THE PITFALLS OF APPLYING FULL AND FRANK TO NEW TECHNOLOGIES

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Piroozzadeh is the latest in an expanding category of cases concerned with recovery of misappropriated cryptocurrencies. Whilst it does nothing to undermine the now established caselaw that the English court will grant proprietary and ancillary orders in respect of cryptoassets in appropriate cases, it has drawn stark attention to the need to comply with the duty of full and frank disclosure in this evolving area of law.

The factual matrix will be familiar to crypto fraud lawyers. The Claimant, Mr Piroozzadeh, had been tricked by unidentified fraudsters into transferring 870,818 USD Tether ("USDT") into cryptocurrency wallets belonging to D3. After engaging an investigator and legal representatives he had allegedly traced his assets on the blockchain to so-called 'Last Hop Wallets' on two exchange platforms, Binance Holdings Limited ("Binance") and Aux Cayes Fintech Co Ltd ("Aux Cayes"). Mr Piroozzadeh then successfully applied for the relief we typically see in these cases – various orders the judge described as orders restraining dealing with the Tether (presumably freezing orders) against 'Persons Unknown', being the unidentified fraudsters, and, also now common, a proprietary injunction against the exchanges.

The basis for this was alleged to be a proprietary claim on the basis that the exchanges held his assets as constructive trustees. All of this was done on an ex parte basis.

At the return date Binance applied to discharge the interim proprietary injunction on various grounds including that:

(a) the application should not have been made without notice;

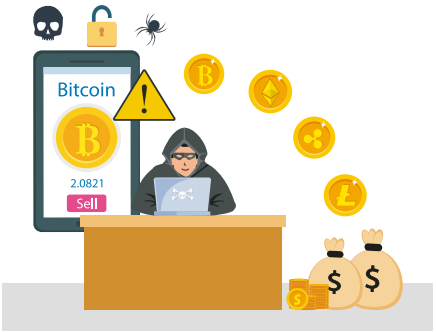
(b) that Mr Piroozzadeh had failed to discharge his duty of full and frank disclosure in applying for the Orders by reason of failing to identify their alleged bona fide purchaser defence;

(c) Mr Piroozzadeh had failed to explain why there was a risk of a sufficient breach of trust;

(d) there was no explanation as to why damages would be an inadequate remedy; and

(e) there was also no explanation as to how Binance was expected to comply with the injunction in practice (which it said it couldn't by reason of the way it operated its wallets).

Trowers J agreed that notice should have been given – the fact that there was justification to proceed ex parte against one defendant did not, without more, justify proceeding against another ex parte. The order could have been obtained against Persons Unknown and then served on Binance as a non party. However, he concluded that taken purely in isolation this factor alone would not have justified discharge of the injunction.



On the question of fair presentation, however, the Judge was clear: the duty had not been discharged and the orders against Binance, and by extension against Aux Cayes, would not be continued.

The Judge canvassed the authorities. Upon an application without notice for injunctive relief, it is well-established

that the applicant and their legal advisor have a duty to give full and frank disclosure of all material facts, to make fair presentation and to show the utmost good faith (Siporex[1]). The duty encompasses a requirement to anticipate the absent respondent's potential defences (emphasised in Pugachev[2]), and which the respondent would raise were they present. In Fundo Soberano de Angola[3], it was clarified that the applicant cannot rely on the judge to identify key points in full and frank disclosure. The judge in such an application is likely to be acting under constraints of time, often upon voluminous exhibits; key points must be signposted in affidavits and skeleton arguments. In short, and unsurprisingly, all of the obligations which exist in seeking an ex parte injunction continue to apply where crypto assets are involved.

Applying those principles to this case, the judge found that:

1. The movement of digital currency and how any particular exchange generally treats those assets is relevant to the question of whether property rights survive, and therefore of what defences may be available.
2. Binance's evidence was that, even assuming that the applicant's digital assets were traceable to an exchange wallet, 'the uncontradicted evidence…is that the user does not retain any property in the Tether deposited with the exchange'. Binance utilises a 'hot wallet', sweeping all incoming cryptocurrency into a pooled wallet. The user's account is credited with the deposit amount, but no segregation of assets takes place. Trower J held "it should have been apparent that the consequence of pooling was that the users' right to receive substitute assets from the exchange was at the very least likely to constitute the exchange a purchaser for value of anything that was transferred in to the account in the first place".
3. The fact Binance operated in this fashion and the fact it was likely to rely on a bona fide purchaser defence was apparent from its position in another case (D'Aloia). Mr Piroozzadeh's counsel had appeared for the claimant in that other case and accordingly were aware that Binance were likely to raise the same defence to Mr Piroozzadeh's claim.

The judge also noted that it remained unclear to him, even at the ex parte hearing, why it was said that damages were not an adequate remedy and why it was said that Binance was able to identify the traceable proceeds of the applicant's Tether.

This case is a salutary lesson in the care which must be taken in complying with the duty of full and frank disclosure in the still evolving field of cryptoassets, and in the case of novel technologies generally.

In particular:

1. Whilst blockchain technology is new (or at least in relative terms), the law is not. Where a fraud has been perpetrated utilising digital assets, it is still vital to consider the usual fraud defences. Bona fide purchaser defences are a staple defence to proprietary claims in many frauds.
2. But, because the technology and the services infrastructure built around it are new, it is also vital to deliberate on whether there may be atypical defences in cryptofraud cases. It is vital to have someone on the legal team with a respectable level of understanding of the unique features of cryptofrauds who can draw these to the court's attention.
3. Think carefully whether it is even necessary to assume a duty of full and frank disclosure. It is important to consider the justifications for applying ex parte in relation to each distinct defendant. In respect of exchanges not alleged to be fraudulent actors themselves, Piroozzadeh is a firm indication that ex parte applications would not be appropriate.

This case provides welcome confirmation of the high standards required on ex parte hearing and helpful insight into the type of issues which ought to be covered in ex parte crypto misappropriation cases. It is also unlikely to be the last interesting hearing in the Piroozzadeh case – Aux Cayes has applied for strike out or reverse summary judgment.

1 Siporex Trade SA v Comdel Commodities Ltd [1986] 2 Lloyd's Rep 428
2 [2014] EWHC 4336 (Ch)
3 [2018] EWHC 2199 (Comm)