



 DREW & NAPIER

DREWTECH SERIES

CHAPTER 9

Of blockchains and stumbling blocks

21 July 2021

LEGAL UPDATE

In this Update

Crypto-fever reached dizzying heights recently, fueled by celebrity endorsements and internet memes. Yet, as with many new and exciting technologies, one finds that the legal problems faced remain much the same.

This article considers some questions of considerable antiquity: Is the (crypto)currency I “own” my property? Who should I sue if and when something goes wrong? If I can sue, and if I can win, what will I get back in return?

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INTRODUCTION

Cryptocurrencies and similar tokens based off blockchain technology have been the centre of attention in recent months, riding the high of celebrity endorsements and cryptic memes. Bitcoin tripled in value between November 2020 to April 2021, before halving around June 2021. Oceans of ink and tears have been spilt over the environmental impact of Bitcoin transactions and the “proof-of-work” system, and “non-fungible tokens” or NFTs, have sprouted like mushrooms after rain.

Peel back the shiny veneer on these technologies, however, and one finds that many of the legal issues remain the same. This article considers issues that have plagued commercial transactions for decades: Is the (crypto)currency I “own” my property? Who should I sue if and when something goes wrong? If I can sue, and if I can win, what will I get back in return?

CRYPTOCURRENCY AND PROPERTY

The question of whether cryptocurrency is property is vexed, and yet one that has immense practical significance. While cryptocurrency has touted itself as being secure and immutable, this security applies to the system as a whole. As long as a majority of the system (or a plurality, depending on the specific system) has not been compromised, the underlying technology should be able to resist attempts to subvert transactions in the system. However, there is nothing to stop a hacker from stealing the notebook you have written your passwords in, or the thumbdrive which holds your private keys, and transferring all your cryptocurrencies to himself. The blockchain will readily record the transaction of all the BTC from you to an unknown actor anywhere around the world, and preserve it for your future review.

In these circumstances, the nature of cryptocurrency becomes a central question. If cryptocurrency is property, it has proprietary rights, which at a high level of abstraction may be enforceable against the whole world. For instance, the “*nemo dat*” rule, which prevents a purchaser of stolen property from obtaining good title over the stolen property, may apply. However, there is at least one gloss to this. If cryptocurrency is not just property, but currency in its legal definition, then the fact that it has been transferred for value and without notice of the illegal behavior may give the recipient good title to the cryptocurrency. There are numerous facets to the analysis, each of which may recast the situation in a different light.

Unfortunately, there is no clear conclusion as to whether cryptocurrencies are property. In a recent decision, Singapore Court of Appeal declined to come to a final position on this question as it was

not necessary to decide the matter. It also opined that if cryptocurrency was property, there would be difficult questions as to the type of property that is involved. This is an exciting new space that will certainly merit close attention, with the far-reaching implications of any decision on this matter.

VINTAGE DISPUTES IN NEW TECHNOLOGY

When one obtains a defective product, such as a bottle of ginger beer contaminated by animal products, the obvious port of call is to look to the seller for a remedy. However, there may be many reasons why the seller is not liable, such as the person suffering loss not being the buyer, the seller expressly disclaiming liability, or having disappeared altogether.

It may then be tempting for the unfortunate drinker of the ginger beer to pursue the manufacturer of the product. However, in the absence of a contract with the manufacturer, one needs to find a different cause of action for the suit.

KEYPOINT

A typical purchaser of cryptocurrencies may, despite all the modern accoutrements of cryptocurrencies, find themselves in a similar situation to plaintiffs almost a century ago. If you own cryptocurrency and the cryptocurrency turns out to be defective, who do you look towards for a remedy?

The seller who sold you the cryptocurrency could be anyone located anywhere around the world (since such transactions can be concluded with a simple click of a button over the world wide web). If pursuing the seller is not feasible, would the next logical step then be to seek a remedy from the issuer of the cryptocurrency, which was the case for a purchaser of ginger beer almost a century ago? What would be the basis of such an action? This presents a very real question of the proper defendant to any claim (and the jury is still out on this), since the only defendants that can even be located have either no relationship with you, or have no assets that you can enforce on (even if you win in legal action).

TIME VALUE OF CRYPTOCURRENCY

The next issue is the remedy that is available (assuming there is a case to be won, and assuming that one can find a party worth suing, and assuming that one wins the case). This is a question that has significant impact on any decision to sue, best illustrated by the following example. Suppose one was defrauded of 10 BTC on 16 April 2021. After protracted investigation and litigation, judgment is entered in your favour on 29 June 2021. If the judgment is for 10 BTC to be returned to you, that is a reduction in value of around USD 290,000. This is something that might be undesirable, and perhaps you could credibly say that you would have sold before the plummet in price.

On the other hand, if the judgment is made for a payment in US dollars, then there would be an argument about when the price of the 10 BTC is to be assessed. While there has been a long-standing rule that damages are assessed at the date of breach, this principle has been under attack for the last decade, and events occurring after the date of breach may be relevant in the assessment of damages. The matter, regrettably, remains unsettled.

The outcome on this issue seems likely to depend in part on whether cryptocurrencies are recognized as a currency or as a commodity. What is clear, however, is that one should expect significant litigation on this point due to the fickle volatility of cryptocurrencies.

CONCLUSION

In dealing with cryptocurrencies, it would be prudent to take all available steps to protect oneself, since the legal position is less clear than one would like. For instance, one can choose to deal only in established cryptocurrencies with a visible, capitalized entity that is backing it, and ensure that there are contractual rights against this entity that address the specific risks that the cryptocurrency is being used for (e.g. Byzantine faults, Sybil attacks, forks, or fraud), to have a cause of action against an entity of means. If one has sufficient bargaining power, it may also be desirable to agree on liquidated damages clauses, which could grant certainty by fixing the quantum of damages ahead of time.

As with many new technologies, the law surrounding cryptocurrencies is still in flux. However, the legal issues and commercial realities ultimately have not changed all that much. Businesses and investors alike have the same concerns: what the nature of the “product” they are trading in is, who is responsible when things go wrong, and how they are protected when things go wrong. While it appears that we must wait for definitive pronouncement on

these issues, parties dealing in cryptocurrencies should be prepared for protracted, expensive, and possibly futile disputes if inadequate risk-management measures are not taken in time.

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