscoe* found that cryptocurrencies satisfied the four criteria of "*property*" set out in the English decision of *National Provincial Bank v. Ainsworth* [1965] AC 1775, in holding that:

- cryptocurrency was "*definable*", as the public key allocated to a cryptocurrency wallet is readily identifiable, sufficiently distinct and capable of being allocated uniquely to individual accountholders;
- cryptocurrency is "*identifiable by third parties*" since only the holder of a private key is able to access and transfer the cryptocurrency from one wallet to another;
- cryptocurrency is "*capable of assumption by third parties*" in that it can be and is the subject of active trading markets; and
- cryptocurrency has "*some degree of permanence and stability*" as the entire life history of a cryptocurrency is recorded in the blockchain.

The court concluded that, in light of the reasoning in other common law jurisdictions and the broad nature of the general definition of "*property*", cryptocurrency is "*property*" capable of being held on trust.

Were the assets held on trust in Re Gatecoin?

To determine whether the assets in accountholders' accounts were held on trust, the court, in *Re Gatecoin*, considered three different sets of terms and conditions that were in force at different periods of time:

- the "**2016 T&Cs**" for Group A accountholders;
- the "**Trust T&Cs**" for Group B accountholders; and
- the "**2018 T&Cs**" for Group C accountholders.

The court considered in detail the wording of the different terms and conditions and whether they created a trust over the cryptocurrencies in favour of accountholders. It formed the view that the 2016 T&Cs and Trust T&Cs created trusts due to, *inter alia*, the language of the terms which described Gatecoin as a "*custodian*" and "*fiduciary*" over the cryptocurrencies in favour of the accountholders. The fact that the cryptocurrencies were pooled together did not negate the existence of a trust, as the subject matter of the trust was still sufficiently certain.

However, the court found that the 2018 T&Cs had superseded the 2016 T&Cs and Trust T&Cs, to the effect that no trust existed in favour of the accountholders. Unlike the prior terms and conditions, the 2018 T&Cs did not contain any express declaration of trust and expressly disclaimed any fiduciary relationship between Gatecoin and the accountholders. The court found that Group A and Group B accountholders had acceded to the 2018 T&Cs by clicking through and acknowledging the new terms and, even where no express agreement had been provided, by continuing to access and use the platform.

Are cryptocurrencies held on an exchange trust assets during an insolvency?

Since the court in *Re Gatecoin* found that the cryptocurrencies were not held on trust, it did not need to give directions on the mechanics of allocating trust assets. Insolvency practitioners will likely have an interest in such guidance being given in future in light of the practicalities and expense involved in distributing cryptocurrencies *in specie*.

The English courts have demonstrated that they will look at the substance of transactions and relationships to determine whether constructive trusts exist over cryptocurrencies. In *Piroozzadeh v. Persons Unknown & Others* [2023] EWHC 1024 (Ch), Binance successfully applied to discharge an interim proprietary injunction obtained by the claimant whose misappropriated cryptocurrencies had been deposited with the exchange.

In particular, the claimant had not demonstrated how Binance could comply with the terms of any order recognising a constructive trust, given Binance's practice of pooling cryptoassets into a central, unsegregated "hot wallet". The decision is consistent with the position that banks who unknowingly receive fraudulent funds are not constructive trustees and may give guidance as to whether pooled assets on a crypto exchange can be trust assets.

In contrast, the conduct of the liquidation of Cryptopia Ltd following the ruling of the New Zealand courts in *Ruscoe* is a cautionary tale on the complexity and time required to administer claims by accountholders under a trust. As of the liquidators' latest report (published on 12 December 2022), more than two years after the court's judgment, claims were still being processed with more than 90,000 users having submitted claims.

The implications of *Re Gatecoin* for the Hong Kong insolvency regime

The recognition of cryptocurrencies as a form of property in the *Re Gatecoin* judgment serves as a strong indication that Hong Kong courts will take a proactive approach to cryptocurrency transactions in other aspects of the insolvency regime.

The authors consider the following two areas to be of particular significance.

1) Fraud and tracing claims by liquidators

One of the key tasks of a liquidator in relation to the insolvent company is to consider and pursue claims available to it. As the industry is still very much in its infancy, participants in the cryptocurrency system are vulnerable to fraud and cybercrime risks due to the relatively light amount of regulatory supervision. See, for example, the liquidation of FTX – a prominent cryptocurrency trading platform – following revelations that its founder had misappropriated funds from customer wallets. The authors envisage that this may be a significant source of work for the liquidators of insolvent cryptocurrency entities in the future.

The precedent set in *Re Gatecoin* indicates that, in the case of cryptocurrency fraud, liquidators will be able to take action to recover or preserve virtual assets as though they were any other form of property belonging to the company.

Case law in both Hong Kong and England and Wales preceding *Re Gatecoin* already indicates that courts are willing to take a proactive approach in the area of cryptocurrency fraud:

- In *Nico Constantijn Antonius Samara v. Stive Jean-Paul Dan* [2022] HKCFI, the court granted the plaintiff, a Dutch citizen, relief over the bitcoin held by the defendant, a sales agent, on the grounds that these were procured by fraud. On the facts of the case, the plaintiff had reached an oral agreement with the defendant to sell 1,000 bitcoin in Hong Kong as sales agent for a 3% commission. The court found that the defendant, as a sales agent, owed fiduciary duties to the applicant, including a duty to account to the plaintiff for the bitcoin and the sales proceeds. By failing to account to the plaintiff for the bitcoin in his possession, the defendant had acted in breach of his fiduciary duties. The court granted the plaintiff relief in the form of a declaration that the defendant held the bitcoin on trust for the plaintiff.

- In *Fetch.ai Ltd v. Persons Unknown* [2021] EWHC 2254 (Comm), the defendant fraudsters hacked into the trading accounts of the applicants and misappropriated their cryptocurrencies. The applicant successfully obtained Bankers Trust and Norwich Pharmacal orders (i.e. disclosure orders) against the fraudsters and the companies that maintained their accounts in the English courts to facilitate tracing of the misappropriated cryptocurrencies.
- In *Jones v. Persons Unknown* [2022] EWHC 2543, the defendant fraudsters convinced the claimant to set up an account with a fake trading platform and to invest £480,206 in bitcoin in the platform. When the claimant discovered the fraud, he instructed an investigator to trace his bitcoin to a wallet held by the Seychelles-based Huobi Exchange. The claimant successfully obtained an interim worldwide freezing injunction against "*persons unknown*" and a proprietary injunction against them and Huobi Exchange to prevent dissipation of the assets. In a pragmatic and innovative move, the English court granted permission to the claimant to serve an order for summary judgment by NFT airdrop into the exchange's wallet as a means of service and to bring the judgment to the attention of the persons unknown.

A question arises as to how an applicant would successfully enforce any court-obtained relief against the fraudsters or other third parties given the anonymous nature of the blockchain. On the one hand, while the cryptocurrency system transparently records all transactions on a public ledger, the identity of the very participants in the system remains anonymous. The only information about participants is registered in the form of their public key, which consists of a random string of characters.

However, existing cases on cryptocurrency fraud indicate that practical solutions will be available in some instances. Where participants have transacted through a public exchange, that exchange will often be required to hold personal information of accountholders as part of their standard AML and KYC procedures. Liquidators may apply under s286B Cap 32 requiring an exchange to provide information and produce books, records and other financial information to allow the liquidator to identify the relevant person against whom they may seek further relief. Additionally, where a person/fraudster has used an exchange to convert their cryptocurrency into fiat currency, this may create an opportunity to identify them via conventional forms of cash and asset tracing.

2) Reviewable transactions

The recognition of cryptocurrency as a form of property under Hong Kong law opens the door for insolvency practitioners to set aside transactions and claw back cryptocurrency in the future. These may include applications in relation to:

- unfair preferences (s266, Cap 32)
- transactions at an undervalue (s265E, Cap 32)
- extortionate credit transactions (s265B, Cap 32)
- floating charges (s267, Cap 32)
- void dispositions (s182, Cap 32)
- fraudulent trading (s275, Cap 32)
- director misfeasance
- transactions defrauding creditors, where a company disposes of a property without receiving value in return when it is or will become insolvent as a result of the disposition (s60 Conveyancing and Property Ordinance (Cap 219))

Given that cryptocurrencies are considered property under Hong Kong law, cryptocurrency transactions will likely be construed as "*transactions*" and "*property*" within the meaning of the above provisions. Liquidators may therefore be able to apply to have such transactions set aside and funds or cryptocurrency clawed back for the benefit of creditors.

Where a liquidator seeks an order that cryptocurrencies subject to a reviewable transaction should be set aside and the cryptocurrencies restored to the company, the volatile nature of cryptocurrencies may pose difficulties in determining the proper value in fiat money that should be recovered. Where, as demonstrated in *Ruscoe*, the recovery of cryptocurrency *in specie* may be impractical, it is worth noting that, for example, in the case of a transaction at an undervalue, a Hong Kong court does not need to order that the original property be restored but has a wide range of discretion to make an order "*that it thinks fit for restoring the position to what it would have been if the company had not entered into that transaction*" (s265D(3), Cap 32). It will therefore be interesting to see how the courts and insolvency practitioners deal with such volatile assets.

Potential areas of difficulty

While *Re Gatecoin* gives comfort to insolvency practitioners and creditors that cryptocurrency transactions can be readily integrated into the existing insolvency regime, this is not to say there may be sources of difficulty, particularly where relevant legislative provisions make more narrow references to fiat currency. This was the case in Singapore and the recent judgment of *Algorand Foundation Ltd v. Three Arrows Capital Pte Ltd* (HC/CWU 246/2022).

In this case, the Singaporean court ruled that debt denominated in cryptocurrency was not a money debt capable of forming the subject matter of a statutory demand. While the claimant did have locus as a *"creditor"* within the meaning of domestic legislation to claim for repayment of approximately 53.5 million USDC (a stablecoin backed by cash and US treasuries), the court considered that a traditional state theory of money should be applied and held that no money debt existed under the claim. It remains to be seen whether the courts in Hong Kong will subscribe to this school of thought and how a cryptocurrency denominated *"debt"* will be construed by the courts.

Commentary

While this remains a new area of law subject to continuing development, the *Re Gatecoin* judgment indicates that the courts of Hong Kong will readily incorporate cryptocurrency transactions into the broader insolvency regime. Insolvency practitioners have reason to be confident in taking a proactive approach in this area and cryptocurrency creditors can take comfort that their interests continue to be protected during liquidations.

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