LITIGATION INVOLVING CRYPTOCURRENCIES AND DIGITAL ASSETS

COMMUNICATING IN A CHANGING REGULATORY ENVIRONMENT

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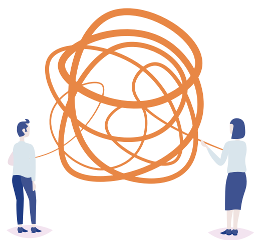
The recent "crypto winter", the expectation defying resilience of consumer demand for cryptocurrencies, and the worldwide development of regulatory models for cryptocurrencies and digital assets indicate that the sector will continue to keep the courts busy.

Given so much of the digital asset sector is unregulated or under-regulated, lawyers have quickly become accustomed to using analogue statute, common law and regulatory guidance to bring and defend actions concerning this newfangled phenomenon. However, as consumer and business usage of digital assets maintains its momentum, a much wider group of stakeholders are finding themselves in the crosshairs of an uncertain legal landscape.

The inherent complexity of cryptocurrencies and digital assets makes providing guidance a challenge. Terms such as NFTs, decentralised finance and algorithmic stablecoin are not well understood and nor do they lend themselves to clear and concise communication. At the same time, a rapidly changing regulatory environment in which states around the world are seeking to catch up with technological developments whilst also seeking to facilitate or disincentivise economic growth in these asset classes results in an almost impenetrable policy ecosystem.

This article examines some of the communications challenges of crypto and digital asset litigation and assesses the different approaches taken by governments to regulate the sector.



Technical complexity and jargon

It is no surprise that the most well known crypto-related scandal of recent times does not rely on the intricacies of blockchain. Instead, from what has been made public of FTX's demise, it seems to be plain, simple, old-fashioned poor governance (and maybe a little fraud - but the courts will determine that). There is little doubt that it is through the prism of corporate governance failures that the world's financial media have approached their reporting.

Nonetheless, future disputes relating to cryptocurrencies and digital assets are likely to necessitate substantive discussion of the technologies themselves amongst lawyers, journalists, interested parties, and the general public.

Without significant effort, including from regulators, there are risks that many members of the public will fail to understand their rights. They could also fail to bring actions they are entitled to bring. More broadly, there is a risk that the judicial process itself is undermined due to confusion and misinterpretation caused by industry specific jargon and technical terms.

The motive to regulate

One of the ironies of cryptocurrencies and digital assets is that in many of their forms, a core tenant of their appeal is that they exist outside of existing financial (and regulatory) institutions. However, from a political perspective, several elements make regulation vital. First, the risk (no matter how valid) that they might undermine confidence in existing financial systems. Put more starkly - currencies are how states control the fortunes of their economies. Second, the fact that cryptocurrencies and digital assets are often marketed directly to consumers and consumers need protecting. Third, the risk that they can be used for terrorism or crime. Fourth, they are a potential source of tax revenue.

Whilst scandals such as FTX have little to do with cryptocurrencies themselves, there is no doubt that they galvanise momentum. Across the globe, we have seen the regulatory landscape develop at different paces in different states. This momentum is increasing. There is also a general consensus that because you cannot ban the mathematics on which digital asset technologies are based, it is too difficult to ban cryptocurrencies (although China has tried). Instead, countries across the globe are seeking to assert varying levels of control of digital assets. Different governments are consequently taking approaches which mirror domestic concerns and, in many cases, the opportunities they see in attracting fintech investment.

A patchwork of rights

The result of this policy development is a rapidly evolving legislative and regulatory landscape in which regulatory divergence between states is common. Countries such as Switzerland have moved early to try to create regulatory certainty whilst the EU's flagship MiCAR Act seeks the same outcome but on a larger scale. Many see it as an attempt by the EU to set global standards much as it did with data and GDPR. The US approach has been characterised by strong enforcement by agencies such as the SEC rather than federal regulation, whilst the UK and Dubai are developing their own regimes whilst claiming to create crypto-friendly states.

There is an irony that a nation-state patchwork of regulation is springing up for crypto technologies which are often inherently borderless. The challenge for any interested parties is that this nation-state regulatory approach adds confusion.

The lack of a global approach to digital asset regulation causes several other issues too. From a competition perspective there is no level playing field. Furthermore, despite a global consensus towards regulation, the risk of a race to the bottom is increasing as companies in the crypto sector move their operations to the nations with the friendliest approaches to the crypto community.

Conclusion

It is clear that regulatory developments will continue to have a significant impact on ongoing litigation whilst opening up new avenues for disputes. However, it also seems that despite the efforts of regulators to provide clarity, the development of regulations will create more cross-jurisdictional complexities associated with litigation. Disputes are already regularly involving parties from different countries, each of which have varying regulatory approaches and legal systems. Similarly, several regulatory regimes only cover parts of the crypto asset value chain. Given the sector's track record of innovation, regulators will struggle to keep pace, leaving the courts to pick up the pieces.

In this regard, regulators would do well to remember that many of the failed high profile businesses in the cryptocurrency and digital asset space were run by people who were relatively inexperienced in providing financial services. It is here that the Kelly Report into the failure of the UK Co-operative Bank in 2013 provides a salutary lesson. Sir Christopher found that the bank had failed not because of lack of regulation but because of its leaderships' lack of knowledge. It is possible that no new regulation would have saved the bank from collapse. In the same way, it is possible that no new regulation can save consumers from crypto-related harm.

This is not to say that regulation is futile but to highlight the importance of enforcement by state agencies and the enforcement of rights by individuals and companies. However regulation develops, the courts will play a vital role in continuing to arbitrate uncertainties.

The coming years will require lawyers, companies, journalists, regulators and politicians to adopt transparent and accessible communication strategies to bridge the gap between the legal world, regulatory changes, and the general public. There will be plenty of education as well as litigation to be done.