

International Caribbean Insolvency Symposium

Innovation vs. Insolvency: Current Issues in Fintech and Cryptocurrency Cases

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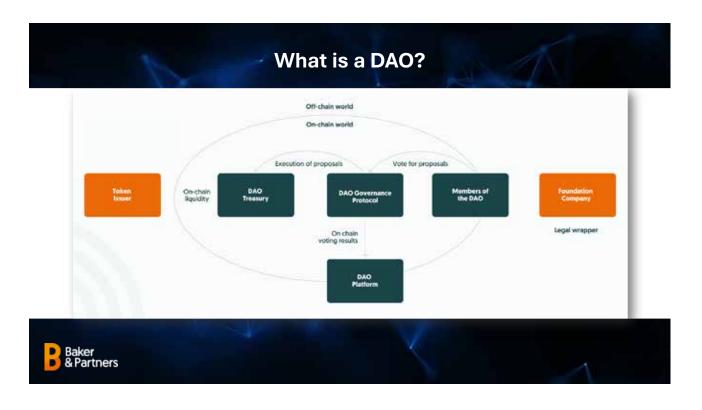
ABI International Caribbean Insolvency Symposium Current Issues in Fintech and Cryptocurrency cases



	Panel
1	Gregory V. Demo , Pachulski Stang Ziehl & Jones, USA
2	Stacy Lutkus, McDermott, USA
3	James Drury, Interpath Ltd., British Virgin Islands
4	Nia Statham, Baker & Partners, Cayman Islands

Innovation vs Insolvency				
Funds and Cryptocurrency Exchanges	Decentralized Autonomous Organizations			
Legal Wrappers and Insolvency	What next? Crypto and US Bankruptcy law			





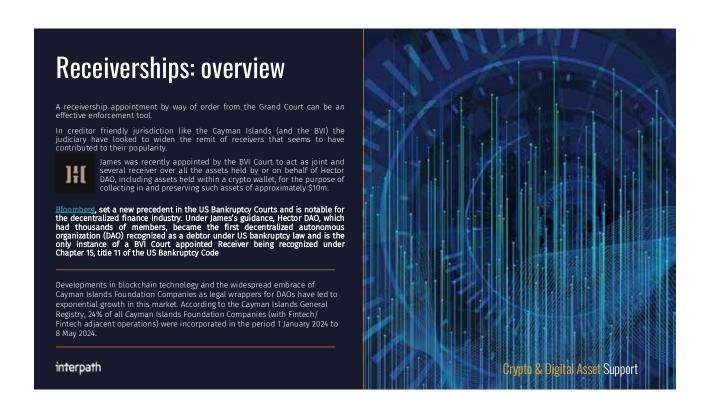
"We're All Gonna Make It" WAGMI DAO













Receivership of a DAO: Key Takeaways

Decentralized Autonomous Organizations, or DAOs, are digitally native organizations that are community led, and governed by rules of code, or 'protocols'. The below table summarises some of our current learnings from our receivership of Hector DAO ahead of a distribution to the token holders:

	Challenge	Solution
Realistion and control of Treasury	Collect and safeguard all the assets held by or on behalf of Hector DAO. Procedures and safeguarding of same. In trust, in estate or a mix? How does the appointee get paid? Berkeley Applegate order?	infractructure and risk process to self custody. Payments of
Ownership of the wallets containing the HEC tokens	The wallets were self hosted and not on an exchange, the identity of the person(s) in control of the wallet(s) were unknown	Tokenholders were required to sign their wallets with a unique code to demonstrate they were in control of the wallet
Identification of the tokenholders	The tokens were freely traded prior to the receivers' appointment and KYC information of the tokenholders was not available	Prior to payment of any distribution tokenholders required to provide KYC byway of a dApp (platform included liveliness facial recognition technology)
Reconciling the tokenholders holdings	No shareholder register, or equivalent, available on the receivers' appointment	A tool was developed that confirmed the number of HEC tokens held at a point of time with reference to the blockchain - immutable
Risk assessment and source of funds	Risk assessment and source of funds information relating to the tokenholders was not available to the receivers	Utilized blockchain analytics to screen Tokenholders' wallets to determine the source of funds in a potential customer's wallet, uncover links to money laundering, terrorist financing and sanctioned entities, and detect potentially suspicious behaviour patterns
Ensuring that the receivership was conducted in a fair manner	Traditionally a committee of the stakeholders would be established to act as a sounding board	An off-chain voting platform was used so that the tokenholders could participate in the direction of the receivership

interpath 7

Receivership of a DAO: Key Takeaways



	Challenge	Solution
Chapter 15 Recognition	Investigations identified leads to bad actors in the US together with the need to defend proceedings brought by disgruntled tokenholders prior to the Receivers' appointment	Hector DAO became the first decentralized autonomous organization (DAO) recognized as a debtor under US bankruptcy law. This recognition was granted by US Bankruptcy Judge Michael Kaplan on July 15, 2024. The case set a significant precedent by acknowledging that DAOs, despite their decentralized and autonomous structures, can be treated as debtors in cross-border insolvency context
Communications with stakeholders	No emails, telephones contact details associated with the tokenholders was available to the receivers	Utilized a secure end to end encryption communication platform such as Telegram and Discord.
Investigations	One of the key drivers of the Receivership was a hack on the treasury assets and smart contract	On chaininvestigations utilizing in house knowledge but engaging with stakeholders who have deep understanding of blockchain technology
Distribution mechanism	The distribution smart contract experienced a security breach before the appointment of the receivers. A subsequent Root Cause Analysis determined that remediation efforts would not be cost-effective	Use of secure dApp to directly distribute stable coins to eligible HEC tokenholders

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INSIGHTS

BRIEFINGS | 11.07.2023

A Petitioner's
Dream and a
Company's
Nightmare: The
Compelling
Case for the
Winding Up of
AAX Crypto
Exchange
Parent
Company, Atom
Holdings



Adam Crane

Contents

Introduction

Introduction

In what appears to be the first liquidation involving a cryptocurrency exchange in the Cayman Islands, Atom Holdings (the "Company"), the Cayman domiciled holding company for the group of entities (the

Background

Adjournment Application

Winding Up Petition

"Atom Group") operating the now defunct centralised cryptocurrency exchange, Atom Asset Exchange ("AAX Platform" or "AAX") was ordered to be wound up on 7 July 2023. The Atom Group operated in multiple jurisdictions, with most users appearing to have invested on the AAX Platform through Seychelles domiciled AAX Limited.

AAX offered a full suite of cryptocurrency services to approximately two to three million investors worldwide (including the sale of its native token, the AAB token) and reportedly had a spot trading volume of US\$57.2 billion in July 2022 and US\$71.1 billion in September 2022.

Background

AAX abruptly shuttered its operations following the now infamous collapse of the high-profile cryptocurrency exchange FTX Trading Ltd ("FTX") on 11 November 2022. Customers were initially informed that AAX's website was undergoing regular maintenance and were subsequently told that a systems upgrade was being undertaken. AAX sought to reassure customers that their deposits were not exposed to any risk as a result of FTX's collapse. However, no further updates were issued to customers after 19 November 2022 and customers have been unable to withdraw any of their deposits to date.

One of the Company's former directors is alleged to have absconded with the private keys to cryptocurrency wallets holding AAX users' assets (at least US\$30 million but likely more) and two top AAX executives were arrested by Hong Kong law enforcement. Other top executives have reportedly distanced themselves from AAX or cannot be located.

In early March 2023, two retail investors (the "Petitioners") presented a petition to wind up the Company (the "Petition") on the basis the Company is insolvent and on just and equitable grounds (based on the need for an investigation and because the Company lost its substratum).

The Petitioners obtained an Order on 8 March 2023 placing the Company into provisional liquidation and appointing Angela Barkhouse ("Ms Barkhouse") and George Kimberley Leck ("Mr Leck") of Quantuma (Cayman) Ltd as Joint Provisional Liquidators

("JPLs") to prevent the dissipation or misuse of assets (including AAX investors' assets) and to prevent mismanagement or misconduct on the part of the Company's directors. Media reports following the AAX collapse suggested that there may be millions more of users' assets held in cryptocurrency wallets, which require further investigation and tracing. Here you can find our articles on the appointment of the JPLs.

Standing of former directors to make an application on behalf of a Company in insolvency proceedings

The Petition was heard on 7 July 2023 but was subject to a last-minute oral application to adjourn the hearing (the "Adjournment Application") by the Company purportedly through the residual authority of the Company's former directors (the "Former Directors"). The Former Directors relied on *In Re Union Accident Insurance Co. Ltd* to assert that the Former Directors had residual powers to instruct solicitors on behalf of the Company and oppose the Petition (notwithstanding that the Former Directors were removed from the Company's board by the JPLs pursuant to a written resolution dated 16 March 2023). The Court permitted the Former Directors to continue with their Adjournment Application on behalf of the Company and indicated that an order appointing provisional liquidators should not be intended to strip the residual rights from a company's former directors to oppose a winding up petition on behalf of a company.

Adjournment Application

The Court then dealt with the Former Directors' Adjournment
Application. Counsel for the Former Directors confirmed that they
were instructed two days before the hearing but acknowledged in Court
that the Former Directors passed a written resolution on behalf of the
Company to appoint solicitors as early as 20 June 2023 to defend the
Petition. The Former Directors relied on an affidavit sworn by a legal
manager employed by their attorneys exhibiting the written resolution
but provided no personal direct evidence explaining the reason for the
delay or the substance of any possible defence to the Petition itself. The
Company's request for an adjournment was sought to give counsel time
to respond to the legal and factual issues raised in the Petition.

The Petitioners argued that the Former Directors had been on notice of these proceedings as early as the 11th, or alternatively, the 18th of May 2023, and that the Former Directors had provided no explanation for waiting until the day of the hearing of the Petition to make an oral application for an adjournment. It was further submitted that the Company and the Atom Group as a whole had ceased operating, that entities within the Atom Group were subject to multiple insolvency proceedings worldwide, and that there was nothing in the business left to be revived due to the collapse of AAX. As such, the Adjournment Application was merely an attempt by the Former Directors to delay the Company's inevitable winding up.

In the Cayman Islands, the Court has jurisdiction under the Companies Act (2023 Revision) (the "Companies Act") and the inherent jurisdiction to grant adjournment applications in insolvency proceedings. However, the Court considered that it was most unattractive for the Former Directors to seek an adjournment when they could not postulate the points they wished to take against the Petition itself. Furthermore, the Adjournment Application was made "not just in the 59th minute [of the proceedings] but in the last minute added on for stoppages" and in "the weakest possible way". The Court refused the Adjournment Application for the following reasons:

- The Former Directors had enjoyed a sufficient amount of time to identify a basis upon which to oppose the Company's winding up;
- There was no evidence to suggest that the Petitioners' debts (as contingent creditors of the Company) would be paid if an adjournment was granted²;
- There was no evidence to suggest that where an adjournment was granted, refinancing efforts would be undertaken;
- It was alleged that the Company's former management were involved in a fraud and had obstructed or failed to cooperate with the JPLs;
- Although the number of creditor claims were small, the claims themselves accumulated into millions of dollars; and
- There was a public interest in investigating the Company's affairs, which was also supported by virtue of the fact that representatives of the Cayman Islands Monetary Authority (CIMA) attended the hearing.

Winding Up Petition

The Court dealt with the Petition summarily the Petition was unopposed and because the Court was already familiar with the circumstances of the matter from the previous hearing for the appointment of the JPLs. The Court accepted that all the grounds relied upon by the Petitioners to appoint joint official liquidators to the Company were cogently made out. These grounds were as follows:

- The Company was unable to pay its debts within the meaning of section 92(d) of the Companies Act on the basis that the Petitioners' debts, together with the debts of hundreds of thousands of creditors, remain unpaid;
- 2. It was just and equitable to appoint official liquidators to the Company because an investigation into the affairs of the Company was required resulting from: (a) the collapse of AAX; and (b) allegations that millions of dollars in users' assets were misappropriated by the Company's Former Directors and other executives within the Atom Group; and
- 3. It was just and equitable to wind up the Company where the Company lost its substratum, because the AAX Platform ceased operations in 2022 and never resumed trading. Furthermore, insolvency practitioners were appointed to various subsidiaries and it would now be impractical or impossible for the Company, as a holding company, to carry on its business. As mentioned above, a number of top executives of the Atom Group had been arrested and the Former Directors were incognito. As such, they were no longer in a position to operate the Company.

In his closing remarks, Justice Kawaley noted that this case was a "petitioner's dream and a company's nightmare" on the basis that there were compelling reasons to wind up the Company. He further remarked that CIMA could present a winding up petition where no qualified petitioner was available to make a petition themselves, it was in the public's interest to maintain the Cayman Islands' reputation as a reputable financial centre.

Justice Kawaley delivered a brief oral judgment at the end of the hearing of the Petition on 7 July 2023 winding up the Company. The continued appointment of Ms Barkhouse and Mr Leck (now as joint official liquidators of the Company) and the ensuing investigations will hopefully lead to the recovery and return of assets to the victims of the AAX collapse.

Baker and Partners' Adam Crane, Nicosia Lawson, and Nia Statham acted for the Petitioners. Baker and Partners are experienced in dealing with digital asset related matters, please contact Adam Crane at adamcrane@bakerandpartners.com for more information.

Authored by: Adam Crane (Partner), Nicosia Lawson (Senior Associate), and Nia Statham (Associate) of Baker & Partners

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^{1 [}No. 002025 of 1971].

² The Former Directors relied on In the Matter of MV Cayman Ltd. (in Official Liquidation) (FSD 8 of 2022 (DDJ)) (Unreported, 28 September 2022) in which Doyle J granted a short adjournment in favour of the winding up petition "At the 59th minute of the eleventh hour". In that case, credible evidence was presented to suggest that there was a reasonable prospect that the petitioner's debt would be paid, and steps had been taken to refinance the company.



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В	[202	HCA 749/2022 24] HKCFI 2099	В	
C		7-j ilikeri 2077	C	
D	IN THE HIGH COURT OF THE HONG KONG SPECIAL ADMINISTRATIVE R	EGION	D	
E	COURT OF FIRST INSTANCE ACTION NO. 749 OF 2022			
F	BETWEEN		F	
G	MANTRA DAO INC.	1st Plaintiff	G	
Н	RIODEFI INC.	2 nd Plaintiff	н	
I	and		I	
J	JOHN PATRICK MULLIN	1st Defendant	J	
K	WILLIAM DONOVAN JOHN CORKIN	2 nd Defendant	K	
L	RODRIGO QUAN MIRANDA	3 rd Defendant	L	
M	JAYANT B RAMANAND	4 th Defendant	М	
N	MD LABS LIMITED	5 th Defendant	N	
0	TRITAURIAN CONSULTING LIMITED	6 th Defendant	o	
P	Defense Han Lab Lin Chamban		P	
Q	Before: Hon Lok J in Chambers Date of Hearing: 25 April 2023 Date of Decision: 25 April 2023		Q	
R	Date of Decision: 25 April 2023 Date of Reasons for Decision: 12 August 2024		R	
S			s	
T	REASONS FOR DECISION		Т	
U				
v			U	
•			V	

A	- 2 -	A
В	1. This is the Plaintiffs' injunction summons dated 29 August	В
C	2022 as amended on 17 February 2023 ("the Summons"). In the	C
D	substantive hearing on 25 April 2023, I made an order, <i>inter alia</i> , requiring the 1 st to 4 th Defendants to provide: (i) the Plaintiffs with the financial	D
E	spreadsheets of the MANTRA DAO project ("the Project") in a certain	E
F	format from 1 January 2021 onwards; (ii) no more than 3 of the Plaintiffs' legal and financial advisers with the supporting documents for each of the	F
G	entries in the said financial spreadsheets subject to written undertakings	G
Н	given by them not to disclose the said documents to the Plaintiffs or any other parties without the order of the court. I now give my reasons.	Н
I		I
J	Background of the dispute and the present application	J
K	2. The present action is a dispute as to the true ownership,	K
L	management and control of the Project, a "decentralised autonomous organisation" ("DAO") finance platform project in the cryptocurrency	L
M	industry. The Project involves the use of novel "blockchain" and	M
N	"cryptoasset" technologies for the purpose of carrying out "Decentralised Finance" activities.	N
0		o
P	3. The Plaintiffs claim that the Project belongs to, and should ultimately be controlled and managed by, the Plaintiffs. The Plaintiffs	P
Q	initially conceived and set up the Project, including conceiving the idea of	Q
R	a DAO project, designing its main components, locating and securing the initial investors and purchasing its website and email domain names.	R
s	minus investors and parenasing no weesite and emain domain names.	s
T	4. The 2 nd Plaintiff ("RioDeFi") is a company incorporated in Malaysia in November 2019 specialising in blockchain technology.	Т
U	RioDeFi's shareholders and directors include Ng Kian Ming ("Calvin"),	U
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James Alan Anderson ("James") and Stéphane Laurent ("Stephane"). Since its incorporation, RioDeFi has founded and established various blockchain projects, and developed its own technologies and products. According to the Plaintiffs, it had always been the intention that the different projects in the RioDeFi ecosystem could complement each other and be integrated as one group with a spectrum of different services and products, with the view that eventually all the projects will leverage off each other and form a unique and holistic offering in the market. RioDeFi's business model is that various subsidiaries and associated entities would be set up and operated by RioDeFi's employees as assigned

by RioDeFi to those entities or projects from time to time.

5. The Project was conceived in May 2020 by Calvin, James, Stephane and other RioDeFi personnel. According to the Plaintiffs, it was first proposed by Calvin as an attempt to capture the trend of cryptocurrency staking (a way of earning dividends or rewards for holding cryptocurrencies over time). Meanwhile, it was also envisaged that a new visionary protocol for a multi-chain framework allowing different decentralised applications would go live in May 2020 (Polkadot protocol), and RioDeFi took the view that it could have a tremendous first-mover advantage if the Project could be built and operate on the Polkadot protocol.

Q

6. The Plaintiffs claim that, as the Project developed, the Plaintiffs delegated the day-to-day management to RioDeFi's employees, namely the 1st Defendant ("John") and the 2nd Defendant ("Will"), and their team in around August 2020, on the basis of and in reliance upon: (i) John and Will's employment duties to the Plaintiff; and (ii) the mutual agreement that John and Will would regularly report to RioDeFi's

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В	management on the assets, financials and operations of the Project ("the	В
C	Management Agreement"). John and Will's respective employment	C
D	relationships with RioDeFi are recorded in two written employment contracts dated 28 March 2020 ("the Employment Agreements").	D
E		E
F	7. However, since around January 2021, reporting from John and Will on the Project became more and more infrequent, contrary to John	F
G	and Will's duties. According to the Plaintiffs, John and Will, together with	G
Н	the other Defendants, began treating the Project as their own. The Plaintiffs now have no visibility at all as to the management decisions	Н
I	made by the Defendants or how the Project's assets are being deployed.	I
J	Further, the Plaintiffs claim that the Defendants have "misappropriated" the Project and its business and assets from the Plaintiffs. Of particular	J
K	relevance, it is alleged that the 1st to 4th Defendants had misappropriated	K
L	assets from a cryptocurrency account (known as "the Hex Account") allegedly belonging to the 1st Plaintiff ("MDI") by making various	L
M	"unaccounted-for" withdrawals from the Hex Account ("the Hex Account	M
N	Withdrawals").	N
o	8. On the other hand, it is the Defendants' case that the Project	o
P	should not be owned or controlled by the Plaintiffs at all. In short, the Defendants claim that:	P
Q		Q
R	(i) A DAO is an organisation where the ultimate decision- making power lies with the holders of digital tokens, known	R
S	as "OM Tokens" in the present case, operating through	s
T	computer codes which exist on a blockchain.	T
U		U
v		V

A			- 5 -	A
В	(ii)	The	operation of the Project is governed by the Governance	В
C	,	Agre	ement which was reflected in the terms of the White	C
D		-	ens to form the basis of their purchase, including:	D
E				E
F		(a)	The Project was not intended to be owned by any single individuals or entities.	F
G				C
Н		(b)	The decision making over the assets of the Project was supposed to lie ultimately with the OM Token holders	H
I			who would exercise their voting rights through smart	I
J			contracts on the blockchain infrastructure of the Project.	J
K		(c)	As the Project, which is a DAO, lacks its own legal	k
L			personality, a Seychelles incorporated foundation ("the Foundation") and MDI were legal entities incorporated	L
M			specifically for holding assets for the benefit of the OM	N
N			Token holders and were not meant to be the beneficial owners.	N
0				C
P		(d)	The Foundation was to be governed by members of its Council ("the Councillors") who were granted such	P
Q			authority to act on behalf of the Project and the OM	Ç
R			Token holders as conferred pursuant to the White Paper or by the OM Token holders through the exercise of	R
S			their voting rights.	s
T		(e)	The Councillors are re-elected every two years.	Т
U		(0)	Decision making by the Council is by majority votes of	τ
v				

A	- 6 -	A
В	the Councillors. At the latest election held in August	В
C	2022, the 1st to 4th Defendants and other individuals	C
D	were elected by the OM Token holders as Councillors whereas James and his associates did not come forward	D
E	to seek re-election.	E
F	(iii) In relation to the Hex Account Withdrawals:	F
G	(a) By reason of the aforesaid matters, the assets in the Hex	G
Н	Account were not beneficially owned by MDI or	Н
I	RioDeFi. John, Will and the 3 rd Defendant (acting in	I
J	the capacity as Councillors at the time) had authority to authorise the Hex Account Withdrawals for legitimate	J
K	business purposes as envisaged in the White Paper.	K
L	(b) In fact, James and Stephane were informed of each of	L
M	the Hex Account Withdrawals when initiated. Further,	M
N	James or Stephane had authorised the vast majority of the Hex Account Withdrawals.	N
0		0
P	9. In this application, the Plaintiffs seek interim injunctive reliefs against the Defendants. The original reliefs sought are much wider,	P
Q	including injunction against disposing of or dealing with cryptocurrency,	Q
R	prohibition against use of trade marks and passing-off, order requiring disclosure of assets and transfer of digital assets. In the first hearing of the	R
S	Summons application before DHCJ Leung (as he then was) on 2	S
T	September 2022, the learned judge refused to grant these original reliefs on an interim-interim basis.	T
U		U
v		V

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10. The Plaintiffs have abandoned the claim for these reliefs in the substantive hearing, and the remaining relief sought is an order requiring the disclosure of books and records relating to the operation of the Project ("the Accounts Disclosure Order"). According to the Plaintiffs, the aim of such relief is to allow them to have access to and inspect information and documents on the Project's financial operation and give effect to the Plaintiffs' alleged "right to information" under the Employment Agreements and the Management Agreement. Mr Lam, SC, counsel for the Plaintiffs, argues that such relief is necessary to allow the Plaintiffs to monitor the Project's operation and development pending trial, and if

necessary, take further protective measures for their interests in the Project.

Discussions

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11. Both sides have made lengthy submissions on the merits of the claim. I do not propose to discuss the merits in any details here. At this stage, it suffices for me to say that cryptocurrency trading is a new, novel and innovative business. The Hong Kong courts, and indeed many other courts in different jurisdictions, have little experience in dealing with such kind of disputes. The courts may not be familiar with the *modius operandi*

and the structures for the operation of such kind of business. The legal effects of the Governance Agreement, the White Paper, the Management Agreement and the Employment Agreements have to be fully investigated

at the trial. Given the allegations by both camps, the court is not in a position to form a preliminary view about the overall merit of the claim.

The court should therefore focus on the balance of convenience issues and examine the possible effects of the granting and non-granting of the

Accounts Disclosure Order on the parties.

 \mathbf{v}

A	- 8 -	A
В	12. In my judgment, the balance of convenience certainly favours	В
C	the granting of the Accounts Disclosure Order.	C
D	13. Damages are plainly an inadequate remedy if the application is	D
E	refused. The cryptocurrency industry is fast-growing, and decisions are	E
F	often made with a view to obtaining a first-mover advantage. With the level of assets controlled and managed by the Defendants, it is important	F
G	that the Plaintiffs be given regular updates on the financial operation of the	G
Н	Project, given their claim over the ownership, management and control of the Project. I agree with Mr Lam that it is difficult if not impossible to	Н
I	quantify the Plaintiffs' loss in monetary terms if they have no visibility of	I
J	the Project's financial operation. They would not be in a position to know the basis of the decisions made by Defendants in the case of any complaint	J
K	or challenge against the Defendants' decisions. The problems are further	K
L	complicated by the difficulties in tracing transactions in the cryptocurrency field, which are often anonymised.	L
M		M
N	14. Further, unlike the other reliefs originally sought in the Summons, the Accounts Disclosure Order would not disrupt the operation	N
o	of the cryptocurrency trading business under the Project. Quite on the	0
P	contrary, the managers of the Project should be under some kind of duty to keep proper accounts, and the Accounts Disclosure Order would certainly	P
Q	promote the healthy operation of the business.	Q
R	15. To oppose the application, the Defendants are also seeking to	R
S	rely on, <i>inter alia</i> , the following arguments to oppose the granting of the	s
Т	relief:	Т
U		U
V		1 7

A		- 9 -	A	
В	(i)	The Accounts Disclosure Order involves a huge task to be	I	
c	.,	performed on a monthly basis preparing a schedule setting out	(
		details of every payment made in the course of the business	·	
D		with various details with supporting documents, and such	Ι	
E		continuous disclosure obligations are highly onerous for the	F	
F		Project which is not a listed company with vast manpower resources.	I	
G			(
Н	(ii)	Some of the books and records may contain confidential business secrets. There is a risk that, if such confidential	I	
I		information is disclosed to the Plaintiffs, it may cause	I	
		irreparable damage to the Project's business and the OM		
J		Token holders who have an economic interest in the business.	J	
K			ŀ	
L	(iii)	There was delay on the part of the Plaintiffs in commencing	I	
м		legal proceedings or lodging the present application.		
M	16	Descrite the oble submissions of Mr Stook SC counsel for the	N	
N	16.	Despite the able submissions of Mr Stock, SC, counsel for the	N	
0	Derendants	s, I cannot agree with these arguments.	(
	17.	Firstly, no matter what is the substantive entity owning or	,	
P		e for the operation of the Project, the 1 st to 4 th Defendants, as the	F	
Q	Councillors, should have a duty to keep proper account about the operation			
_	of the cryptocurrency trading business under the Project. Even if the			
R	Defendants' case is to be upheld by the court, the Councillors would have			
S		ccount to the OM Token holders about the funds in the Project.	S	
T	The Accou	unts Disclosure Order should not cause any additional or	n	
-	significant	hardship or burden on the 1st to 4th Defendants, as one would	1	
U			τ	
V			,	

A	- 10 -	A
В	expect that they have to discharge such duty to the OM Token holders in	В
C	any event.	C
D	18. Secondly, a properly worded undertaking by the Plaintiff's	D
E	legal and financial advisers of not disclosing the supporting documents to	E
F	the Plaintiffs should properly take care of the Defendants' concern about possible disclosure of trade secrets to the Plaintiffs. In the hearing, the	F
G	parties indicated to the court that they would work out the terms of the	G
Н	undertaking, and I do not believe that the risk of disclosure should be a reason for the court to deny the making of the Accounts Disclosure Order.	Н
I		I
J	19. Thirdly, I do not find that there was any delay on the part of the Plaintiffs in commencing legal proceedings or lodging the present	J
K	application. According to the Plaintiffs' case, the Defendants'	K
L	misappropriation intensified gradually, and it was only in early to mid- 2022 that MDI saw fit to commence this action. In any event, even if there	L
M	was delay which I do not accept, justice demands the granting of the	M
N	Accounts Disclosure Order, which is only a protective measure in the case that the Plaintiffs succeed in their claim, or indeed a healthy measure for	N
0	operation of the Project in the interest of the OM Tokens holders.	0
P	20. I also reject Mr Stock's argument that the Plaintiffs, by	P
Q	applying for the Accounts Disclosure Order, are in substance seeking for	Q
R	an order for account under O 43 of the RHC, which is a remedy that should not be granted in the interlocutory stage. As submitted by Mr Lam, there	R
S	is fundamental distinction between the two remedies. The aim of the	S
Т	present application is to preserve the <i>status quo</i> pending trial by letting the Plaintiffs to have some visibility about the financial operation of the	Т
U	Project which they claim is owned by them. There is nothing "novel" with	U
V	· · · · · · · · · · · · · · · · · · ·	V

A	- 11 -	A			
В	such kind of interlocutory relief. Interim orders for preservation of	В			
C	disputed trust assets including disclosure orders are often sought in the	C			
D	courts. There are also many instances in which the courts make interlocutory disclosure orders to ascertain the whereabouts of the property				
E	claimed in the context of misappropriation and breach of fiduciary duty	E			
F	claims. ¹ Hence, such argument has no merit at all.	F			
G	21. For the above reasons, I granted the Accounts Disclosure	G			
Н	Order in the hearing. The parties agreed on the format for the provision of the accounts, and the supporting documents will only be disclosed to the	H			
I	legal and financial advisers of the Plaintiffs subject to non-disclosure	I			
J	undertakings.	J			
K	Despite that the Plaintiffs have abandoned some of the reliefs	К			
L	sought in the original Summons, I am of the view that the costs of the whole application should be costs in the cause. I therefore so ordered.				
M		N			
N		N			
0		O			
P	(David Lok)	P			
Q	Judge of the Court of First Instance High Court	Q			
R	Mr Douglas Lam, SC and Mr Charlie Liu, instructed by Mung, for the Plaintiffs	R			
S	Mr Alexander Stock, SC and Mr Val Chow, instructed by DLA Piper Hong	s			
T	Kong, for the Defendants	Т			
U	¹ China Shanshui Cement Group Ltd v Zhang Caiku, unreported, HCA 2880/2015, 15 January 2016, at	U			
V	§§41-42 per Au-Yeung J; see also Civil Fraud, Law, Practice & Procedure (1 ed), at §29-028				

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IN THE GENERAL DIVISION OF

THE HIGH COURT OF THE REPUBLIC OF SINGAPORE

[2022] SGHC 196

In the Matter of Section 64 of the Insolvency, Restructuring and Dissolution Act 2018

Zipmex Company Limited

... Applicant

Originating Application No 382 of 2022

Originating Application No 381 of 2022

In the Matter of Section 64 of the Insolvency, Restructuring and Dissolution Act 2018

Zipmex Pte Ltd

... Applicant

Originating Application No 383 of 2022

In the Matter of Section 64 of the Insolvency, Restructuring and Dissolution Act 2018

Zipmex Asia Pte Ltd

... Applicant

Originating Application No 384 of 2022

In the Matter of Section 64 of the Insolvency, Restructuring and Dissolution Act 2018

Zipmex Australia Pty Ltd

... Applicant

Originating Application No 385 of 2022

In the Matter of Section 64 of the Insolvency, Restructuring and Dissolution Act 2018 $\,$

Zipmex Exchange Indonesia

... Applicant

BRIEF GROUNDS

[Insolvency Law — Moratoria]

[Insolvency Law — Cross-border insolvency]

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Re Zipmex Co Ltd

and other matters

[2022] SGHC 196

General Division of the High Court — Originating Application Nos 381, 382, 383, 384 and 385 of 2022

Aedit Abdullah J

15 August 2022

17 August 2022

Aedit Abdullah J:

- 1 These are my brief remarks capturing my decision granting an extension of the moratoria operating in favour of the applicants. The focus of these remarks will be on the jurisdiction of the Court over the applicants which are foreign companies, which turns on the existence of a substantial connection to Singapore. It is hoped that the publication of these remarks will assist counsel and practitioners in this area, and that it will also clarify to the account holders abroad what is happening in these Singapore proceedings.
- 2 A recording of the hearing for this case has been uploaded to YouTube, though, because of an error, the video footage was not recorded, and only the audio was captured. The recording may be accessed at the following address: https://www.youtube.com/watch?v=Exo9cAqfjHM. A full recording was uploaded of a separate moratoria application relating to another crypto company, Defi Payments Pte Ltd ("Defi"), which may be accessed at the following link: https://www.youtube.com/watch?v=HH1pd8d0GOM. These efforts were made primarily to address the needs of the large number of creditors who are account holders in these various entities, most of whom are situated outside Singapore, and who may not have been able to attend the open court proceedings, even online.

Background

- 3 The applications were made by companies in the Zipmex Group: Zipmex Asia Pte Ltd (the group holding company incorporated in Singapore, "Zipmex Asia"), Zipmex Pte Ltd (a Singapore subsidiary, "Zipmex Singapore"), Zipmex Company Limited ("Zipmex Thailand"), Zipmex Australia Pty Ltd ("Zipmex Australia") and PT Zipmex Exchange Indonesia ("Zipmex Indonesia"). The group operates a cryptocurrency exchange platform, which is accessed through the Zipmex App, on which various cryptocurrencies are traded. The various country entities were apparently established to comply with local market regulations.
- 4 A registered customer gains access to the Zipmex App and a "trade wallet". The trade wallet contains a "fiat wallet", into which they deposit fiat currency, *ie*, national currencies, which can be used to buy cryptocurrencies. These cryptocurrencies are known as "On-Exchange Assets", and are stored in a "hosted wallet", which is also part of the "trade wallet". The cryptocurrencies can be kept in another wallet outside of the Zipmex App or withdrawn. For customers registered with Zipmex Singapore, Zipmex Australia, and Zipmex Indonesia, once fiat currency is converted to a crypto asset or a crypto asset is deposited into the "hosted wallet", the ownership of the said asset is transferred to each respective entity. These assets may be used by the entities, such as to pledge, re-pledge, hypothecate, *etc*, as it sees fit for its own purposes. For Zipmex Thailand, the assets are held on a custodial basis.
- 5 Yet another wallet, the "Z wallet" is used for the ZipUp+ service ("ZipUp+"), which is subject to separate terms and conditions. ZipUp+ is offered to all users. Apart from Zipmex Thailand, the remaining entities offer their local customers access to ZipUp+, which is run by the respective entities. For Zipmex Thailand, Thailand-based customers use the service through Zipmex Singapore. ZipUp+ allows existing customers to deposit crypto assets held in their "hosted wallet" (which is held in their "trade wallet") into the "Z wallet", in return for various benefits. Upon transfer of the crypto assets from the "hosted wallet" to the "Z wallet", the crypto assets cease to be governed by the terms and conditions of each specific entity. Instead, they are governed by the terms and conditions of ZipUp+. Under these terms, the assets in the "Z wallet" are held by Zipmex Asia (which is incorporated in Singapore), ie, at a group level, in an aggregated hot wallet (ie, a wallet connected online rather than one kept offline, or "cold"). Essentially, this allows the Zipmex Group to make use of the cryptocurrencies.
- 6 All of the crypto assets, whether deposited in the various "Z wallets" (hosted by Zipmex Australia, Zipmex Indonesia, and Zipmex Singapore) or in the "hosted wallet", are held in a wallet which is hosted by Zipmex Asia. Zipmex Asia has the right to utilise these assets and deploy them to third parties, such as crypto exchanges or crypto asset management companies. As for the fiat currencies, which are deposited into the "fiat wallet" (which is a part of the "trade wallet"), they are held on a custodial basis for the customers, and are held in omnibus accounts created and maintained with banks in each of the subsidiary entities' names.

Section 64 and 65 applications in summary

- As noted in *Re IM Skaugen SE and other matters* [2019] 3 SLR 979 ("*IM Skaugen*"), the precursor to s 64 of the Insolvency, Restructuring and Dissolution Act 2018 ("Act"), namely s 211B of the Companies Act (Cap 50, 2006 Rev Ed) ("Companies Act"), introduced the moratoria regime, to allow a company in difficulties breathing space to put together a rescue plan, avoiding a scramble among creditors to liquidate the company: [41] of *IM Skaugen*, citing the second reading of the Companies (Amendment) Bill 2017 (*Singapore Parliamentary Debates, Official Report* (10 March 2017) Vol 94). The trade-off for the moratorium or suspension of proceedings against the company is showing that there is support from creditors, and an undertaking or promise by the company to put forward a rescue plan or proposal: s 64(4) of the Act. The cases interpreting s 211B of the Companies Act continue to be applicable to s 64 of the Act. *IM Skaugen*, in particular, gives guidance on the approach to be taken. Where a company intends to propose a compromise or arrangement, evidence of creditor support for the moratorium had to be shown, requiring on a broad assessment that there was reasonable prospect of the intended compromise or arrangement working and being acceptable to the general run of creditors. The Court does not take a vote at this time, but takes a broad assessment bearing in mind the quality of creditor support, particularly from significant or crucial creditors: [48]–[58] of *IM Skaugen*. The Court in s 64 proceedings cannot determine the merits of claims or order the applicant to pay them off.
- 8 Section 65 of the Act extends the protection of the moratoria by an applicant under s 64 to subsidiaries, holding companies or ultimate holding companies, where such related companies play a necessary and integral role in the proposed compromise or arrangement being considered in the application under s 64. In gist, the objective is to protect integral parts of the group to ensure the success of the restructuring effort.

The applications

- 9 I was satisfied that the requirements under ss 64 and 65 of the Act were met by the respective applicants. In particular, there was sufficient indication that the proposed scheme would work and be acceptable to the general run of creditors. However, I was of the view that a five-month moratoria extension would not be appropriate, and instead allowed an approximately three-month extension for each of the applications, so that the Court could monitor progress and engagement. The Court did indicate for the benefit of the possible investors that further extensions could be granted if matters were in order.
- 10 It should also be noted that, as empowered by ss 64(5)(b) and 65(4)(b) of the Act, the moratoria operate against the acts of a person in Singapore or within the jurisdiction of the Court regardless of whether that act occurs in Singapore or elsewhere.
- 11 While much of the application did not throw up substantial issues, I was of the view that the establishment of substantial connection merited separate submissions, which I consider below. I also consider it opportune in these remarks to highlight a few considerations for future applications.

Substantial connection - jurisdiction over entities

- 12 Sections 64 and 65 of the Act govern moratoria of proceedings against a company and its subsidiaries and holding companies. Section 63 includes within the term "company", any corporation liable to be wound up under the Act. Section 246(1) provides that an unregistered company, which is a foreign company, may be wound up only if it has a substantial connection. Such substantial connection may be established by a number of factors including that Singapore is the centre of main interests of the company: s 246(3) of the Act.
- 13 The concept of the centre of main interests (also known as "COMI") has been considered in Singapore primarily in the context of recognition of foreign proceedings, where COMI is used in the UNCITRAL Model Law, as implemented in Singapore through s 252(1) of the Act: Re Zetta Jet Pte Ltd and others (Asia Aviation Holdings Pte Ltd, intervener) [2019] 4 SLR 1343 ("Re Zetta Jet"). In Re Opti-Medix Ltd (in liquidation) and another matter [2016] 4 SLR 312 ("Opti-Medix"), I considered that a common law notion of COMI could be introduced and used in common-law recognition, ie, recognition outside the operation of the UNCITAL Model law.
- 14 I am satisfied that there is no reason to differentiate between the use of COMI in different contexts, *ie*, recognition of proceedings under the Model Law, winding-up under the Act and protection of restructuring *via* moratoria through ss 64 and 65 of the Act. I did not see anything that would indicate any such intention on the part of Parliament, in its adoption of the term outside the context of the Model Law. Nor would there be any reason in principle for such differentiation: COMI is a useful concept in identifying the jurisdiction with the closest and most tangible or impactful connection to a company.
- 15 In Zetta Jet, a number of observations were made about the determination of COMI:
 - (a) What COMI factors are objectively ascertainable by potential creditors is a material consideration: [76] of Zetta Jet.
 - (b) What weight would be given by such a creditor to a particular factor: [78] of Zetta Jet.
 - (c) The focus is on the practical, with activities on the ground being more important than the legal structure: [82] of Zetta Jet.
 - (d) The factors should have an element of settled or intended permanence: [79] of Zetta Jet.
 - (e) Ultimately, the court considers on a robust basis, where, on balance, the centre of gravity of the material factors is located: [80] of Zetta Jet.

- 16 The applicants relied on Singapore being their COMI being established for each of them through their business structure and interlinked operations. Reliance was placed on Singapore being the hub of the business, with each of the subsidiary applicants being established to comply with local regulations. For the Thai customers, the use of the "Z wallet" (which provides additional benefits) was through Zipmex Singapore. This allowed the assets to be dealt with by Zipmex Singapore. All the "On-exchange Assets", ie, the crypto assets, are held in a hot wallet hosted by Zipmex Asia, with each of the subsidiaries giving Zipmex Asia the authority to effectively trade or commit these assets for business purposes. Thus for the individual entities, Singapore was the COMI because:
 - (a) In respect of Zipmex Thailand, the management and operations of the company are made in Singapore, and a large majority of the assets are credited to Zipmex Singapore because of the ZipUp+ facility.
 - (b) Similar factors point to Singapore in respect of Zipmex Indonesia and Australia with strong indications of support in favour of the restructuring in Singapore.
- 17 I determined that the COMI was Singapore, and that this gave substantial connection, allowing the Court to exercise its ss 64 and 65 jurisdiction under the Act.
- 18 The consolidation of assets in the hot wallet hosted by Zipmex Asia in Singapore, from all the entities, lay at the bottom of the business model and operations of the group. While not all the creditors may have actually been aware of this, the fact that such consolidation occurred does point to a Singapore centre of gravity.
- 19 I did note that in the present case, while there would be some creditors who would have, in depositing their cryptocurrency with Zipmex Thailand, put store by the cryptocurrencies being held in Thailand, there were clearly those who were happy to have the benefits of the upscaled account in the form of the ZipUp+. Those accounts would have involved contracts with Zipmex Singapore. I also noted that there were complaints that there was not enough notified to the account holders about what the ZipUp+ account would entail, and there was not much choice given. However, the analysis from a COMI perspective was not what specific creditors would have known or done, but what would have been evident to a creditor before extending credit. Thus, the fact that some creditors did not know of the Singapore connection would not affect the analysis.
- 20 As for direction and control, these did point to a Singapore focus, but I would note that its strength would be less than that in cases such as *Zetta Jet*, where the fact that management and direction was largely centred in the US as opposed to Singapore would be more readily apparent to creditors and other observers.
- 21 Taking a holistic assessment of these various factors, therefore, given the location of the ultimate use of the assets through the hot wallet, the use of the ZipUp+ facility, and the locus of management in Singapore, the COMI for each of the entities was Singapore. Specifically for the Thai entity, the preponderance of the use of the ZipUp+ facility and the hot wallet was significant.

Substantial connection on other grounds

- 22 The applicants put forward an alternative argument, that the factors above also established a substantial connection aside from their COMI being in Singapore, citing *Re Pacific Andes Resources Development Ltd and other matters* [2018] 5 SLR 125 ("Pacific Andes"). The applicants point in particular, that for Zipmex Indonesia and Zipmex Australia, substantial assets were, with the consent of their customers, held by Zipmex Asia. It is argued that the *lex situs* of the assets is Singapore. As for Zipmex Thailand, a large proportion of the assets are held in Zipmex Singapore because of the management of the assets held through the ZipUp+ accounts. Additionally, the applicants rely on the business of the group being centred in Singapore, with Singapore being the nerve centre, and the focus of the investments
- 23 I accept that these factors would operate to establish, aside from COMI, substantial connection to Singapore, which would be sufficient to give the Court jurisdiction under ss 64 and 65 of the Act. This is not however the appropriate case for the court to explicate further on what counts as substantial connection under s 246(3) of the Act, given the absence of contrary submissions here. I would only reiterate what I noted in *Re PT MNC Investama TBK* [2020] SGHC 149 at [13], that there should be activities of some permanence or permanent effect, and that transient activities would be excluded. Here, in particular, the holding of a large proportion of the assets, whatever their nature, in Singapore, is a substantial connection. Added to that is the management and direction of the group as a whole being concentrated here. I have not determined the *lex situs* of the assets, nor do I assume that these assets have a *lex situs*: the resolution of the precise nature of cryptocurrencies in an insolvency case in Singapore is left for another day.
- 24 I note that in *Pacific Andes* there was some discussion whether the factors went to discretion or jurisdiction. It did not make a difference there, ultimately. In the present case, given the language of ss 64, 65 and 246 of the Act, I would think that these matters would now go to jurisdiction, but again, not much difference, if any, results.

Townhall / Engagement / Creditor Committees / Independent advisors

25 I would highlight, for the benefit of potential applicants dealing not just with crypto assets, but with large numbers of unrepresented creditors, that engagement is important, and would be under scrutiny by the courts when an application for extension is made. What follows is not a checklist: what may be needed will vary from case to case, but applicants should seriously consider each of them, and be prepared to answer to the court why a particular form of engagement is not being used.

- 26 Applicants should ensure proper communication and engagement, perhaps through the use of townhalls. At a minimum, facilities should be provided for dissemination of information, electronically or otherwise. It will not be an answer to point to large numbers: the applicant would have had the benefit of a large customer base, and cannot seek to hide behind numbers when things come to grief. Similarly, translations of documents should be provided wherever feasible. Explanations of how s 64 of the Act works, possible investments and the likely timelines should also be given. I would also note that the website of the Singapore Courts provided a simplified overview of s 64 of the Act for the benefit of creditors in the present application by way of an information note. The note may be accessed at the following address: https://www.judiciary.gov.sg/news-and-resources/news/news-details/information-note-on-zipmex-entities-hearing-on-15-august-2022.
- 27 Serious thought should be given to the establishment of creditor committees. A framework for selection and representation ought to be explored. It is important to give voice to the creditors. If feasible, independent legal and financial advisors should be appointed and their remuneration provided for. These advisors should be focused on the needs of unrepresented creditors in navigating the process in obtaining a moratorium under s 64 of the Act, which together with any scheme application under s 210 of the Companies Act 1967, may take a while to come to a landing.
- 28 At the very least, the appointment of a financial advisor by the applicant, as is being pursued here, would be helpful.
- 29 I have no doubt that there may be other mechanisms that may be helpful, and would encourage applicants to consider what is done in other jurisdictions. The objective is to provide timely communications, and to assist the creditors in understanding what is happening, and to have some voice in the process.
- 30 The court for its part will consider what can be done to facilitate access to hearings. The use of the Zoom webinar system for the present application as well as in the Defi application, is one such measure, as is the uploading of the recordings on YouTube. It is likely, subject to specific needs, that similar cases will continue to be held in open court in this way. While the court will endeavour to accommodate large numbers of creditors as best as it can, there will be limits on resources available, so it may not always be possible to do so. Nonetheless, the court will continue to consider what may be done in appropriate situations.

Conclusion

31 The applications were accordingly allowed, with extensions granted until 2 December 2022. Directions were given for various matters to be pursued by the applicants, including the holding of town halls and exploration of the establishment of creditor committees, especially for Thailand.

Aedit Abdullah

Judge of the High Court

Daniel Chia Hsiung Wen, Tang Yuan Jonathan, Wong Ru Ping Jeanette and Kuek Ying Ching Chrystle (Morgan Lewis Stamford LLC) for the applicants.



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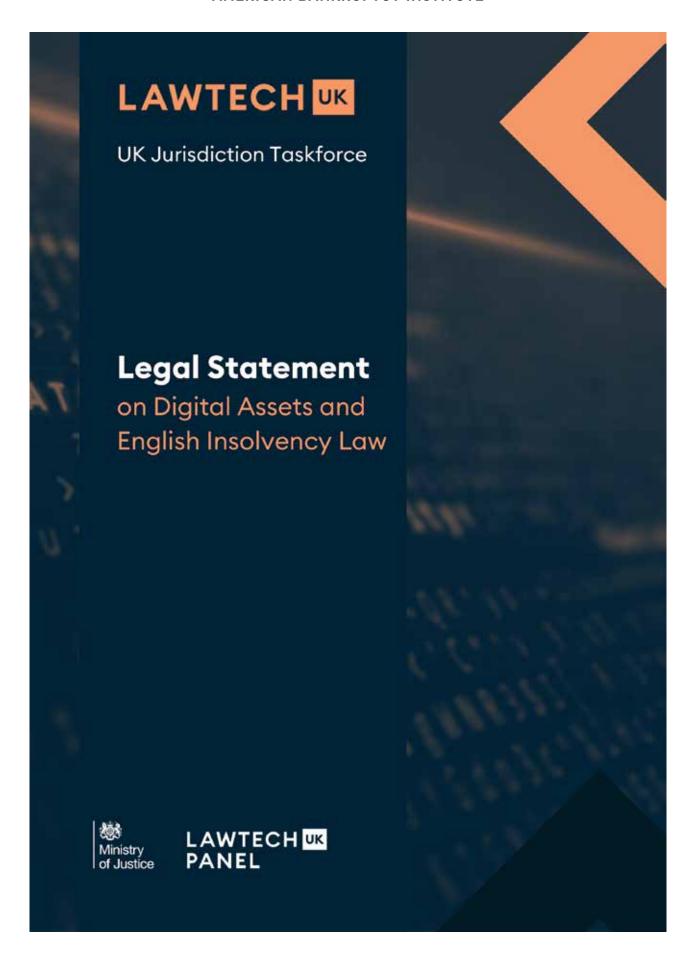
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Legal Statement on Digital Assets and English Insolvency Law

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Foreword by Sir Geoffrey Vos, Master of the Rolls

I am delighted to welcome the UK Jurisdiction Taskforce's (UKJT) Legal Statement on Digital Assets and English Insolvency Law.

This is the third Legal Statement issued by the UKJT. The first was its Legal Statement on the Status of Cryptoassets and Smart Contracts published in November 2019. The second was its Legal Statement on the Issuance and Transfer of Digital Securities under English private law. Both have been well received and referred to with approval in court decisions in England & Wales and other common law countries.

One of the most pressing concerns of mainstream investors considering a digital investment strategy is uncertainty surrounding recovery of digital assets within an insolvent estate. The UKJT now publishes its third Legal Statement addressing the way in which English insolvency law applies to digital assets. This third statement has been prepared by a team led by Lawrence Akka KC and David Quest KC, and including Ryan Perkins, Alexander Riddiford, Matthew Kimber, Rory Conway and Hannah Crawford. I congratulate the entire drafting team on their comprehensive analysis.

It is not my role as a judge, nor that of the UKJT or its parent, LawtechUK, to endorse the contents of the Legal Statement. Instead, the UKJT has promoted public and private consultation to ensure that the drafting team were answering the most pressing legal questions with the most expert input.

The Legal Statement concludes, amongst other things, that digital assets fall within the definition of property in the English Insolvency Act 1986, and that proprietary rights can be retained to digital assets held by insolvent estates. A valid statutory demand cannot yet, however, be served in respect of a debt of a digital asset.

Summary

- 1 Existing English insolvency law is entirely capable of convenient and sensible application to disputes concerning digital assets. Although the issues which arise are technical and fact-specific in nature, they can be resolved by recourse to existing and well-established principles.
- 2 Digital assets are capable of amounting to property for the purposes of law on insolvency.
- Insofar as international jurisdiction falls to be determined by reference to COMI (Centre of Main Interests), the English courts will apply the existing and well-established test for the purposes of ascertaining the COMI of a company dealing in digital assets.
- 4 Digital assets are not yet treated as money in this jurisdiction. This has the consequence that, although they fall within the statutory definition of 'property' for the purposes of the Insolvency Act 1986, a claim to such assets will not (of itself) found a statutory demand.
- For the same reason, such assets do not amount to foreign currency for the purpose of Rule 14.21 of the Insolvency Rules 2016, which requires an office-holder to convert all debts incurred or payable in a "foreign currency" into pounds sterling, at a single rate for each currency determined by the office-holder, by reference to the exchange rates prevailing on the relevant date.
- 6 Nevertheless, a claim to digital assets held by a company or bankrupt individual can (in principle) be a claim to recover property. Whether or not it is, in any given instance, depends on the manner in which the assets are held (in particular upon whether the holding arrangements in any given case are as a matter of analysis structured as a trust).
- Insofar as office-holders decide to liquidate digital assets owned by the insolvent company, the usual obligations apply, including the obligations to exercise their powers in good faith, and to obtain the best price reasonably

obtainable on the sale of property, although of course the volatile nature of digital assets might present particular challenges regarding the fair realisation of value. Office-holders may also, in the exercise of their discretion, determine that assets should not be realised and sold in return for cash, but instead distributed in specie.

- 8 The law allows for transactions in digital assets at an undervalue to be reversed and for preferential transactions and transactions defrauding creditors to be set aside. Floating charges and property dispositions may be avoided. Whilst it may not be technologically possible for a blockchain transaction to be literally undone, there would be no difficulty in a judge making an order to bring about the same result, for example by ordering a recipient to make an equal and opposite transfer.
- The interlocutory, investigatory and enforcement powers generally available to insolvency office-holders under English law are available in relation to digital assets. Office-holders may require a wide range of people, such as officers and former officers of a company, and certain employees, to provide information and documents, and they may apply to a judge for an order that relevant private keys be disclosed.
- There are existing rules which are flexible enough to be applied to allocate any shortfalls in circumstances where digital assets belonging to different persons have been pooled. Although digital assets are created with new technology, they do not require a fundamental change in the longstanding legal analysis of tracing, mixed accounts, and shortfalls, although the technological structure of certain kinds of digital assets may be relevant to that exercise. The rules contained in the FCA's Client Assets Sourcebook are unlikely to apply, since digital assets are not yet money.

Introduction

- 11 The past few years have seen increased turbulence in the digital asset markets. Recent high-profile collapses of digital asset exchanges, platforms and funds¹ have highlighted the importance of robust insolvency processes to ensure fair and predictable outcomes in respect of this form of investment.
- 12 However, the courts of England and Wales have not to date had occasion to address in any detail the application of English² insolvency law concepts to digital assets. As and when such concepts fall to be applied by the English courts in resolving disputes concerning digital assets, important questions may arise as to the precise manner of their application to this new category of asset.
- Our view is that English insolvency law as it presently stands is entirely capable of convenient and sensible application to disputes concerning digital assets. We demonstrate that below.
- 14 This Legal Statement, like those before it,³ is intended to address areas of perceived legal uncertainty and to provide clarity as to the application of certain aspects of English insolvency law to digital assets.
- As with previous Legal Statements, this is not intended to be a detailed academic paper or a comprehensive discussion of English law as it relates to digital assets. Instead, our aim again has been to ascertain the questions which are of interest to those involved, and to answer them in an accessible manner, bearing in mind that this technical legal topic has some inevitable complexity. In particular, we have not described general principles of insolvency law in detail.

The Public Consultation

16 So that we could be sure that we were answering the right questions, the UKJT held a public consultation in November 2023. We invited comments on the preliminary list of questions, and views as to whether there were any material issues of concern to stakeholders in relation to digital assets and English insolvency law. We are very grateful to those—academics, lawyers and market participants—who provided a number of detailed responses, all of which we have taken into account. In places, we have reframed the questions slightly as a result.

Scope

- 17 Our role in producing this Legal Statement has been to focus on the existing law of England and Wales. We have made no comment on how the law should develop in the future.
- 18 Further, because the law can be highly fact-sensitive, we are unable to deal here with areas where too many potential factual scenarios would need to be considered in or for us to provide any helpful answers. This Legal Statement is not intended to be legal advice, for which readers should consult a lawyer, and nothing in it should be relied upon as being relevant to any particular circumstances.

Structure of this Statement

19 The questions we have answered and our conclusions are set out below, under separate headings. We have provided a number of references in the endnotes for those who would like more detail.

Editors

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Legal Statement

1 Property

Are digital assets "property" forming part of the estate of the insolvent company or individual for the purposes of the English insolvency legislation?

- 20 The UKJT's November 2019 Legal Statement on Cryptoassets and Smart Contracts concluded that digital assets are capable of being "property" as a matter of English and Welsh common law.¹²
- 21 The courts of England and Wales have adopted and affirmed that reasoning in several cases, including at the Court of Appeal level.¹³ Courts worldwide have adopted a similar approach and reasoning.
- The Insolvency Act 1986, contains its own definition of property. Section 436(1) says:

"property" includes money, goods, things in action, land and every description of property wherever situated and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property

- As the Legal Statement on Cryptoassets noted, ¹⁴ that definition is very wide indeed. It has been said that "it is hard to think of a wider definition". ¹⁵ It is at least as wide, and likely wider, than the common law conception of property: things which the common law might not classify as property may therefore be property for the particular purposes of the Insolvency Act. That is unsurprising—when a person or a company becomes insolvent, it is usually advantageous to the creditors that as many valuable assets as possible be classified as property so that they can be gathered in and liquidated to pay off the debts.
- 24 Since it is now clear that digital assets are capable of being things to which property rights can relate as a matter of common law, we have no doubt that they fall within the wider definition of property in the Insolvency Act.¹⁶

2 International Jurisdiction

For international allocation of insolvency jurisdiction based upon location of centre of main interests (COMI), what rules apply to determine where digital assets are controlled and/or administered?

- The Business and Property Courts in England and Wales very often deal with insolvent debtors, whether individuals or corporate entities, with commercial interests in various countries. Where a petition or application is made to the Court to open insolvency proceedings in respect of such a debtor, the first question the Court needs to ask itself is whether it has jurisdiction to do so at all.
- In this context, one question which will typically arise is whether the Court has jurisdiction to commence what is known as a comprehensive 'main proceeding' in respect of the debtor (encompassing all assets and all creditors, wherever located), or whether it will have jurisdiction only to commence some form of ancillary proceedings (concerning, for example, only assets located in England and Wales). In the former case, the Courts have established the 'centre of main interests', or "COMI", test, for determining whether the Court has jurisdiction to commence a main proceeding.
- The COMI test is intended to ensure, in the interests of judicial comity, 27 that the Court will only accept main proceeding insolvency jurisdiction over a particular debtor if the strength of that debtor's connection with England and Wales is sufficiently strong to justify it. It was first developed in the context of the EU Insolvency Regulation (and its predecessors), but is also now applicable in other contexts, notably in the context of applications for the recognition by the English Court of 'foreign representatives' of debtors subject to insolvency proceedings in other jurisdictions under the UNCITRAL Model Law on Cross-Border Insolvency Proceedings.¹⁷ Accordingly, the question addressed below concerns situations where the Court must determine a debtor's COMI, whether that be for the purposes of establishing where main insolvency proceedings should be commenced for the purposes of the Retained Insolvency Regulation, 18 or for the purposes of establishing what constitutes foreign main proceedings for the purposes of the UNCITRAL Model Law, or otherwise.

- 28 There is a substantial body of EU and English case law addressing the applicable test for the purposes of identifying a debtor's COMI.¹⁹ For present purposes, the relevant principles are as follows:
- 29 First, unless the contrary is proved, a judge will presume that the country in which a company has its registered office (or, if it does not have one, the country in which it is incorporated), will be its COMI.
- 30 Second, the Court will consider where the debtor conducts the administration of its interests on a regular basis, that is where the debtor regularly carries on (and can be seen to carry on) its business.
- 31 Third, the location of a debtor's COMI must be objectively ascertainable by third parties, with the actual subjective knowledge of specific relevant third parties (especially creditors) not excluded from this analysis.
- 32 Fourth, special consideration is to be given to creditors and their perception of the conduct of the administration of the debtor's affairs.
- 33 Fifth, there is no principle of immutability; a debtor can shift its COMI.
- 34 Sixth, by way of qualification to the fifth principle, a debtor's shift of COMI must have a degree of permanence which may, in certain circumstances, require a debtor to inform creditors about it.
- There are separate questions regarding what is known as the lex situs of digital assets. These questions may be relevant for the purposes of allocating insolvency jurisdiction otherwise than on the basis of COMI, for example for the purposes of establishing the English Court's jurisdiction to open ancillary proceedings on the basis that some of the debtor's assets (including digital assets) are situate in England and Wales. These questions regarding the lex situs of digital assets are beyond the scope of this Legal Statement and we do not address them further here. It is notable, however, that judges in the cases of *Ion Science* and *Fetch AI*²¹, have taken the view, based on Professor Dickinson's proposal, that the location of a cryptoasset (in those cases Bitcoin) is the place where the person or company who owned the coin or token is domiciled.²²
- 36 Whatever the proper lex situs of a particular class or classes of relevant digital asset may be, the ascertaining of a debtor's COMI is likely to depend primarily on the precise way in which that debtor interacts with the digital asset in question. Where digital assets are controlled or administered is likely to depend on the facts of the debtor's particular

- case, in particular on the kind of business in which the debtor is engaged and the way in which it deals with the digital assets.
- 37 In this regard, some useful guidance can be drawn from the Singapore case of *Zipmex*²³ where the Singapore High Court decided that the same test applied for establishing COMI both under the UNCITRAL Model Law and under section 64 of the (local) Insolvency, Restructuring and Dissolution Act 2018 ("IRDA").
- Zipmex concerned a cryptoasset exchange incorporated in Singapore and a number of its subsidiaries. Some were Singaporean, but others were incorporated in Thailand, Indonesia and Australia. In the end, the most important factor for the Court was that the various entities in the Zipmex group carried out the practical administration of the digital assets they held. The Court had to determine whether the COMI of each of these entities was in Singapore or elsewhere for the purpose of establishing jurisdiction under section 64 IRDA. In particular, the Court considered the following factors in determining the COMI of the various entities to be of particular importance:
- 39 The location from which control of the cryptoassets was exercised;
- 40 The location of clients, creditors and employees;
- 41 The location of the debtors' operations; and
- 42 The location of dealings with third parties.
- 43 Most of the Court's analysis in Zipmex in relation to COMI focused on the first of these factors, with an emphasis on the practicalities of the mechanics by which cryptoasset deposits were centrally held and administered in Singapore using a hot wallet facility²⁴ and a ZipUp+ facility. The judge, Abdullah J, said "The consolidation of assets in the hot wallet hosted by Zipmex Asia in Singapore, from all the entities, lay at the bottom of the business model and operations of the group. While not all the creditors may have actually been aware of this, the fact that such consolidation occurred does point to a Singapore centre of gravity." He continued: "Taking a holistic assessment of these various factors, therefore, given the location of the ultimate use of the assets through the hot wallet, the use of the ZipUp+ facility, and the locus of management in Singapore, the COMI for each of the entities was Singapore. Specifically for the Thai entity, the preponderance of the use of the ZipUp+ facility and the hot wallet was significant."25

- Abdullah J's analysis illustrates that what is likely to matter most when applying the COMI test in a context involving cryptoassets, is not so much the location of the cryptoassets themselves (which may well be a vexed question where the cryptoasset in question exists on a distributed ledger), but instead the objective perception of the debtor's commercial activities in relation to those cryptoassets (and also, following East-West Logistics LLP²⁶, the actual subjective perception of creditors and other counterparties as to the location of those activities).
- The Zipmex case also illustrates that the nature of the debtor's relationship with the relevant cryptoassets, i.e. the way in which the debtor interacts with those assets, is likely to have a vital bearing on the question of COMI. For this reason different considerations may well apply where the debtor is an exchange (as in Zipmex where the location of the exchange's commercial activities made ascertaining COMI relatively straightforward), or a principal holder of cryptoassets (where the location of the debtor's commercial activities may well be more difficult for the Court to discern).
- 46 In any event, the existing canon of principles for the establishing of COMI, as developed by the English and other Courts, is adequate for the task of determining the COMI of a debtor that has commercial dealings with cryptoassets.

3 Claims to Digital Assets

Is a claim to digital assets held by a company or bankrupt capable of being a claim to recover property? If so, what factors determine whether it is to be so characterised.

Where one person—Alice, say—has a claim in respect of a digital asset held by an insolvent company or bankrupt —Bob Ltd, or Bob, say—that may be a claim based on a personal right or a proprietary right. Where such claims are based on personal rights, they will be primarily ²⁷ personal contractual claims to the return of digital assets equivalent to those held. On the insolvency or bankruptcy of the holder of the digital assets, any personal claim to the monetary value of the digital assets would rank as unsecured claims only and would give rise to no priority right of recourse to any specific digital assets or entitlements thereto. However, where such claims are based on property rights, an action or

- a proprietary remedy in respect of the asset itself may be available. This is significant in an insolvency or bankruptcy because (in general) if Alice's claim is based on a proprietary right, then she may be able to recover her asset in priority to Bob Ltd or Bob's unsecured creditors. This position has been affirmed by foreign courts in the high-profile insolvencies of Voyager, Celsius and Three Arrows Capital.²⁸
- Since digital assets are capable of being property, we see no difficulty in principle in a person acquiring or retaining a proprietary right in digital assets held by an insolvent company or bankrupt. In general, where a person acquires or retains a proprietary right in digital assets held by a company or bankrupt, those digital assets would not form part of the company or bankrupt's estate and would not be available to meet the claims of its general creditors. The precise nature of the proprietary right will depend on the particular circumstances and arrangements, but in English law, this is most likely to be the case where it is determined that property is held on trust. Cases decided in other common law jurisdictions have now established it is possible for a valid trust to be created over digital assets (including over commingled, unallocated holdings of digital assets) and we consider that to be clearly the better view under English law also.

The three certainties

49 Establishing a trust requires proof of three things: (i) intention by the relevant party (Bob, in our example above) to hold the digital asset on trust; (ii) sufficient identification of the beneficiary of the trust (Alice); and (iii) sufficient identification of the digital assets that are the subject matter of the trust.³¹

The arrangement in question

- 50 Whether a valid trust is established over digital assets will of course depend on the details of the specific arrangement in question.
- A distinctive feature of digital assets is that they can be held, administered and controlled using technological or operational methods that are not available for conventional assets, such as by transfer controls built into the blockchain on which the assets are held or via smart contracts. One relatively straightforward example is the use of multiple digital signatures, where different private keys are held by different

- interested parties, and all (or some specified combination) are required to authenticate a transfer.
- 52 The parties to such an arrangement may consider that the technological controls in place offer sufficient protection for their interests, and accordingly the intention to create a trust may be absent, with the result that the relationship between the parties is likely to be purely contractual.
- In contrast, there are some arrangements which are likely to involve the holding of a digital asset on trust, notwithstanding that technological measures are in place. Centralised digital asset custodians are perhaps the most likely to structure their holding arrangements as trusts. In particular, they are likely to offer holding arrangements under which the custodian maintains full factual control over the digital assets in question. In general, this will be because the custodian itself holds the digital assets in question in a public address, and has control over them by means of the relevant private keys.
- 54 Such arrangements are often structured or designed to prioritise execution services and typically involve:
 - The individually segregated records of each individual client's entitlements to the digital assets held by the exchange on behalf of such clients (i. e. books and records segregation).
 - Omnibus wallets (i.e. on-chain addresses) where the digital assets of
 multiple clients are pooled together for operational efficiency. Such
 omnibus wallets may also contain a small amount of the exchange's
 own assets for the purpose of facilitating client transactions (eg to
 pay transaction fees, to match small client trades that would
 otherwise not settle, or as a result of the deduction of trading fees
 meaning a small portion of assets traded are reclassified as the
 exchange's proprietary assets on a rolling basis).
 - A combination, or the option for digital assets to be held by the centralised digital asset custodian in trading wallets which are "hot" wallets that hold private key material on infrastructure that is connected to the internet for fast execution, transfers and settlement and "cold" (offline slower transfers but more secure) wallet ³² environments to strike an optimal balance between liquidity needs and security. Such arrangements often involve the conduction of regular, eg daily, on-chain rebalancing and

- reconciliations in respect of the target small amount of the exchange's proprietary assets contained in client omnibus hot wallets.
- The additional option for premium custody services to institutions that are willing to pay for the additional cyber security and on-chain transparency of holding their assets in a fully segregated wallet with the private key material held in cold storage.
- However, the existence of such an arrangement, or similar, is not in itself determinative of whether a valid trust exists. Indeed, such an arrangement could be structured either as a purely contractual arrangement under which the legal title transfers to a custodian and no valid trust exists, or, alternatively as a valid trust arrangement. Whether the "three certainties" have been satisfied will determine whether such an arrangement involves a valid trust. A principal evidential factor will be whether an express contractual term between the two parties that includes either an express declaration of trust or similar language clarifying that the custodian holds the assets "for the benefit of the client". However, the Court will need to examine the arrangement in question in detail to determine whether or not a trust exists. A number of foreign courts have had to undertake this exercise in respect of digital assets.³³

4 A debt for a liquidated sum, or foreign currency?

If a claim to digital assets held by a company or bankrupt is a contractual claim, is it a debt for a liquidated sum so as to be capable of founding a statutory demand or a winding up petition?

Circumstances in which a company may be wound up

A creditor to whom a company owes money may apply to the Court to wind up the company by presenting a winding-up petition. There are various circumstances in which a company may be wound up, but under the Insolvency Act 1986, Section 122(f) (Circumstances in which company may be wound up by the court), a company may be wound up by the court if, among other things, it is unable to pay its debts. The circumstances in which that is deemed to be the case are defined in section 123 and are:

- 57 if a formal written demand (known as a 'statutory demand') in the prescribed form is served on the company and the company has failed to pay the sum demanded for a period of three weeks;³⁴
- if the court is satisfied that the company is unable to pay its debts as they fall due (this is known as the "cashflow insolvency test");³⁵ or
- 59 if the court is satisfied that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities (this is known as the "balance sheet insolvency test").³⁶

Statutory demand and winding-up petition

- 60 If a creditor seeks to rely on the first of these, and presents a winding-up petition based on the failure of a company to pay a sum demanded under a statutory demand, both the statutory demand and the winding-up petition must be founded on a liquidated sum because:
- According to the relevant part of the Insolvency Act, a winding-up petition "must be in respect of one or more debts owed by the debtor".³⁷ The debt in question must be "for a liquidated sum payable to the petitioning creditor",³⁸ must be a debt which the debtor appears either to be unable to pay or to have no reasonable prospect of being able to pay.³⁹
- 62 A debt may be one which the debtor appears either to be unable to pay or to have no reasonable prospect of being able to pay if a valid statutory demand in the prescribed form⁴⁰ is served on the company and the company has failed to pay the sum demanded for a period of three weeks. The debt referred to in a statutory demand must also be "for a liquidated sum payable to the petitioning creditor".⁴¹

A debt for a liquidated sum

- 63 In short, therefore, a valid statutory demand can only be served, or winding up petition presented, in respect of an amount of digital assets if those digital assets can be said to be a "debt" for a "liquidated sum".
- A liquidated sum is a sum that that is "pre-ascertained" or "a specific amount which has been fully and finally ascertained", although that allows for calculation in accordance with a contractual formula or mere addition.⁴²

- Although an obligation expressed in a specific quantity of digital assets, is an obligation to pay (or deliver) a specific quantity of the digital assets in question, it is not a debt for a liquidated sum that can be expressed as a "'money sum". The use of the term "debt" in section 267(2)(b) of the Insolvency Act 1986 implies or requires that the obligation in question must be "monetary": section 123(3) specifically refers to the sum demanded under a valid statutory demand in the prescribed form for the purposes of Section 123(1)(a) as a "money sum".
- An obligation to pay (or deliver) a specific quantity of digital assets does not satisfy that requirement because digital assets cannot be treated as money, at least not yet. In Miller v Race Lord Mansfield said that what is treated as money "by the general consent of mankind" is given "the credit and currency of money to all intents and purposes". 43 Digital assets, even where used as a means of payment, do not yet have such credit and currency. The value of digital assets "depends on different structural and social concepts compared to existing fiat currencies"44 and all digital assets (including stablecoins) fluctuate in value against fiat currencies. The holder of a digital asset has no legal right to exchange that digital asset for any specific fiat currency.⁴⁵ Many obligations that specify a certain quantity of digital assets require delivery or repayment of the digital asset in question and cannot be recharacterised as a monetary obligation or a debt for a liquidated sum of money. The "core" legal obligation in respect of a quantity of digital assets "owed" by a company or bankrupt is one of delivery of those digital assets, rather than payment of a monetary sum. An action to enforce such an obligation would therefore be characterised or construed as a claim for unliquidated damages for failure to deliver, rather than as a monetary debt.

A claim provable in liquidation, administration or bankruptcy

- 67 However, a claim in respect of an obligation to pay (or deliver) a specific quantity of digital assets would nonetheless be provable in a liquidation, administration or bankruptcy. That is because the definition of a "provable debt" under Rule 14.1(3) of The Insolvency (England and Wales) Rules 2016⁴⁶ includes all claims by creditors whether ascertained or sounding only in damages; the definition is not limited to a "debt" for a "liquidated sum".⁴⁷
- 68 The position described above mirrors the position taken in the High Court of Singapore in Algorand Foundation Ltd v Three Arrows Capital

Pte Ltd.⁴⁸ The Court held that the claimant in question was a "creditor" within s 124(1)(c) of the Singapore Insolvency, Restructuring and Dissolution Act 2018 but that an obligation to re-transfer loaned stablecoins (USDC) could not constitute a monetary debt for the purposes of founding a valid statutory demand under s 125(2)(a) of that Act.

- 69 The question of whether a digital asset is held on trust will be highly relevant to determining whether, and to what extent, claims in respect of digital assets can be compromised by restructuring procedures under English law.
- By way of background, the key restructuring procedures are schemes of arrangement under Part 26 of the Companies Act 2006, restructuring plans under Part 26A of the Companies Act 2006, and company voluntary arrangements (CVAs) under Part I of the Insolvency Act 1986. These restructuring procedures represent a significant proportion of the work carried out by insolvency lawyers and judges in England. Such procedures are highly attractive internationally, and are desirable because they provide a flexible way of reducing, discharging or deferring indebtedness owed by the relevant company, subject to certain conditions.
- 71 For example, in the case of a Part 26 scheme of arrangement, the Court has the power to sanction (i.e. approve) any arrangement proposed by a company with its creditors (or any class of them), provided that the arrangement is approved by a majority in number representing 75% in value of the creditors present and voting at a meeting of each class. The Court has a broad discretion which is exercised in accordance with well-established principles.
- 72 These restructuring procedures can only be used to compromise the claims of a company's "creditors" (in their capacity as such). The concept of a "creditor" is very broad; it includes the holders of personal pecuniary claims of any description (secured or unsecured, of any ranking).⁴⁹
- 73 However, the concept of a creditor is not unlimited. In particular, it does not extend to the proprietary rights of a beneficiary of trust property. The result is that a scheme, plan or CVA cannot be used to modify the proprietary rights of a beneficiary of trust property: see *Re Lehman Brothers International (Europe)*, 50 in which the Court of Appeal held that a scheme of arrangement proposed by the administrators of Lehman

- Brothers to compromise proprietary rights in respect of client assets (held on trust for the relevant clients) fell outside the jurisdictional scope of Part 26 of the Companies Act 2006.
- 74 For this reason, to the extent that the holder of a digital asset has a personal claim against a custodian thereof, that claim will be capable (at least in principle) of being compromised by a scheme, plan or CVA proposed by the relevant custodian. However, to the extent that a holder of a digital asset has a proprietary claim (for example, under a trust), that proprietary claim is immune from being restructured by a scheme, plan or CVA. This illustrates why the resolution of personal/proprietary debate may be of vital importance in the context of restructuring.

Is a claim to digital assets a claim in a "foreign currency" such that it should be converted to the currency of the insolvency on day one?

Rule 14.21 of the Insolvency Rules 2016

- 75 For the purposes of making distributions to unsecured creditors, the office-holder (i.e. the liquidator or administrator or bankruptcy trustee) is required to convert all debts incurred or payable in a "foreign currency" into pounds sterling, at a single rate for each currency determined by the office-holder, by reference to the exchange rates prevailing on the relevant date.⁵¹
- 76 This raises a question as to whether an obligation of the insolvent or individual company to deliver digital assets (being a provable debt) amounts to a debt owed in a "foreign currency".
- 177 If so, then a creditor with such a claim is no longer exposed to fluctuations in the market for the relevant digital assets, from the relevant date onwards. If not, then (absent the termination of that delivery obligation and its replacement with an obligation denominated in a fiat currency) the debtor will continue during the insolvency to owe an obligation the monetary value of which fluctuates with the market value of the digital assets in question.
- 78 The question could accordingly be of significant practical importance, including in light of the volatility in the prices of many prevalent digital assets.

"currency"

- 79 In order for digital assets to be capable of constituting "foreign currency" for these purposes, it is of course necessary that they be properly characterised as "currency".
- 80 We consider the question of whether or not an obligation to deliver digital assets is a debt owed in a "currency" to be the same as the question as to whether or such assets amount to 'money'. Further, for the reasons outlined above, 52 we think that digital assets are not (yet) 'money' (or, therefore, "currency" for the purposes of Rule 14.21), but that one or more forms of digital assets may become "currency" at some point in the future, if and when they are (as a matter of fact) commonly and continuously accepted as a means of exchange or a unit of account.
- That is not to say, however, that that Rule 14.21 in the meantime has no application at all in respect of an obligation to deliver digital assets. As and when an obligation to deliver digital assets is replaced by an obligation to pay a sum in a fiat currency, whether by operation of any close-out mechanism appearing in the applicable contractual arrangements, or because the contract is brought to an end and replaced by a damages claim (denominated in fiat currency) for failure to deliver the digital assets, the resulting obligation to pay a fiat sum will, if denominated otherwise than in pounds sterling, will fall to be converted into the latter currency pursuant to Rule 14.21.
- 82 Further, for so long as the obligation to deliver digital assets subsists in that form, there always is a possibility of it being replaced in the future with an obligation to pay a sum in a fiat currency, whether by operation of a contractual close-out mechanism or otherwise. To that extent, for so long as it subsists, the obligation to deliver digital assets reflects a contingent debt denominated in a fiat currency. Insofar as an administrator or liquidator comes to make a distribution to unsecured creditors whilst the underlying delivery obligation remains extant, it will be necessary for that office-holder to estimate the value of the contingent debt to which the delivery obligation in those circumstances gives rise ⁵³ and on that basis include the relevant creditor in the distribution in question.
- 83 If that contingent debt is denominated in a currency other than sterling (whether because the applicable contractual arrangements contemplate the delivery obligation being replaced with a debt denominated in a non-sterling fiat currency upon a termination event; or because any

damages claim for failure to deliver would be denominated otherwise than in sterling), then the administrator or liquidator will, for the purposes of the distribution in question, then need to convert its estimated value into sterling, using the exchange rate that applied as between those two fiat currencies as of the relevant date, in accordance with Rule 14.21. The office-holder will however, need to update its estimate for the purposes of any subsequent distributions, and then (for those purposes) apply Rule 14.21 to such updated estimate. In this way, the fact that Rule 14.21 does not (yet) apply directly to the obligation to deliver digital assets (as opposed to any contingent debt denominated in a fiat currency to which such delivery obligation may give rise) means that the creditor who is owed digital assets remains exposed to fluctuations in the value of those digital assets, unless and until either the delivery obligation is replaced by an actual monetary claim (whether in debt or damages), or the office-holder makes a final distribution to creditors.

"foreign"

- As noted above, the conclusion that digital assets are not (yet) "currency" is reached by reference to the present degree of acceptance of digital assets as a means of exchange or a unit of account. It accordingly turns on a factual state of affairs that may change over time. If and when one or more forms of digital asset do, as a matter of fact, become sufficiently accepted in society as a means of exchange or a unit of account, so as to be treated in a general sense as 'money', there will be a legitimate basis for those digital assets to be properly characterised "currency" for the purposes of Rule 14.21.
- In that event, a further question arises as to whether digital assets amounting to "currency" can be accurately characterised (for the purposes of Rule 14.21) as "foreign". If not, then they would appear still to fall outside of the purview of Rule 14.21.
- 86 The use of the word "foreign" arguably suggests some essential involvement of another state (or at least another jurisdiction) in the promulgation of the currency in question. In circumstances where digital assets are typically not issued by any state (or any organ thereof), as a matter of language it is difficult to characterise them as "foreign".
- Nonetheless, having regard to that policy objective underlying Rule 14.21, we consider that a broader interpretation of the word "foreign" is appropriate. In particular, given that the purpose of Rule 14.21 is to

ensure that the insolvent estate can distributed fairly (i.e. *pari passu*) between creditors, by ensuring that their respective claims can be compared and weighed against one another, we think there is a good argument (based on a purposive construction of Rule 14.21) to the effect that "foreign" should in this context be read as encompassing any non-sterling currency.⁵⁴

- 88 Support for that interpretation can be found in the rules relating to insolvency set off in administration ⁵⁵ and liquidation. ⁵⁶ Those rules expressly adopt the currency conversion provided for by Rule 14.21, for the purposes of bringing non-sterling debts into the set-off account. ⁵⁷ Instead of referring to "foreign" currencies, however, each of them refers to sums "payable in a currency other than sterling" arguably suggesting that the draftsman, in using the word "foreign" in Rule 14.21, was intending not to signal some essential involvement of another state, but merely to capture any currency "other than sterling".
- 89 We accordingly consider that, if and when any given digital asset becomes, as a matter of fact, sufficiently accepted within society as a means of exchange or a unit of account as to be considered 'money', it will fall to be treated as "foreign currency" for the purposes of Rule 14.21, which will then apply directly to obligations denominated in it.

5 Obligations of office-holders

Are office-holders subject, generally, to any obligations in relation to holding/realisation of volatile digital assets in an English insolvency?

Rules on the holding and realisation of assets

90 English law applies certain rules to different types of office-holders regarding the holding and realisation of an insolvent debtor's assets. A brief summary of the relevant regimes is set out below.

Administration

91 Once appointed, an administrator must take all of the company's property into their custody or control.⁵⁸ Their powers in relation to the company's property are broad, including anything "necessary or

- expedient for the management of the affairs, business and property of the company".⁵⁹
- As officers of the court⁶⁰ administrators are under a duty to act fairly and honourably.⁶¹ They owe the company a common law duty to exercise reasonable care and skill in the performance of their functions to the standard of an ordinary, reasonably skilled and careful insolvency practitioner.⁶²
- 93 If administrators decide to cause the company to dispose of its assets, they owe duties:
 - to obtain the "best price reasonably obtainable", which the circumstances (as the administrators reasonably perceive them to be) permit; this includes taking reasonable care in choosing the time at which to sell the property;⁶³ in this context, "the best price reasonably obtainable" is synonymous with "a proper price";⁶⁴
 - to exercise their powers in good faith, for a proper purpose and rationally; and
 - of loyalty, to protect the creditors of the company (the duty to creditors as a whole is merely one to prevent unnecessary harm).⁶⁵
- Administrators are required to perform their functions in accordance with a statutory hierarchy of purposes 66. This hierarchy gives primacy to rescuing the company (itself) as a going concern; the next objective is to achieve a better result for creditors as a whole than liquidation. Only if neither of those objectives is reasonably practicable can the administration be used for the third statutory objective, which is to realise assets for distribution to secured or preferential creditors; in pursuing this objective, administrators are required not to "unnecessarily harm" the interests of the company's creditors as a whole. 67 Administrators are also required to perform their functions as quickly and efficiently as is reasonably practicable. 68
- 95 Statement of Insolvency Practice 16 provides an additional protective framework in the context of pre-packaged sales in administrations, 69 including requirements to provide creditors with sufficient information such that a reasonable and informed third party would conclude that the pre-packaged sale was appropriate, and that the administrator has acted with due regard for the creditors' interests.

Liquidation

- 96 Liquidators are also officers of the court 70 (with the exception of voluntary liquidators); accordingly, they too must comply with the duty to act fairly and honourably. They are required to use their own discretion in the management of assets and their distribution among creditors.⁷¹
- 97 English law therefore already provides a framework for the exercise of insolvency office-holders' discretion in realising value from an insolvent debtor's estate. The English Court is typically reluctant to interfere with the professional judgment of an insolvency office-holder in this regard.⁷²

How should digital assets be realised and distributed?

- 78 The volatile nature of digital assets presents a particular challenge regarding the fair realisation of value in respect of those assets. The questions facing an insolvency practitioner in relation to realising a digital asset include both the timing and the manner in which the relevant asset should be realised; namely, should the relevant office-holder sell the digital asset in return for its equivalent value in cash, or should a distribution be made in specie i.e. in the native (digital, rather than its equivalent cash or other value) form of the asset? At what point in time should the relevant realisation be made?
- 99 Whilst these questions are technical and fact-specific in nature, they are not new. For instance, a bankruptcy trustee can effect a distribution of non-cash assets (often known as a distribution *in specie*) with the prior consent of the creditors' committee. The Insolvency Rule 14.13 also enables administrators and liquidators, with permission, to divide property which from its peculiar nature or other special circumstances cannot be readily or advantageously sold among the company's creditors in its existing form (the required permission is that of the creditor committee or, if there is no such committee, the creditors themselves). These principles should enable the division and distribution of digital assets if necessary.
- 100 Given the complex and volatile nature of digital assets, should an office-holder determine (in their discretion) that the relevant digital assets should be realised and sold in return for cash (rather than *in specie*) to be distributed to the creditors, it may be helpful for the office-holder to consult a third party specialist prior to making any decision in this regard

- to assist them in determining the appropriate time and method of realisation and subsequent distribution.
- 101 Although not within the scope of this Legal Statement, it should also be noted that there is a financial regulatory overlay for office-holders in the exercise of their duties when dealing with digital assets in situations where the insolvent company holds digital assets on behalf of others, for example in a wallet, as a storage provider, on an exchange etc. and it may therefore be an option for office-holder to seek specialist advice in this regard at an early stage depending on the circumstances. This regulatory overlay may require the office-holder to work closely with regulators to ensure that appropriate steps are taken with regard to not only the ever-developing regulatory framework in this area but also the existing regulatory framework in place relating to the orderly return of client assets among other things.
- 102 Regardless of the office-holders' decisions in respect of the realisation of digital assets, office-holders may be minded to disclose their approach to creditors as soon as reasonably practicable and ideally to obtain creditor consent in advance as appropriate and depending on the circumstances of the case—eg by inclusion in the office-holders' proposals put to creditors.

6 Avoidance of prior transactions

Can you perceive any difficulties in the application of the English insolvency legislation relating to avoidance of prior transactions to pre-insolvency dealings with digital assets? If so, what are they?

- 103 The Insolvency Act 1986 contains a number of provisions that empower the Courts, on the application of an insolvency office-holder, to unwind or otherwise adjust transactions entered into by the debtor company prior to the commencement of insolvency proceedings ('antecedent transactions'). These powers exist for the protection of the insolvent company's creditors and, in essence, are there to uphold and facilitate the fair and equal (i.e. *pari passu*) distribution of the company's assets to those creditors.
- 104 Insofar as the insolvent company's assets at any stage included valuable digital assets, it would seem obviously desirable that these legislative

- provisions and common law rules should be capable of application to such assets. Our view is that they are.
- 105 In the subsections that follow, we examine that question by reference to each of the key legislative provisions in the Insolvency Act 1986.

s 238: Transactions at an undervalue

- 106 An office-holder may apply to court seeking the setting aside of a transaction at an undervalue under section 238 of the Insolvency Act 1986, if, during the run-up to the commencement of formal insolvency proceedings, the company (being unable to pay its debts as the time): (i) made a gift or otherwise entered into a transaction on terms that the company received no consideration; or; (ii) entered into a transaction for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company (in either case, a "TUV").
- 107 If the court concludes that the insolvency company entered into a TUV at a relevant time, it is (subject to exceptions not relevant for present purposes) empowered to make such order as it thinks fit for restoring the position to what it would have been if the company had not entered into that transaction.
- 108 As can be seen from the above, the provisions of section 238 impose no limitations as to the types of assets that may form the subject of a TUV. The courts have applied the provision to a wide variety of property including, for example, licences ⁷⁵ debts owed to the insolvent company, ⁷⁶ and goodwill. ⁷⁷
- 109 We accordingly consider it to be clear that section 238 is capable, in principle, of applying to a transaction the subject matter of which is digital assets.

s 239: Preferences

- 110 An office-holder may apply to court seeking the setting aside of a "preference" under section 239 of the Insolvency Act 1986.
- 111 A company gives a relevant "preference" to a creditor or a surety or guarantor of one of its debts (a "Relevant Person") if, in the run-up to the commencement of formal insolvency proceedings, it (being unable to pay its debts as the time): (i) does anything, or suffers anything to be

done, which has the effect of putting the Relevant Person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done; and (ii) in deciding to do so, is influenced by a desire to prefer the Relevant Person.

- 112 If the court concludes that the insolvent company has given a relevant preference, it is empowered to make such order as it thinks fit for restoring the position to what it would have been if the company had not done so.
- 113 As can be seen from the above, like the provisions of section 238 of the Insolvency Act 1986, the provisions of section 239 impose no limitations as to the types of assets that may form the subject of a preference.
- 114 We accordingly consider it to be clear that section 239 is capable, in principle, of applying to a dealing in digital assets.

s 241: Orders in respect of TUVs and Preferences

- 115 Section 241 of the Insolvency Act 1986 sets out a non-exhaustive list of the types of order that the court may make in restoring the position to what it would have been if the company had not entered into a TUV or given a preference. Such possible orders include (among others):
- 116 requiring any property transferred as part of the transaction, or in connection with the giving of the preference, to be vested in the company,
- 117 requiring any property to be so vested if it represents in any person's hands the application either of the proceeds of sale of property so transferred or of money so transferred,
- 118 releasing or discharging (in whole or in part) any security given by the company,
- 119 requiring any person to pay, in respect of benefits received by him from the company, such sums to the office-holder as the court may direct.
- 120 For reasons explained above, we consider that digital assets are plainly "property" within the meaning of the Insolvency Act 1986, such that limbs (a) and (b) above are capable of application to such assets.

- 121 Given how digital assets are typically transferred on blockchain, if a court were to make an order under either of those limbs, it would nonetheless not be practically possible for the offending transfer actually to be literally undone once a transfer has been effected, it is immutably reflected throughout the distributed ledger. Nonetheless, we do not think that a court would have any difficulty in making an order that brought about effectively the same result, for instance by ordering the recipient party to make an equal and opposite transfer on the blockchain.
- 122 Further, we consider that no difficulty arises in this context from the conclusion, reached in the UKJT's November 2019 Legal Statement on Cryptoassets and Smart Contracts, to the effect that the 'transfer' of a digital asset in truth amounts to: (i) the extinguishment (at least as a unit of economic value) of the original digital asset in the hands of the 'transferor'; and (ii) the creation of a brand new such asset in the hands of the 'transferee'.⁷⁸ In particular, we think that either:
- section 241(1)(a) can be interpreted purposively, such that the words "any property transferred as part of the transaction" encompasses not just the 'original' digital asset, but also the 'replacement' digital asset that (on this basis) arises in the hands of the 'transferee' upon a transfer; or
- 124 the 'replacement' digital asset in any event amounts to "benefits received by [the 'transferee'] from the company" for the purposes of section 241(1)(d).

s 423: Transactions defrauding creditors

- 125 A transaction can be set aside under section 423 of the Insolvency Act if the company has entered into a TUV, for the purpose of putting assets beyond the reach of a person who is making or may make a claim against the company, or to otherwise prejudice a person's interests in relation to such a claim.
- 126 We consider that it is accordingly clear, for the same reasons as given above in relation to section 238 of the Insolvency Act 1986, that section 423 is capable, in principle, of applying to a transaction the subject matter of which is digital assets.
- 127 Further, section 245 of the Insolvency Act 1986 sets out a non-exhaustive list of the types of order that the court may make in restoring the position

to what it would have been if the company had not entered into a transaction defrauding creditors. The types of orders included in that list include all of those extracted above in the context of the discussion of section 241. Equivalent considerations and conclusions accordingly apply in this context.

s 245: Avoidance of certain floating charges

- 128 Subject to certain exceptions, a floating charge granted over a company's assets to an unconnected party is invalidated by section 245 of the Insolvency Act if the company is unable to pay its debts at the time of the grant (or becomes so as a result of it) and enters into administration within two years thereafter. Subject to the same exceptions, a floating charge granted over a company's assets to a connected party is invalidated by section 245 if the company enters into administration within twelve months following the grant.
- 129 Section 245 draws no distinction between the types of asset over which a floating charge within its scope may have been granted. On the assumption that valid security rights, including floating charges, are otherwise capable of being granted over digital assets (which we think they are),⁷⁹ we do not see any difficulty in section 245 applying to such security rights where (putting aside the fact that the subject matter of the charge in question includes digital assets) the conditions set out in section 245 are met.

s127: Avoidance of property dispositions

- 130 Whilst not a provision dealing with antecedent transactions, also worthy of mention in this context are sections 127 and 284 of the Insolvency Act 1986.
- 131 In the context of a compulsory winding-up, section 127 provides (among other things) for any "disposition of the company's property", made during the period between the 'commencement of the winding-up' (broadly speaking and insofar as relevant for present purposes, the presentation of the winding-up petition or, if earlier, the passing of a resolution for a voluntary winding-up) and the making of the winding up order, to be void unless the court orders otherwise.
- 132 As appears from the above, in order for the disposition of an asset to be caught by this section, it is necessary that the asset in question: (i) be

- "property"; and (ii) belong to the company. For those latter purposes, this means that the property in question must be beneficially owned by the company.⁸⁰
- 133 As to the former requirement (i. e. that the asset in question be "property"), as noted above, we consider that digital assets are plainly "property" within the meaning of the Insolvency Act 1986.
- 134 As to the latter requirement (i. e. that the asset in question beneficially belong to the company), on the facts of any given case, this may raise questions as to the basis on which the insolvency company holds the digital assets in question. For instance, in the case of an insolvent custodian, it may be that assts are held on trust for customers and thus not beneficially by the company.
- 135 Subject to those points, we think that section 127 is capable of application to digital assets in precisely the same way as it applies to other categories of (tangible or intangible) asset.
- 136 Section 284 of the Insolvency Act 1986 is a broadly equivalent provision, albeit applicable in the context of personal bankruptcy, as opposed to corporate insolvency. The point has been made that authorities addressing section 127 cannot automatically be transposed to section 284 (as the language of the provisions differs, as do aspects of their respective purposes) 81, but it is clear that the latter provision is conceptually capable of applying to "property" belonging to the bankrupt and we consider that dispositions of digital assets are certainly capable of being captured by section 294.
- 137 In addition to applying to dispositions of "property", section 284 also captures (by virtue of section 284(2)) "a payment (whether in cash or otherwise)". In Pettit v Novakovic⁸² HHJ Norris QC said that section 284(2) "appears to contemplate 'payments in kind'" (emphasis added), that "'payment' is the process by which money (or some acceptable substitute) passes from one to another" (emphasis added) and that "a 'payment' is the money or value that is the subject of that process" (emphasis added). On that basis, we see no reason why a transfer of digital assets in the relevant circumstances should not amount to a "payment" for the purposes of section 284 and thus also be within its scope on that alternative basis, even if (as discussed above) digital assets do not (yet) amount to 'money'.

7 Mixing and shortfalls

If a claim to digital assets held by a custodian company can be a proprietary claim, what mechanisms are available to deal with mixing of the property of various clients and/or a shortfall in an insolvency of an exchange or custodian?

- 138 Consider the following situation. Charlie is a digital custodian. Alice and Bob are customers of Charlie, and each places 100 bitcoin with him. Charlie subsequently becomes insolvent, and his office-holder discovers that only 50 of the 200 bitcoin remain in Charlie's control. How should they be distributed?
- 139 There are two general frameworks under English law for dealing with such shortfall situations where assets belonging to different people have been mixed and the assets are 'fungible', that is, of a type that cannot be distinguished once mixed.
- 140 It is necessary to introduce each of these two frameworks, before turning to consider whether (and, if so, how) each framework might apply to digital assets.

First framework: the rules of tracing under the general law

- 141 The first framework consists of the rules under the general law known as the "rules of tracing", which have been developed by the courts over many years as a means of analysing claims to assets where the original asset has been sold or transferred or substituted. As a matter of principle, the same rules of tracing should apply in equity (where the relevant assets are held on trust) and at common law (where there is no trust), although that is not the case in all areas of the law.⁸³
- 142 The rules of tracing should provide a fair and principled way of dealing with situations where fungible assets belonging to different people have been mixed but there is a shortfall in the monies or assets available for distribution to the relevant claimants. Most of the rules of tracing are well established at appellate level, which means that there is already a relatively high degree of legal certainty in this area.
- 143 It is not necessary to set out the rules of tracing in any detail; reference should be made to specialist commentaries.⁸⁴ Some of the key rules of

tracing can be illustrated by the following examples (all of which involve money, but could be adapted to any other fungible assets):

- (a) Suppose that Charlie, introduced above, holds funds of £1 million on trust for Alice. The trust funds are then wrongfully transferred into the Charlie's own bank account with an existing balance of £1 million, resulting in a mixed account with a total balance of £2 million. Charlie then dissipates £1 million of the funds held in the mixed account (e.g. to repay an unsecured personal loan). In those circumstances, Charlie is treated as having dissipated his own funds before dissipating the trust funds. This means that the remaining balance of £1 million held in the mixed account belongs to Alice (and will not be available to Charlie's creditors in the event of his bankruptcy).
- (b) On the other hand, suppose that Charlie uses £1 million in the mixed account to buy a valuable asset (such as shares). Alice may then prefer to "trace" into the shares, which means that the shares will be treated as trust property belonging to her.
- (c) Because Charlie is regarded as a wrongdoer, Alice can pursue whichever of those two remedies is better for her.
- 144 However, the position is more difficult if Charlie holds money for Alice and Bob mixed together in a single account. If there is a shortfall between the total amount of their claims and the balance of the mixed account, then the shortfall should ordinarily be borne proportionately by Alice and Bob.
- In some cases, it has been suggested that a "first in, first out" rule should apply as between innocent beneficiaries. According to this rule, payments out of a running account (i.e. one that is subject to continual credits and debits) are allocated to payments into the account in chronological order. So if Charlie receives £2m from Alice, then receives £2m from Bob, then spends £3m, the money spent is allocated first to Alice (as "first in") until her contribution is exhausted, and only then to Bob. The result is that the £1m remaining in the account is treated as Bob's. This rule is not always applied, however, if it is fairer for the losses or gains to be borne or shared rateably by A and B. In this regard, it has been held that the "first in, first out" rule will be displaced if another approach is more practical or more consistent with the intention of those contributing to the fund.⁸⁵

Second framework: statutory regimes such as CASS

- 146 In the UK, investment banks (as well as brokers, custodians and other such firms) are normally subject to special rules for dealing with client money and client assets. These special rules displace the general rules of tracing with a more detailed and bespoke statutory regime.
- 147 For example, as regards client money, FCA-regulated firms are subject to the rules set out in the Client Assets Sourcebook ("CASS") promulgated by the FCA. 86 This imposes a statutory trust on client money held by the relevant firm and lays down a statutory order of priority (known as a "waterfall") for distributing client money in the event of the firm's insolvency, superseding the rules of tracing that would otherwise apply at common law. The CASS rules were the subject of extensive litigation (up to the Supreme Court) in the Lehman Brothers insolvency. 87
- 148 The CASS regime is complicated but it represents a self-contained and very detailed code for dealing with client money and allocating shortfalls between competing clients in the event of the firm's insolvency.
- 149 In addition, there is a statutory regime for dealing with client assets (not being client money) held by insolvent investment banks: see regulation 12(2) of the Investment Bank Special Administration Regulations 2011, which provides that any shortfall shall "be borne pro rata by all clients for whom the investment bank holds securities of that particular description in that same account in proportion to their beneficial interest in those securities". Again, this statutory regime supersedes the general rules of tracing.

Treatment of digital assets

150 As a matter of principle, it is clear that the general rules of tracing are capable of applying to digital assets. It has often been said that the rules of tracing are capable of being adapted to deal with sophisticated and elaborate dealings in money, securities and other intangible assets, ⁸⁸ and there is no reason why the same process of adaptation cannot be applied to digital assets. Although digital assets are created with new technology, they do not require a fundamental change in the longstanding legal analysis of tracing, mixed accounts, insolvency shortfalls and so forth. That is particularly true in circumstances where a fraud has been committed and the Court is trying to do justice between

- innocent victims (which is the most common context in which the rules of tracing fall to be applied).
- 151 That said, the analysis is likely to depend on the precise nature of the digital assets in question. For certain digital assets (especially those using UTXOs), the underlying algorithms are themselves based on "first in, first out" allocations, and this might well have an impact on whether it is fair to apply the "first in, first out" rule for the purposes of tracing. (As noted above, the application of the "first in, first out" rule will depend on whether that approach is practical and consistent with the intention of those contributing to the fund.)
- 152 It remains unclear whether, and to what extent, the special regulatory regimes set out above (including, for example, the CASS regime) are currently applicable, or will in the future be applied, to digital assets. Taking the CASS rules as an example, "client money" is defined as "money of any currency ... that a firm receives or holds for, or on behalf of, a client ..." It is unlikely that any digital assets will fall within this description, since digital assets do not (yet) constitute any form of currency. The FCA has stated that some digital assets "are likely to be subject to the CASS regime" (not as client money, but as "specified investments"), ⁸⁹ although the precise regulatory position remains unresolved.
- 153 There is a similar issue regarding which (if any) digital assets would be treated as "securities" for the purposes of the Investment Bank Special Administration Regulations 2011. These are defined as "financial instruments as defined in regulation 3 of the Financial Collateral Arrangements (No.2) Regulations 2003", which are in turn defined as shares, bonds and other debt instruments tradeable on the capital markets, and derivative securities in respect thereof. Taken at face value, this definition does not apply to any digital assets, although the analysis will (as always) depend on the precise nature of the asset in question. 90

8 Available procedures

What interlocutory, investigatory or enforcement procedures are available to insolvency office-holders under English law, in order to

get in digital assets or their monetary equivalent for the benefit of the insolvent estate?

154 Office-holders have wide-reaching interlocutory, investigatory and enforcement powers available to them to assist not only in the collection of an insolvent company's property but also to seek information and records relating to such property. These powers are granted to office-holders of a company in administration, administrative receivership, provisional liquidation or liquidation pursuant to sections 234, 235 and 236 of the Insolvency Act 1986. The powers are particularly important as often a company's records may be outdated, deficient or inaccurate. As outlined below, these powers are extensive and should be of practical assistance to office-holders in the investigation, collection and administration of digital assets in the context of a company's insolvency.

s 234: Getting in the company's property

- 155 This section enables the court to require any person in possession or control of property or records to which the company appears to be entitled to deliver that property to the insolvency office-holders.
- 156 It also protects the office-holders against potential claims for loss or damage resulting from seizing (or disposing) of property which subsequently transpires not to be property of the company.

s 235: Duty to co-operate with office-holder

- 157 This section imposes a duty on certain parties to provide such information as may be "reasonably required" by an office-holder to a company in administration, administrative receivership, provisional liquidation or liquidation proceedings.
- 158 A wide range of people related to the company are subject to this duty, including:
 - officers and former officers of the company;
 - those who have taken part in the formation of the company at any time within one year before the company entered into insolvency;
 - employees and former employees of the company within one year before the company entered into insolvency;

- officers or employees (including former officers and employees within the year prior to the company's entry into insolvency) of another company which is, or within the year prior to the company entering insolvency was, an officer of the company in question; or
- in the case of a company being wound up by the court, any person who has acted as administrator, administrative receiver or liquidator of the company.
- 159 Office-holders have the power to require such parties to provide "information concerning the company and its promotion, formation, business, dealings, affairs or property". Should the relevant parties not comply with the office-holder's request within a reasonable timescale, the office-holder may apply to court to compel compliance. A person is liable to a fine if they fail to comply with this duty to co-operate without reasonable excuse.⁹¹

s 236: Inquiry into company's dealings, etc.

- 160 This section permits the court, on the application of the insolvency office-holder, to require a party to give disclosure, provide an account of dealings, or produce books, papers or records relating to a company in insolvency proceedings.
- 161 The scope of this section is even broader than section 235; affected parties comprise:
 - any officer of the company;
 - any person known or suspected to have in his possession any property of the company or supposed to be indebted to the company; or
 - any person whom the court thinks capable of giving information concerning the promotion, formation, business, dealings, affairs or property of the company.
- 162 Where such powers are applied as against persons outside the jurisdiction of the English court, it will be necessary to obtain the permission of the court for service in the relevant country. Where an order is made under section 236 of the Insolvency Act 1986 against a person who is present in England, the court may restrain that person

from leaving the jurisdiction or require that they give security as a condition of leaving the country.

Effectiveness of existing powers

- 163 The regime set out in sections 234–236 of the Insolvency Act 1986 is extensive and far-reaching and should assist office-holders in seeking to recover digital assets which form part of an insolvent estate. The essential item of information for the office-holder is the private key relating to, and giving control over, a digital asset. The regime enables office-holders to apply to court for an order to compel any person who knows or has access to the private key to disclose it, whether or not that person is an employee or officer of the company.
- 164 A wallet⁹² is likely to be secured using a further password or access code; the disclosure regime is broad enough to permit on office-holder to recover that information too.
- 165 There are practical impediments to the effective exercise of an office-holder's powers in sections 234–236 given that access to a private key or wallet may be limited to only one individual, who may be in a foreign jurisdiction or whose whereabouts may be unknown. While foreign enforcement of the provisions of the Insolvency Act 1986 is outside the scope of this statement, it is noteworthy as being a practical hurdle to bear in mind when seeking relief pursuant to sections 234–236.
- 166 It is also noteworthy that existing powers are predicated on the digital assets or information being the property or records "of the company". It is therefore critical for office-holders to identify how, and by whom, the digital asset is held. This may be a challenge, particularly as there is often a question as to whether the digital assets are truly "property" of the insolvent estate or merely held on behalf of others by the insolvent estate (for example if the company acted as a digital asset exchange or custodian). Helpfully, section 234(2) of the Insolvency Act 1986 extends to property or records to which the company "appears to be entitled" i.e. an office-holder does not need to be certain that the digital assets in question are property of the insolvent estate, it is enough that the insolvent estate appears to be "entitled" to it.
- Similarly, and as outlined above, the digital and global nature of the assets themselves will present practical impediments to investigating and procuring information in respect of them, including from the holders of such information. This may be a challenge, even if such individuals

were compelled by order of the court to provide such information, as it may require extra-territorial relief to be sought and therefore the cooperation of foreign courts in an office-holder's pursuit of information.

168 In respect of these challenging practical hurdles, it would be advisable for office-holders to seek the counsel and assistance at an early stage of those who have expertise in identifying and locating the whereabouts of digital assets including in respect of the individuals with knowledge or possession of the assets in question. This initial practical step will assist office-holders in their subsequent pursuit and enforcement of information relating to the assets of the insolvent estate by reference to the existing statutory regime in place.

Appendices

Appendix 1 - The consultation paper

UK Jurisdiction Taskforce of the LawtechUK Delivery Panel

Public consultation

Digital Assets and English Insolvency Law

UK Jurisdiction Taskforce

17 October 2023

Foreword

by Sir Geoffrey Vos, Master of the Rolls

In November 2018, the UK Jurisdiction Taskforce published its **Legal Statement on the Status of Cryptoassets and Smart Contracts**. The Legal Statement expressed the view that cryptoassets were property and smart contracts were contracts under English law, and has been well received in many jurisdictions.

In April 2021, the UK Jurisdiction Taskforce published its **Digital Dispute Resolution Rules** to be incorporated into on-chain digital relationships and smart contracts. They allow for arbitral or expert dispute resolution in very short periods, for arbitrators to implement decisions directly on-chain using a private key, and for optional anonymity of the parties.

In February 2023, the UK Jurisdiction Taskforce published its **Legal Statement on the issuance and transfer of digital securities under English private law**. This Legal Statement addressed the question of whether equity, debt or other securities can be validly issued and transferred under English law using blockchain systems.

The UK Jurisdiction Taskforce has now turned its attention to the way in which English insolvency law applies to digital assets. We are asking experts and members of the public to provide their input into the questions that the proposed **Legal Statement on Digital Assets and English Insolvency Law** can most usefully answer.

We will be very grateful to receive responses from as many people as possible in the legal, digital and insolvency sectors. The UKJT intends to host a public event to discuss the consultation in November 2023. It will formally close the consultation on Monday 4 December.

It is intended that an expert panel within the UKJT will prepare the Legal Statement for publication thereafter.

The UKJT comprises:-

Sir Geoffrey Vos (Chancellor of the High Court and Chair of the UKJT)

Professor Sarah Green (Law Commissioner for commercial and common law, as an observer)

Richard Hay (Linklaters LLP)

Lawrence Akka KC (Twenty Essex)

David Quest KC (3 Verulam Buildings)

Peter Hunn (Accord Project)

Nicholas Smith (Crypto Policy, Financial Conduct Authority as an observer)

Mary Kyle (City of London Corporation)

Sir Richard Snowden (Lord Justice of Appeal)

Sir Antony Zacaroli (Justice of the High Court)

For present purposes, by 'digital assets' we mean a digital asset, such as a crypto-token or an NFT, that is (under English private law) capable of being the object of personal property rights, but that is neither a thing in action nor a thing in possession. In that sense, we attribute to the term a broadly equivalent meaning to that given to "digital objects" in the Law Commissions Final report on Digital Assets (Law Com No 412)

Consultation on the Digital Assets and English² Insolvency Law

1 The UK Jurisdiction Taskforce

The UK Jurisdiction Taskforce (UKJT) is a part of LawtechUK, an industry-led group tasked with supporting the digital transformation of the UK legal services sector and with positioning English law as a law of choice for new technologies.

The UKJT brings together the Judiciary, the Law Commission of England and Wales, the regulators and technology and legal professionals within its membership. The remit of the UKJT is to provide legal certainty for new technologies under English law.

In November 2019, the UKJT published an authoritative legal statement on the legal status of cryptoassets and smart contracts.³ The legal statement was drafted by a panel of practising lawyers (Lawrence Akka KC, David Quest KC, Matthew Lavy and Sam Goodman) and has since received judicial approval in various jurisdictions. It has been instrumental in providing legal certainty that certain cryptoassets are to be regarded as property under English law and that English law will support legally binding smart contracts. The legal statement was preceded by a public consultation process, which informed the list of questions to be addressed.

The UKJT has also undertaken other work in this area, including publishing a second legal statement (this time addressing issuance and transfer of digital securities under English private law)⁴, publishing a set of digital dispute resolution rules (which seeks to enable the rapid resolution of blockchain and crypto legal disputes)⁵ and publishing a report on Smarter Contracts.⁶

2 Background to this consultation

Digital transformation has become a top priority for many institutions operating in the financial markets. It is widely recognised that blockchain, DLT and associated technologies offer significant potential in this regard. Institutional investors have increasingly embraced digital assets in their portfolios. The UK, including the UK legal services sector, would benefit considerably if English law and forum were to be a leading choice of law/forum for such arrangements.

At the same time, the past 18 months have seen increased turbulence in the digital asset markets. Recent high-profile collapses of digital asset exchanges, platforms and funds⁷ have highlighted the importance of robust insolvency processes to ensure fair and predictable outcomes in respect of this form of investment.

² In this consultation paper, references to "English law" should be read as references to the law of England and Wales.

³ Available at https://lawtechuk.io/explore/cryptoasset-and-smart-contract-statement

⁴ Available at https://ukjt.lawtechuk.io/

⁵ Available at https://resources.lawtechuk.io/files/2.%20UKJT%20Digital%20Disupte%20Rules.pdf

⁶ Available at https://lawtechuk.io/programmes/smarter-contracts

See e.g. Mt. Gox, FTX, Zipmex, Terra, Celsius, Voyager Digital and Three Arrows Capital

Including in light of the collapses referenced above, the application to digital assets of the insolvency regimes of various other jurisdictions has now been tested in the courts of those jurisdictions.

The English courts have thus far not had occasion to address the application of various important English insolvency law concepts to digital assets. English insolvency law is nevertheless on any view capable of coherent application to an extremely broad range of assets.

In order to provide clarity to the market as to the application of English insolvency law to digital assets, the UKJT accordingly sees merit in delivering a further legal statement, (a "Legal Statement on Digital Assets and English Insolvency Law").

The aim of this consultation paper is to ensure that the issues addressed in the Legal Statement on Digital Assets and English Insolvency Law are those about which key stakeholders are most concerned.

3 Scope of the Legal Statement on Digital Assets and English Insolvency Law

Following initial exploratory discussions with legal and insolvency practitioners, the UKJT understands that such practitioners would welcome guidance and certainty as to how various aspects of the English insolvency law regime apply to issues involving digital assets.

Further, the UKJT has been advised that greater certainty, in that respect, would potentially assist investors when choosing English law as the governing law for e.g. debt instruments, or selecting England as a forum for pre-insolvency restructuring or a formal insolvency (and, if a formal insolvency, selecting which type of procedure to use).

The purpose of the proposed Legal Statement is accordingly to offer such guidance and promote certainty, by seeking to answer questions relating to the application of English insolvency law principles to digital assets. A draft set of such questions is set out in the Annex to this consultation paper. The purpose of this consultation is to seek input from key stakeholders on this list of questions.

4 Consultation questions

Your input is sought in relation to the following question:

Are there any material issues of concern to stakeholders in relation to the application of English insolvency law to digital assets, other than those set out in the Annex to this consultation paper?

In your response, you are also invited to comment on the questions in the Annex to this consultation paper (for example, are any of these questions not material, or could they be framed

differently). There is no need to provide an answer to those questions themselves (although you may of course do so if you wish).

5 Consultation process

This consultation will remain open for responses until Monday 4 December. Once this consultation has closed and the results have been considered, it is intended that the Legal Statement on Digital Assets and Insolvency Law will be published in early 2024. It will then be possible to see whether any further steps are necessary or appropriate.

Written responses to the consultation questions should be provided by email to UKJT@justice.gov.uk

The UKJT will also be hosting a virtual consultation event in order to receive feedback on the consultation questions. This will take place on Tuesday 28 November. The UKJT will provide further detail in due course.

Annex

Questions to be addressed in the Legal Statement on Digital Assets and Insolvency

Each of the following questions is posed as a matter of English law:

- Are digital assets "property" forming part of the estate of the insolvent company or individual for the purposes of the English insolvency legislation?
- 2 For international allocation of insolvency jurisdiction based upon location of centre of main interests (COMI), what rules apply to determine where digital assets are located and/or administered?
- 3 Is a claim to digital assets held by a company or bankrupt capable of being a claim to recover property? If so, what factors determine whether it is to be so characterised.
- If a claim to digital assets held by a company or bankrupt is a monetary claim, is it a claim for a liquidated sum so as to be capable of founding a statutory demand/winding up petition? Is it a claim in a "foreign currency" such that it should be converted to the currency of the insolvency on day one?
- Are office-holders subject, generally, to any obligations in relation to holding/realisation of volatile digital assets in an English insolvency?
- 6 Can you perceive any difficulties in the application of the English insolvency legislation relating to avoidance of prior transactions to pre-insolvency dealings with digital assets? If so, what are they?
- If a claim to digital assets held by a custodian company can be a proprietary claim, what mechanisms are available to deal with mixing of the property of various clients and/or a shortfall in an insolvency of an exchange or custodian?
- What interlocutory, investigatory or enforcement procedures are available to insolvency officeholders under English law, in order to get in digital assets or their monetary equivalent for the benefit of the insolvent estate?

Appendix 2 - List of respondents to the consultation

LawtechUK and its UK Jurisdiction Taskforce are grateful to the academic experts and industry leaders who have contributed to the Legal Statement on Digital Assets and English Insolvency Law through the public consultation and as expert consultees, including those who have agreed to be named below:

Dr Alisdair MacPherson, Professor Donna McKenzie Skene and Dr Chike Emedosi, Centre for Commercial Law and the Centre for Scots Law, University of Aberdeen

Etay Katz, Ashurst LLP

The City of London Law Society

Crypto Fraud and Asset Recovery Network

Catherine Phillips, Gowling WLG

Celine Buttanshaw, Willkie Farr & Gallagher (UK) LLP

Göker Tataroğlu, Bilkent University Faculty of Law

Gabrielle Ruiz, Tim Lees, Chris Norman, Clifford Chance LLP

Joanna Ford, Irfan Baluch, Cripps

Insolvency Lawyers Association

Julian Turner, Charles Kerrigan, CMS

The International Digital Assets Counsel Association

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Notes

- including Mt. Gox, FTX, Zipmex, Terra, Celsius, Voyager Digital and Three Arrows Capital.
- ² for brevity, we refer to the law of England and Wales as English law.
- Legal Statement on Cryptoassets and Smart Contracts (November 2019), Legal Statement on the Issuance and Transfer of Digital Securities under English Private Law (February 2023), both available at https://ukjt.lawtechuk.io.
- 4 <https://lawtechuk.io/events/public-consultation-for-the-legal-statement-on-digital-assets-and-english-insolvency-law-28-november-2023/>.
- ⁵ <https://twentyessex.com/people/lawrence-akka/>.
- ⁶ https://3vb.com/barrister/david-quest-kc/.
- ⁷ .
- ⁸ <https://essexcourt.com/barrister/alexander-riddiford/>.
- ⁹ https://southsquare.com/barristers/ryan-perkins/>.
- ¹⁰ https://www.kirkland.com/lawyers/c/crawford-hannah>.
- 11 https://matter-labs.io/>
- Strictly, the term 'property'does not describe a thing itself but a legal relationship with a thing: it is a way of describing a power recognised in law as permissibly exercised over the thing: Legal Statement on Cryptoassets (n 3) para 35.
- Tulip Trading v Van Der Laan [2023] EWCA Civ 83, [2023] 4 WLR 16. There is a helpful list of cases at Law Commission, "Digital Assets: Final Report", Law Com No 412, para 3.41.
- ¹⁴ (n 3) paras 108–109.
- Bristol Airport plc v Powdrill [1990] Ch 744, 759 (Browne-Wilkinson VC); In re GP Aviation Group International Ltd (in liquidation) [2013] EWHC 1447 (Ch), [2014] 1 WLR 166 [25] "the definition ... is cast in the widest terms".
- For an example of the treatment of digital assets as property in this context, see the Joint Administrators' Final Progress Report for Dooga Ltd (Trading As Cubits) In Administration (No 010642 of 2018)

https://www.thegazette.co.uk/company/04430228/filing-history/MzI1MDq4NjM2MmFkaXF6a2N4.

- ¹⁷ https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border_insolvency>.
- i.e. Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), as now given effect in this jurisdiction by the Insolvency (Amendment) (EU Exit) Regulations 2019.
- ¹⁹ Eurofood IFSC Limited (Case C-341/04) [2006] Ch 508; Interedil Srl v Fallimento Interedil Srl [2012] Bus LR 1582; Shierson v Vlieland-Boddy [2005] BCC 949; Re Galapagos SA [2022] EWHC 1633 (Ch); East-West Logistics LLP v Melars Group Ltd [2022] EWCA Civ 1419
- ²⁰ In this regard, see in particular the Law Commission's recent work on this topic (https://lawcom.gov.uk/project/digital-assets-and-etds-in-private-international-law-which-court-which-law/); also the Legal Statement on Cryptoassets paras 89ff (n 3).
- Ion Science Ltd v Persons Unknown (unreported) (21.12.2020) and Fetch.Al Ltd v Persons Unknown [2021] EWHC 2254 (Comm).
- The question of the *lex situs* of digital assets also arose in *Zipmex* (below n 23), where it was argued by the applicants that the companies had a "substantial connection" with Singapore for the purposes of establishing jurisdiction under ss 64 and 65 IRDA on the basis that the lex situs of the digital assets in question was Singaporean law. However, these points were not fully argued and were not decided in *Zipmex*.
- ²³ Re Zipmex Pte Ltd and other matters [2022] SGHC 196 https://www.elitigation.sg/gd/s/2022_SGHC_196.
- Private keys are typically long and unmemorable strings of letters and numbers, and, therefore, for convenience and practicality are usually stored and retrieved using software known as a 'wallet'. Wallets are referred to as 'hot' or 'cold' depending on whether they run online (e.g. on a website) or offline (e.g. on a USB stick or similar dedicated hardware).
- ²⁵ (n 23) [18].
- ²⁶ (n 19).
- ²⁷ As the Law Commission notes, the existence (and breach of) a fiduciary obligation on the part of the holder could entitle users to seek a proprietary remedy (such as disgorgement of profits): Law Commission, "Digital Assets: Final Report", Law Com No 412, para 7.26(2).

- ²⁸ Celsius Network LLC https://cases.stretto.com/Celsius/court-docket/, Voyager Digital Holdings Inc https://cases.stretto.com/Voyager/court-docket/, Voyager
- ²⁹ Law Commission, "Digital Assets: Final Report", Law Com No 412, para 7.26(1), fn 13.
- Ruscoe v Cryptopia Limited (in liquidation) [2020] NZHC 728, [2020] 22 ITELR 925 (New Zealand); Quoine Pte Ltd v B2C2 Ltd [2020] SGCA(I) 02 (Singapore); Re GateCoin Ltd (In Liquidation) [2023] HKCFI 914 (Hong Kong).
- ³¹ e.g. Bridge, Gullifer and ors: *The Law of Personal Property* (3rd Ed, Sweet & Maxwell 2022) para 15–027.
- ³² (n 24).
- See, in particular: B2C2 Ltd v Quoine Pte Ltd [2020] SGCA(I) 02; [2019] SGHC(I) 03 and Ruscoe v Cryptopia [2020] NZHC 728, [2020] 22 ITELR 925 (High Court of New Zealand).
- 34 Insolvency Act 1986, s 123(1)(a).
- ³⁵ Insolvency Act 1986, s 123(1)(e).
- ³⁶ Insolvency Act 1986, s 123(2).
- ³⁷ Insolvency Act 1986, s 267(1).
- ³⁸ Insolvency Act 1986, s 267(2)(b).
- ³⁹ Insolvency Act 1986, s 267(2)(c).
- Insolvency Act 1986, s 268; The Insolvency (England and Wales) Rules 2016 SI 2016/1024, r 10.1 (The statutory demand (section 268)).
- Insolvency Act 1986, s 268(1)(a), referring back to s 267(2), which contains cumulative requirements. See also Standard Chartered Bank v Dorchester LNG [2016] QB 1 [38].
- ⁴² Dusoruth v Orca Finance UK Ltd [2022] EWHC 2346 [123] (ICC Judge Mullen). In addition, "it does not matter whether the petitioner puts a figure on his claim, even if he can calculate it "down to the last penny". It must be liquidated either because the quantification of the debt is one from which the debtor is not permitted to resile as a matter of admission, acknowledgment or agreement, or because it has been determined as a matter of the court process."
- ⁴³ Miller v Race (1758) 1 Burr 452, 457.
- 44 Law Commission, "Digital Assets: Final Report", Law Com No 412.

- ⁴⁵ At least in England and Wales and other jurisdictions that have not adopted certain digital assets as legal tender.
- ⁴⁶ (n 40).
- ⁴⁷ See also the definition of "bankruptcy debt" in Insolvency Act 1986, s 382.
- ⁴⁸ HC/CWU 246/2022 (30 March 2023) (General Division of the High Court, Singapore).
- ⁴⁹ Re T&N Ltd [2005] EWHC 2870 (Ch), [2006] 1 WLR 1728.
- ⁵⁰ Re Lehman Brothers [2009] EWCA Civ 1161, [2010] 1 BCLC 496.
- ⁵¹ Insolvency Rules 1986, r 14.21.
- ⁵² Para 66.
- ⁵³ Insolvency Rules 1986, r 14.14.
- See also Mr Justice Antony Zacaroli's October 2019 lecture to the Insolvency Lawyers Association entitled "Crypto-currencies and insolvency": https://www.ilauk.com/docs/ILA_-_AZ_Talk_Crypto-currencies_and_insolvency.pdf
- ⁵⁵ Insolvency Rules 2016, r 14.23.
- ⁵⁶ Insolvency Rules 2016, r 14.25.
- ⁵⁷ See, respectively, r 14.24(8)(b)(i) and r 14.25(8)(b)(i) of the Insolvency Rules 2016.
- ⁵⁸ Insolvency Act 1986, Schedule B1, paragraph 67.
- ⁵⁹ Insolvency Act 1986, Schedule B1, paragraph 59(1).
- 60 Insolvency Act 1986, Schedule B1, paragraph 5.
- ⁶¹ Ex p James (1873-74) L.R. 9 Ch App 609; Re One Blackfriars Ltd [2021] EWHC 684 (Ch) [205].
- ⁶² See eg *Davey v Money* [2018] EWHC 766 (Ch), [2018] Bus LR 1903 [622].
- 63 Re Charnley Davies (No 2) [1990] BCC 605 [618].
- ⁶⁴ Michael v Miller [2004] EWCA Civ 282.
- 65 Insolvency Act 1986, Schedule B1 para 3(4).

- 66 Insolvency Act 1986, Schedule B1, para 3.
- ⁶⁷ Insolvency Act 1986, Schedule B1, para 3(4)(b).
- 68 Insolvency Act 1986, Schedule B1, para 4.
- ⁶⁹ A pre-packaged sale in administration is an arrangement pursuant to which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator, and the sale contract executed on the appointment of the administrator or very shortly thereafter.
- ⁷⁰ Insolvency Act 1986, s 160(1).
- ⁷¹ Insolvency Act 1986, s 168(4).
- ⁷² Patley Wood Farm LLP and others v Kicks and another [2023] EWCA Civ 901.
- ⁷³ Insolvency Act 1986, s 326.
- ⁷⁴ Insolvency Rules 2016, r 14.13.
- ⁷⁵ Singla v Hedman (No 2) [2010] EWHC 902 (Ch).
- ⁷⁶ Re Fastfit Station Ltd; Bonney v Barker [2023] EWHC 496 (Ch).
- 77 Re Sofra Bakery Ltd [2013] EWHC 1499 (Ch).
- ⁷⁸ See paras 42–48, especially at para 45.
- ⁷⁹ for the reasons given in the UKJT's November 2019 Legal Statement on Cryptoassets and Smart Contracts at paras 100–106.
- ⁸⁰ Re Branston & Gothard Ltd [1999] BPIR 466.
- 81 Pettit v Novakovic [2007] BCC 462.
- 82 (n 84).
- ⁸³ Goff & Jones, *The Law of Unjust Enrichment* (10th ed, Sweet & Maxwell 2022) para 7-18. This is a consequence of the obiter remarks made by Lord Millet and Lord Steyn in_Foskett v McKeown [2001] 1 AC 102, where Lord Steyn (at [113]) and Lord Millett (at [128]–[129]) both said that there is now only one set of tracing rules in English law, applicable to common law and equitable claims alike. However, it must be acknowledged that there are cases that point in the contrary direction: see *Tecnimont Arabia Ltd v National Westminster Bank plc* [2023] Bus LR 106 [150] (HHJ Bird sitting as a High Court Judge), where it was common ground that it was impossible to trace through a mixed fund at common law.

- ⁸⁴ See Tucker and ors: Lewin on Trusts (20th Ed, Sweet & Maxwell, 2020) Chapter 44.
- ⁸⁵ National Crime Agency v Robb [2015] Ch 520 [64]–[65] (Sir Terence Etherton C).
- 86 https://www.handbook.fca.org.uk/handbook/CASS/.
- ⁸⁷ Re Lehman Brothers International (Europe) [2012] Bus LR 667.
- 88 Federal Republic of Brazil v Durant International Corp [2016] AC 297 [39] (Lord Toulson).
- 89 https://www.fca.org.uk/news/statements/notice-regulated-firms-exposure-cryptoassets.
- 90 See also Law Commission, "Digital Assets: Final Report", Law Com No 412, para 8.47ff. The conclusion reached by the Law Commission is that crypto-tokens generally do not fall within the scope of the FCAR regime, but that a different answer might conceivably apply to other classes of digital assets.
- 91 Insolvency Act 1986, s 235(5).
- ⁹² (n 24).

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KeyCite Yellow Flag - Negative Treatment

Distinguished by Samuels v. Dao, N.D.Cal., November 18, 2024

664 F.Supp.3d 1100 United States District Court, S.D. California.

Christian SARCUNI, et al., on behalf of themselves and other similarly situated, Plaintiffs,

BZX DAO, et al., Defendants.

Case No.: 22-cv-618-LAB-DEB

Signed March 27, 2023

Synopsis

Background: Noncitizen users of blockchain-based software who individually lost between \$800 and \$450,000 in phishing attack brought putative class action against purported general partners of the decentralized autonomous organization that operated the software for negligence. Defendants moved to dismiss on various grounds.

Holdings: In a case of apparent first impression, the District Court, Larry Alan Burns, J., held that:

- [1] users sufficiently alleged that defendants had a duty to exercise reasonable care with respect to management and protection of funds users deposited;
- [2] users sufficiently alleged that defendants breached that duty of care;
- [3] users plausibly alleged that a general partnership existed, in support of their theory of liability against defendants;
- [4] one defendant did not have sufficient minimum contacts with California to establish specific personal jurisdiction over him:
- [5] complaint did not demonstrate an irreconcilable conflict of interest between named plaintiffs and putative class members;
- [6] complaint would not be dismissed for insufficient service of process; and

[7] users sufficiently alleged a causal nexus between their injuries and the conduct of two named defendants.

Ordered accordingly.

Procedural Posture(s): Motion to Dismiss for Failure to State a Claim; Motion to Strike All or Part of a Pleading; Motion to Dismiss for Lack of Personal Jurisdiction; Motion to Dismiss for Lack of Subject Matter Jurisdiction; Motion to Dismiss.

West Headnotes (57)

[1] Evidence Administrative proceedings and

Federal Civil Procedure Matters considered in general

District court would take judicial notice of the Commodity Future Trading Commission's (CFTC) order instituting proceedings against purported general partners of decentralized organization that autonomous blockchain-based software that was hacked to determine whether they violated the Commodity Exchange Act, when ruling on partners' motion to dismiss negligence claim asserted against them by noncitizen users of the software, who individually lost money in the hack, since the CFTC order was administrative material. Commodity Exchange Act, § 1 et seq., 7 U.S.C.A. § 1 et seq.; Fed. R. Civ. P. 12(b)(6); Fed. R. Evid. 201(b).

[2] Federal Civil Procedure Matters considered in general

In ruling on motion to dismiss for failure to state claim, courts may consider relevant matters subject to judicial notice. Fed. R. Civ. P. 12(b) (6); Fed. R. Evid. 201(b).

[3] Negligence 🕪 Elements in general

In order to establish negligence under California law, a plaintiff must establish four required

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elements: (1) duty; (2) breach; (3) causation; and (4) damages.

[4] Negligence Processity and Existence of Duty

Under California law, the general rule is that people owe a duty of care to avoid causing harm to others and that they are thus usually liable for injuries their negligence inflicts.

[5] Negligence Economic loss doctrine

Under California law, liability in negligence for purely economic losses is the exception, not the rule.

[6] Negligence Economic loss doctrine

Under California law, primary exception to the general rule of no-recovery for negligently inflicted purely economic losses is where the plaintiff and the defendant have a special relationship.

[7] **Negligence** Economic loss doctrine

Under California law, as part of analysis into existence and scope of defendant's duty of reasonable case, in a negligence action involving purely economic losses, courts consider six factors to determine whether a special relationship exists: (1) the extent to which the transaction was intended to affect the plaintiff, (2) the foreseeability of harm to the plaintiff, (3) the degree of certainty that the plaintiff suffered injury, (4) the closeness of the connection between the defendant's conduct and the injury suffered, (5) the moral blame attached to the defendant's conduct, and (6) the policy of preventing future harm.

[8] Finance, Banking, and

Credit ← Obligations Imposed; Practices Prohibited or Required

Users of blockchain-based software sufficiently alleged that software operator had a duty to exercise reasonable care with respect to management and protection of funds deposited, as required to state a claim for negligence under California law against operator, arising from a phishing attack that resulted in \$55 million dollar theft; users alleged that they used software after connecting a wallet and depositing supported cryptocurrency, that operator was targeted by three previous hacks, that \$1.7 million of users' cryptocurrency was stolen, that but for operator's failure to implement promised security measures, users' cryptocurrency would have been safe, and that a finding that operator owed users a duty furthered policy of preventing future harm arising from negligent oversight of security measures.

[9] Finance, Banking, and

Credit Obligations Imposed; Practices Prohibited or Required

Users of blockchain-based software sufficiently alleged that software operator breached its duty to exercise reasonable care with respect to management and protection of funds deposited, as required to state a claim for negligence under California law against operator, arising from a phishing attack that resulted in \$55 million dollar theft; users alleged that a software developer was sent a phishing email to his personal computer that contained an attachment that when opened ran a script on his personal computer, enabling the hacker to access developer's private keys that then provided access to users' funds, that private keys had been used previously to successfully target the software in similar hacks, and that operator failed to implement promised security measures that would have prevented users' injuries.

[10] Partnership > Implied agreements

Under California law, persons may unintentionally create a partnership where their actions and behavior demonstrate an intent to

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engage in business together. Cal. Corp. Code § 16202.

[11] Partnership Partnership Partnership

Under California law, the existence of a partnership is a question of fact. Cal. Corp. Code § 16202.

[12] Partnership — Creation and Requisites in General

Under California law, a plaintiff can plead the existence of a partnership by making specific factual allegations demonstrating: (1) the right of the purported partners to participate in the management of the business; (2) the sharing of profits and losses among the purported partners; and (3) contributions of money, property, or services by the purported partners to the partnership. Cal. Corp. Code § 16202.

[13] Partnership • Sharing control or management of business

Under California law, to participate to some extent in the management of a business is a primary element in partnership organization, and it is virtually essential to a determination that such a relationship existed. Cal. Corp. Code § 16202.

[14] Partnership ← Sharing Profits and Losses Partnership ← Sharing control or management of business

Under California law, the distinguishing feature of partnership is association to carry on business together, not an agreement to share profits. Cal. Corp. Code § 16202.

[15] Partnership Particular agreements and transactions

Under California law, users of blockchain-based software plausibly alleged that decentralized autonomous organization that operated the software was an association of two or more persons and that it operated as a business for profit, in support of users' general partnership theory of liability, in negligence action seeking to recover for injuries sustained when software was hacked; users alleged that the organization was an association the holders of a cryptocurrency, or token, issued by the organization that conferred certain governance rights, or investors, and that the organization generated profits through its margin trading and lending products. Cal. Corp. Code § 16202.

[16] Partnership Particular agreements and transactions

Under California law, users of blockchain-based software plausibly alleged that holders of a cryptocurrency, or token, conferring governance and voting rights in decentralized autonomous organization that operated the software, carried on as co-owners of the organization, in support of users' general partnership theory of liability, in negligence action seeking to recover for injuries sustained when software was hacked; users alleged that tokenholders could propose spending treasury funds to hire people, changing organizational goals and policies, and even distributing treasury assets among themselves, like how corporations could authorize dividends, and that if a proposal received the required number of votes the organization would take the proposed action. Cal. Corp. Code § 16202.

[17] Partnership Sharing control or management of business

Under California law, limited governance rights do not divest a partnership of its essential nature —a partnership can still exist when individual partners only control a part of the enterprise.

[18] Partnership Sharing Profits and Losses Partnership Weight and Sufficiency

Under California law, actual sharing of profits is prima facie evidence, which is to be considered, in light of any other evidence, when determining

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if partnership exists; the fact, however, that profits and losses are not shared equally does not necessarily compel a conclusion that no partnership existed.

[19] Partnership Particular agreements and transactions

Under California law, users of blockchainbased software plausibly alleged that holders of a cryptocurrency, or token, conferring governance and voting rights in decentralized autonomous organization that operated the software shared in organization's profits, in support of users' general partnership theory of liability, in negligence action seeking to recover for injuries sustained when software was hacked; users' alleged that tokenholders could vote to distribute treasury assets among themselves, and a judicially noticed administrative order involving organization found that organization's assets were supplied by liquidity providers who, in exchange, had received interest-generating tokens, as well as tokens conferring voting rights on matters relevant to organization's governance. Cal. Corp. Code § 16202.

[20] Partnership Sharing Profits and Losses

Under California law, agreement to divide profits in a partnership implies agreement for corresponding division of losses, unless otherwise expressly stipulated.

[21] Partnership Particular agreements and transactions

Under California law, users of blockchain-based software plausibly alleged that co-founders of original entity that controlled the software, prior to their decision to transition both revenue from the software and control of aspects of the software to decentralized autonomous organization (DAO), held cryptocurrency, or tokens, issued by DAO, which made them partners in the DAO general partnership, in support of users' general partnership theory of liability, in negligence action seeking to

recover for injuries sustained when software was hacked; users alleged that co-founders participated in decision making related to partnership's governance and that the only way to participate in such decision making was by holding DAO's cryptocurrency.

[22] Partnership Particular agreements and transactions

Under California law, users of blockchain-based software failed to plausibly allege that limited liability company (LLC) that operated cryptocurrency, or token, trading platform when phishing attack and hack of software occurred was a partner in decentralized autonomous organization that operated the software, in support of users' general partnership theory of liability, in negligence action seeking to recover for injuries sustained when software was hacked; complaint did not allege that LLC held governance tokens issued by organization, that LLC participated in the management of the organization, or that it shared in the profits of the organization.

[23] Partnership Particular agreements and transactions

Under California law, users of blockchainbased software failed to plausibly allege that limited liability company (LLC) that created and controlled the software, prior to its co-founders' decision to transition both revenue from the software and control of aspects of the software to decentralized autonomous organization (DAO), was a partner in the DAO general partnership, in support of users' general partnership theory of liability, in negligence action seeking to recover for injuries sustained when software was hacked; LLC did not exist as a legal entity at time of hack, and complaint did not contain any allegations suggesting that LLC held DAO's cryptocurrency, which was required to participate in its governance, that LLC participated in the management of DAO, or that it shared in the profits of DAO.

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[24] Partnership Particular agreements and transactions

Under California law, users of blockchain-based software plausibly alleged that two limited liability companies (LLCs) held cryptocurrency, or tokens, issued by decentralized autonomous organization (DAO) that operated the software, which made them partners in the DAO general partnership, in support of users' general partnership theory of liability, in negligence action seeking to recover for injuries sustained when software was hacked; users alleged that both LLCs were investors in the software, that they participated in software decision making, and that the only way to participate in such decision making was by holding DAO's cryptocurrency.

[25] Corporations and Business

Partnership Mature and Extent of Partnership Liabilities

Under California law, co-founders of original limited liability company (LLC) that controlled blockchain-based software, prior to their decision to transition both revenue from the software and control of aspects of the software to decentralized autonomous organization (DAO), were not shielded from liability by their LLCs, in software users' negligence action against them, as general partners of the DAO general partnership, seeking to recover for injuries sustained when software was hacked; users were not seeking to hold co-founders liable as members of their LLCs.

[26] Copyrights and Intellectual Property → Technology and software licenses

Under California law, contracts formed on the internet come primarily in two flavors: "clickwrap agreements," or click-through agreements, in which website users are required to click on an "I agree" box after being presented with a list of terms and conditions of use; and "browsewrap agreements," in which a website's terms and conditions of use are generally posted on the website via a hyperlink at the bottom of the screen.

[27] Copyrights and Intellectual Property → Technology and software licenses

Under California law, browsewrap agreements are binding on a website user only when the user has actual or constructive knowledge of a website's terms and conditions.

[28] Copyrights and Intellectual Property → Technology and software licenses

Under California law, where a website makes its terms of use available via a conspicuous hyperlink on every page of the website but otherwise provides no notice to users nor prompts them to take any affirmative action to demonstrate assent, even close proximity of the hyperlink to relevant buttons users must click on, without more, is insufficient to give rise to constructive notice.

[29] Copyrights and Intellectual

Property Fechnology and software licenses

Finance, Banking, and

Credit → Obligations Imposed; Practices Prohibited or Required

Under California law, users of blockchain-based software did not have actual or constructive notice of cryptocurrency trading platform's browsewrap terms of use that they allegedly agreed to when they accessed the software via the platform, and thus the terms of use did not bar users' negligence claim against operator, arising from phishing attack and hack that resulted in multi-million dollar theft; the terms of use were located at the bottom of platform's homepage and appeared to be visible only if a user scrolled through other material, including the "start now"

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buttons used to access the platforms trading and lending features, and the terms of use were displayed in small font located below at least 18 other hyperlinks.

[30] Federal Courts 🕪 Weight and sufficiency

Plaintiff must establish that the court has personal jurisdiction over the defendant by making only a prima facie showing of jurisdictional facts to withstand the motion to dismiss; to make prima facie showing, plaintiff need only demonstrate facts that if true would support court's exercise of personal jurisdiction over the defendant. Fed. R. Civ. P. 12(b)(2).

[31] Federal Courts Presumptions and burden of proof

When ruling on a motion to dismiss for lack of personal jurisdiction, uncontroverted allegations in the complaint must be taken as true, and conflicts over statements contained in affidavits must be resolved in plaintiff's favor. Fed. R. Civ. P. 12(b)(2).

[32] Federal Courts Personal jurisdiction

Federal courts ordinarily follow state law in determining the bounds of their jurisdiction over persons. Fed. R. Civ. P. 4(k)(1)(A).

[33] Constitutional Law Pon-residents in general

Courts Actions by or Against
Nonresidents, Personal Jurisdiction In; "LongArm" Jurisdiction

California's long-arm statute allows the exercise of personal jurisdiction to the full extent permissible under the United States Constitution; the inquiry centers on whether exercising jurisdiction over a particular defendant comports with due process. U.S. Const. Amend. 14; Cal. Civ. Proc. Code § 410.10.

[34] Constitutional Law Pon-residents in general

Due process requires that a nonresident defendant have certain minimum contacts with the forum state such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice. U.S. Const. Amend. 14.

[35] Federal Courts • Unrelated contacts and activities; general jurisdiction

Federal Courts ← Related contacts and activities; specific jurisdiction

Federal courts may exercise either general or specific jurisdiction over nonresident defendants.

[36] Federal Courts • Unrelated contacts and activities; general jurisdiction

General personal jurisdiction exists when a nonresident defendant has substantial or continuous and systematic contacts with the forum state.

[37] Constitutional Law Pon-residents in general

Federal Courts Purpose, intent, and foreseeability; purposeful availment

Federal Courts Related contacts and activities; specific jurisdiction

A three-part test determines whether a non-resident defendant has sufficient contacts to be subject to specific personal jurisdiction: (1) the non-resident defendant must purposefully direct his activities or consummate some transaction with the forum or resident thereof, or perform some act by which he purposefully avails himself of the privilege of conducting activities in the forum, thereby invoking the benefits and protections of its laws; (2) the claim must be one which arises out of or relates to the defendant's forum-related activities; and (3) the exercise of

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jurisdiction must comport with fair play and substantial justice, i.e. it must be reasonable.

[38] Federal Courts Presumptions and burden of proof

Plaintiff bears the burden of satisfying the purposeful availment or purposeful direction and arising out of prongs of the test for determining whether a nonresident defendant is subject to specific personal jurisdiction, and if plaintiff does so, the burden then shifts to defendant to set forth a compelling case that the exercise of jurisdiction would not be reasonable.

[39] Federal Courts 🕪 Torts in general

For claims sounding in tort, Court of Appeals applies a purposeful direction test in determining whether it has specific personal jurisdiction over non-resident defendant, and looks to evidence that defendant has directed his actions at the forum state, even if those actions took place elsewhere.

[40] Federal Courts → Personal Jurisdiction Federal Courts → How Established; Grounds

Liability and personal jurisdiction are independent; liability depends on relationship between plaintiff and defendants and between individual defendants, and jurisdiction depends only upon each defendant's relationship with forum.

[41] Courts Shareholders, members, or other individual owners of entities

Under California law, jurisdiction over a partnership does not necessarily permit a court to assume jurisdiction over the individual partners.

[42] Courts Shareholders, members, or other individual owners of entities

Under California law, courts have jurisdiction over only those individual partners who personally established the requisite minimum contacts with California.

[43] Federal Courts Partnerships and joint ventures

Federal Courts 🦫 Torts in general

Nonresident member of general partnership that operated blockchain-based software that was hacked did not have sufficient minimum contacts with California to establish specific personal jurisdiction over him, in software users' negligence action against him, alleging that they individually lost between \$800 and \$450,000 in the hack; although users sufficiently alleged that defendant was a partner in the general partnership, users only alleged that defendant was aware that a co-partner moved to California and that he intentionally communicated with co-partner in California about partnership business.

[44] Federal Civil Procedure Procedure Representation of class; typicality; standing in general

The adequacy inquiry for class certification serves to uncover conflicts of interest between named parties and the class they seek to represent. Fed. R. Civ. P. 23(a)(4).

[45] Federal Civil Procedure Procedu

To satisfy adequacy requirement for class certification, a class representative must be part of the class and possess the same interest and suffer the same injury as the class members.

Fed. R. Civ. P. 23(a)(4).

[46] Federal Civil Procedure ← Representation of class; typicality; standing in general

To assure adequate representation, the class representative's personal claim must not be

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inconsistent with the claims of other members of the class. Fed. R. Civ. P. 23(a)(4).

[47] Federal Civil Procedure Prime for motion

Where the complaint demonstrates that a class action cannot be maintained on the facts alleged, a defendant may move to strike class allegations prior to discovery. Fed. R. Civ. P. 12(f), 23.

[48] Federal Civil Procedure 🕪 Capacity and representation, allegations of

Putative class action complaint did not demonstrate an irreconcilable conflict of interest between named plaintiffs and putative class of all people who delivered cryptocurrency tokens to blockchain-based software and had any amounts of funds stolen in phishing attack, by alleging that none of the plaintiffs or proposed class members held meaningful stakes in cryptocurrency or tokens issued by general partnership that operated the software, while also seeking to hold anyone who held such tokens liable as a general partner because the tokens conferred certain voting and governance rights, and thus motion to strike class allegations would be denied; allegation did not demonstrate that plaintiffs necessarily held tokens at issue, it could also have been interpreted to mean the plaintiffs held no tokens. Fed. R. Civ. P. 12(f), 23(a)(4).

[49] Federal Civil Procedure Process, defects

If a summons does not include the correct information, dismissal is proper for insufficient service of process. Fed. R. Civ. P. 4(b), 12(b)(4).

[50] Federal Civil Procedure Process, defects

When a defendant asserts the plaintiff named the wrong party, dismissal for insufficient service of process is inappropriate if the plaintiff subsequently states they named the defendant they intended to. Fed. R. Civ. P. 4(b), 12(b)(4).

[51] Federal Civil Procedure Process, defects

Complaint against two limited liability companies (LLCs) alleged to be general partners, in decentralized autonomous organization (DAO) general partnership that operated blockchain-based software that was hacked, by virtue of their investment and participation in partnership-related decision making, would not be dismissed for insufficient service of process, based on LLCs' contention that they were not holders of cryptocurrency, or tokens, issued by DAO, that conferred certain voting and governance rights in the DAO, which was required under users' general partnership theory of liability, where LLCs did not offer any evidence to support their contention, and complaint's allegations allowed for reasonable inference that LLCs possessed the tokens. Fed. R. Civ. P. 4(b), 12(b)(4).

Federal Civil Procedure 🕪 Jurisdictional [52] discovery

When parties dispute facts bearing on jurisdiction, court may allow limited jurisdictional discovery to resolve dispute.

Federal Courts Pleadings and motions [53]

Motion to dismiss for lack of standing is properly raised in motion to dismiss for lack of subject matter jurisdiction. Fed. R. Civ. P. 12(b)(1).

[54] Federal Civil Procedure 🕪 In general; injury or interest

Federal Civil Procedure Pausation; redressability

To establish standing, plaintiff must show injury in fact, causation, and redressability.

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[55] Federal Civil Procedure Causation; redressability

To satisfy causation prong of standing inquiry, plaintiff must demonstrate that their injury is fairly traceable to defendant.

[56] Finance, Banking, and Credit PRight of action; standing

Users of blockchain-based software who individually lost between \$800 and \$450,000 in phishing attack sufficiently alleged that their injury was fairly traceable to the negligence of decentralized autonomous organization (DAO) general partnership that operated the software, and thus had standing to bring negligence action against two limited liability companies (LLCs) alleged to be general partners, under California law; complaint's theory of liability was premised on existence of a general partnership among all persons holding specific a cryptocurrency, or token, distributed by DAO to confer governance rights, and complaint's allegations that LLCs invested in the software and participated in decision making supported the reasonable inference that LLCs held the tokens at issue. Cal. Corp. Code § 16306(a).

[57] **Partnership** • Joint and several liability in general

Under California partnership law, all partners are jointly and severally liable for partnership obligations. Cal. Corp. Code § 16306(a).

1 Case that cites this headnote

Attorneys and Law Firms

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ORDER:

1) DENYING IN PART AND GRANTING IN PART MOTION TO DISMISS, [Dkt. 27];

2) DENYING MOTION TO STRIKE, [Dkt. 27]; and

3) DENYING MOTION TO DISMISS, [Dkt. 31]

Larry Alan Burns, United States District Judge

In what appears to be a case of first impression, nineteen named Plaintiffs brought this putative class action against Kyle Kistner, Tom Bean, bZeroX LLC, Leveragebox LLC (collectively, the "Leveragebox Defendants"), Hashed International LLC, and AGE Crypto GP, LLC (the "Hashed Defendants," and, together with the Leveragebox Defendants, "Defendants") as members of a general partnership for one count of negligence. (Dkt. 21, First Amended Complaint ("FAC")). Plaintiffs allege that each Defendant is a general partner of the bZx DAO, a purported "Decentralized Autonomous Organization." The FAC also names the bZx DAO and its successor, the Ooki DAO, as Defendants. Plaintiffs allege they were injured by Defendants' negligence after a developer working for the bZx DAO was successfully targeted by a phishing attack which led to the theft of \$55 million in cryptocurrency. (Id. \P 1). The named Plaintiffs lost \$1.7 million. (Id.).

*1109 The Leveragebox Defendants move to dismiss the FAC for failure to state a claim, lack of personal jurisdiction, and to strike the FAC's class allegations (the "Leveragebox Motion"). (Dkt. 27). The Hashed Defendants

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join the Leveragebox Motion and separately move to dismiss the FAC for failure to state a claim, insufficient service, and lack of subject matter jurisdiction (the "Hashed Motion").

Having considered the parties' submissions and the relevant law, the Court **GRANTS IN PART** and **DENIES IN PART** the Leveragebox Motion, (Dkt. 27), and **DENIES** the Hashed Motion, (Dkt. 31). The claims against Tom Bean, bZeroX LLC, and Leveragebox LLC are **DISMISSED WITHOUT PREJUDICE**.

I. BACKGROUND

According to the FAC, the bZx DAO operated a blockchain-based software called the bZx Protocol, which offered cryptocurrency margin trading and lending products. (FAC ¶¶ 42–44, 68, 71). In order to understand the nature of the bZx DAO and FAC's allegations, a brief overview of cryptocurrency and the technology underlying that asset class is necessary. A cryptocurrency is a digital asset based on a network that is distributed across a large number of computers. (*Id.* ¶ 35). This decentralized computer network securely and publicly records all transactions for a given cryptocurrency on a distributed ledger called a blockchain. (*Id.* ¶ 37). Some blockchains can record transactions for multiple cryptocurrencies. (*Id.*). The blockchains at issue in this case are Ethereum, Polygon, and the Binance Smart Chain ("BSC"). (*Id.*).

An individual unit of a given cryptocurrency is called a token. (Id. ¶ 38). Tokens are fungible and tradeable. (Id.). The value of many cryptocurrencies fluctuates relative to the U.S. Dollar (or other currency), similar to how the price of a traditional commodity might fluctuate. (Id. ¶ 35). Some cryptocurrencies, like Bitcoin or Ether, can be used to purchase goods or services and are also bought, sold, and held for their value. (Id. ¶¶ 35, 37). Other cryptocurrencies take advantage of the blockchain's distributed ledger to perform functions such as recording votes. (Id. ¶ 41). Cryptocurrency tokens are stored in a digital wallet, which can be accessed with a unique password. (Id. ¶ 39).

As the cryptocurrency industry expanded, new decentralized finance, or "DeFi," applications developed that allow users to engage in increasingly complex transactions without having to interact with traditional banks or other regulated entities. (*Id.* ¶ 40). One possible method for governing a DeFi protocol is through a Decentralized Autonomous Organization ("DAO"). (*Id.* ¶ 41). DAOs don't typically take on a formal corporate structure, opting instead to

distribute governance rights among persons who hold a specific governance token. (*Id.*). Tokenholders can propose and vote on actions for the affiliated DAO to take. (*Id.*). If a proposal receives the required number of votes, the DAO adopts the proposal. (*Id.*).

At issue in this case is a DeFi application called the bZx Protocol. (Id. ¶ 42). The bZx Protocol is "a protocol for tokenized margin trading and lending." (Id.). Essentially, the bZx Protocol enables margin trading and lending in various cryptocurrencies instead with a traditional fiat currency and traditional securities. (Id. ¶ 43). The bZx Protocol offers two products: Fulcrum, which allows margin lending and trading, and Torque, which allows users to make loans with fixed interest rates. (Id. ¶¶ 43-44). The bZx Protocol supports three blockchains: Ethereum, Polygon, and BSC. (Id. ¶ 45). To use the bZx Protocol, a user selects which blockchain network to *1110 use and then connects a wallet to deposit cryptocurrency tokens. (Id.). The bZx Protocol claims to be "non-custodial" because users maintain control over their own passwords and digital assets. (Id. ¶ 46). The bZx Protocol's website contains numerous claims about the Protocol's security. (Id. ¶¶ 46, 48-50). bZx Protocol developers used private keys which allowed the developer to access all of the assets recorded on two of the three compatible blockchains—Polygon and BSC. (Id. ¶¶ 47, 54).

[1] [2] When the bZx Protocol was first created, it was controlled by bZerox LLC, an LLC co-founded and controlled by Defendants Tom Bean and Kyle Kistner. (*Id.* ¶ 67). The Fulcrum and Torque products were operated by Leveragebox LLC, which was also co-founded and controlled by Bean and Kistner. (*Id.*). In August 2021, the bZx Protocol announced plans to transition control of the Protocol from bZeroX LLC to the bZx DAO, a DAO controlled by real and legal persons holding BZRX tokens—a cryptocurrency issued by the DAO. (*Id.* ¶¶ 68–69). In a public call describing the pending transition, Kistner stated:

It's really exciting. We're going to be really preparing for the new regulatory environment by ensuring bZx is future-proof. So many people across the [cryptocurrency] industry right now are getting legal notices and lawmakers are trying to decide whether they want DeFi companies to register as virtual asset service

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providers or not—and really what we're going to do is take all the steps possible to make sure that when regulators ask us to comply, that we have nothing we can really do because we've given it all to the community.

In re bZeroX, LLC, CFTC No. 22-31, 2022 WL 4597664, at *4 (Sept. 22, 2022). When the transfer of control was completed in August 2021, bZeroX LLC transferred all of its assets to the bZx DAO and dissolved. (FAC ¶ 68). At that time, the bZx Protocol held \$80 million in assets and the bZx DAO was charged with "maintaining the protocol, building new products, marketing the brand, and managing the community." (Id.). From that point forward, the bZx DAO and Protocol were controlled by BZRX tokenholders, who became "the main drivers of governance and decision making of the bZx platform." (Id. ¶ 69). Tokenholders can suggest and vote on governance proposals which, if adopted, are implemented by the bZx Protocol. (Id.).

On or about November 5, 2021, an unknown hacker sent a phishing email to a bZx Protocol developer's personal computer. 2 (Id. ¶ 52). The email appeared legitimate and included a Word document containing *1111 hidden malicious software. (Id.) Once the Word document was opened, the hacker was able to access the developer's personal digital wallet, which in turn provided access to the developer's private key. (Id. ¶ 54). Once the hacker obtained the private key, he or she was able to transfer all cryptocurrencies held on the Polygon and BSC blockchains out of the bZx Protocol. (*Id.*). The Ethereum blockchain wasn't impacted by the hack because the bZx Protocol had finished implementing certain security protocols. (Id. ¶ 59). As a result of the hack, users lost approximately \$55 million worth of cryptocurrency tokens. (Id. \P 55). This wasn't the first time the bZx Protocol was hacked—in 2020 the Protocol was targeted by three hacks with losses of approximately \$9 million, at least one of which involved a phishing attack. (*Id.* ¶ 61).

On November 21, 2021, the bZx DAO approved a compensation plan for those impacted by the hack. (Id. ¶ 63). The plan compensated anyone who lost BZRX tokens by providing replacement BZRX tokens or BZRX tokens that would vest over time. (Id. ¶ 64). The compensation plan also provided "debt tokens" which will gradually be repurchased to make victims whole. (Id. ¶ 65). The FAC alleges complete repayment will take thousands of years. (Id.).

In December 2021, the bZx Protocol encouraged users to transfer to a successor platform called the Ooki Protocol. (*Id.* ¶ 66). The Ooki Protocol is controlled in the same manner as the bZx Protocol, except the controlling DAO is called the Ooki DAO and the governance tokens are called OOKI tokens. (*Id.*). Many BZRX tokenholders transferred their tokens for OOKI tokens. (*Id.*) While bZx, Fulcrum, and Torque still exist, it is undisputed that the Ooki DAO is the direct successor to the bZx DAO. (*Id.*).

Plaintiffs are nineteen non-citizen bZx Protocol users who individually lost between \$800 and \$450,000 in the hack, and collectively lost \$1.7 million. (*Id.* ¶¶ 1, 3–21). Plaintiffs initiated this putative class action on May 2, 2022, (Dkt. 1), and filed their FAC on June 27, 2022, (Dkt. 21, FAC). The Leveragebox Defendants moved to dismiss the FAC in its entirety on July 18, 2022, (Dkt. 27), and the Hashed Defendants moved to dismiss the FAC on July 29, 2022, (Dkt. 31).

II. RULE 12(b)(6) MOTION TO DISMISS

A. Legal Standard

A Rule 12(b)(6) motion to dismiss tests the sufficiency of the complaint. Navarro v. Block, 250 F.3d 729, 732 (9th Cir. 2001). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face." "Ashcroft v. Igbal, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 547, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). A claim is plausible if the factual allegations supporting it permit "the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." Id. The factual allegations need not be detailed; instead, the plaintiff must plead sufficient facts that, if true, "raise a right to relief above the speculative level." Twombly, 550 U.S. at 545, 127 S.Ct. 1955. The plausibility standard isn't a "'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully." [Igbal, 556 U.S. at 678, 129 S.Ct. 1937 (quoting **Twombly, 550 U.S. at 556, 127 S.Ct. 1955). Courts aren't required to accept legal conclusions couched as factual allegations and "formulaic recitation[s] of the elements of a cause of action" aren't sufficient. *1112 Twombly, 550 U.S. at 555, 127 S.Ct. 1955. The Court

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accepts as true all facts alleged in the complaint and draws all reasonable inferences in favor of the plaintiff. al-Kidd v. Ashcroft, 580 F.3d 949, 956 (9th Cir. 2009). Ultimately, a court must determine whether the plaintiff's alleged facts, if proven, permit the court to grant the requested relief. See *Igbal*, 556 U.S. at 666, 129 S.Ct. 1937; Fed. R. Civ. P. 8(a) (2).

B. Negligence Claim

[3] "In order to establish negligence under California law, a plaintiff must establish four required elements: (1) duty; (2) breach; (3) causation; and (4) damages." Ileto v. Glock Inc., 349 F.3d 1191, 1203 (9th Cir. 2003) (citing Martinez v. Pacific Bell, 225 Cal. App. 3d 1557, 1564, 275 Cal. Rptr. 878 (1990)). The Leveragebox Defendants argue the FAC fails to allege facts sufficient to establish the duty and breach elements of a negligence claim. (Dkt. 27-1 at 12-18).

1. Duty

people owe a duty of care to avoid causing harm to others and that they are thus usually liable for injuries their negligence inflicts." S. Cal. Gas Leak Cases, 7 Cal. 5th 391, 398, 247 Cal.Rptr.3d 632, 441 P.3d 881 (2019). However, "liability in negligence for purely economic losses ... is 'the exception, not the rule.' " Id. at 400, 247 Cal.Rptr.3d 632, 441 P.3d 881. "The primary exception to the general rule of no-recovery for negligently inflicted purely economic losses is where the plaintiff and the defendant have a 'special relationship.' " Id. The parties here agree that courts consider six factors to determine whether a special relationship exists:

(i) "the extent to which the transaction was intended to affect the plaintiff," ... (ii) "the foreseeability of harm to the plaintiff," (iii) "the degree of certainty that the plaintiff suffered injury," (iv) "the closeness of the connection between the defendant's conduct and the injury suffered," (v) "the moral blame attached to the defendant's conduct," and (vi) "the policy of preventing future harm."

Id. at 401, 247 Cal.Rptr.3d 632, 441 P.3d 881 (quoting J'Aire Corp. v. Gregory, 24 Cal. 3d 799, 804, 157 Cal.Rptr. 407, 598 P.2d 60 (1979)); see also Rowland v. Christian, 69 Cal. 2d 108, 113, 70 Cal.Rptr. 97, 443 P.2d 561 (1968) (articulating an earlier version of the factors).

[8] The FAC alleges that the "bZx protocol and its partners owed Plaintiffs a duty to maintain the security of the funds deposited using the bZx protocol, including but not limited to putting in place procedures such that a phishing attack on a single developer would not result in a multi-million dollar theft." (FAC ¶ 99). Plaintiffs allege that the creators of the bZx Protocol "told users that they need not 'ever worry about ... getting hacked or [anyone] stealing [their] funds.' " (Id. ¶ 1). The FAC further alleges that the "bZx protocol and its partners also owed Plaintiffs a duty to supervise developers and those working on the protocol such that important passwords or security details could not be revealed through the actions of a single developer." (Id. ¶ 100). Finally, the FAC alleges that the developer targeted by the phishing attack "owed Plaintiffs a duty to secure [passwords] against malicious attacks." (Id. ¶ 101).

In Fabian v. LeMahieu, No. 19-CV-54-YGR, 2019 WL 4918431 (N.D. Cal. Oct. 4, 2019), the Court considered a claim of negligence based on similar facts. The plaintiffs [7] "In California, the 'general rule' is that elleged that cryptocurrency had been stolen from the defendant's exchange due to "unauthorized transactions."

> Id. at *5. In denying a motion to dismiss, the court applied the six-factor special relationship *1113 test and found the defendant owed plaintiffs a duty of care:

> > Here, five of the six factors weigh in favor of finding a duty. It was foreseeable that a lack of security on the primary exchange for [the cryptocurrency] would cause harm to individuals who, like plaintiff, deposited their [cryptocurrency] on that exchange and that any security failure on that exchange would result in harm to plaintiff and other similarly situated individuals. Further, it is plausible that [the defendants'] alleged conduct, if true, could be viewed as morally reprehensible and this type of action could further the goal of preventing future harm. Imposing a duty to exercise care in this instance will not result in an undue burden

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on the [defendants] or the industry at large. Moreover, [the defendants'] conduct was proximately connected to plaintiff's injury.

Id. at *12 (citing **Rowland, 69 Cal. 2d 108, 70 Cal.Rptr. 97, 443 P.2d 561).

Applying the special relationship factors here counsels in favor of finding Defendants owed Plaintiffs a duty of care. First, Plaintiffs were the intended beneficiaries of the transaction in that they were the bZx Protocol's users. The FAC alleges that the bZx Protocol is a platform for "tokenized margin trading and lending," (FAC ¶ 42), which Plaintiffs traded on after connecting a wallet and depositing a supported cryptocurrency, (id. ¶ 45). Second, it was foreseeable that lack of security on the bZx Protocol would cause harm to individuals, like Plaintiffs, who used the BSC and Polygon blockchains on the platform. This conclusion is bolstered by the allegation that bZx was targeted by three previous hacks with initial losses of approximately \$9 million, at least one of which involved a phishing attack. (Id. ¶ 61). Third, Plaintiffs allege an injury with a high degree of certainty: the named Plaintiffs were injured by the theft of approximately \$1.7 million of their cryptocurrency tokens, while the total theft was approximately \$55 million. (Id. ¶ 1, 3-21). Fourth, Plaintiffs allege a close connection between the negligent conduct and their injury: but for the bZx DAO's negligent failure to implement security measures that the operators knew were reasonably necessary to protect the Protocol, Plaintiffs' cryptocurrency would have been safe. (See id. ¶ 1). Fifth, Plaintiffs allege the DAO's conduct is morally reprehensible in light of their promises of safety. (See id. ¶ 1). Sixth, a finding that Defendants owed Plaintiffs a duty furthers the policy of preventing future harm stemming from negligent oversight of security measures on DeFi protocols. See Fabian, 2019 WL 4918431, at

on DeFi protocols. See Fabian, 2019 WL 4918431, at *12 (applying six-factor test). The factors weigh in favor of finding a special relationship between the bZx DAO and Plaintiffs. Accordingly, the Court finds that Plaintiffs have alleged that the bZx DAO had a duty to exercise reasonable care with respect to their management of the protocol.

This conclusion isn't disturbed by the Leveragebox Defendants' arguments that *Fabian* is distinguishable. (Dkt. 43 at 3–4). First, the Leveragebox Defendants' attempt

Protocol are "non-custodial" because transactions with the bZx Protocol are "non-custodial" because users maintain custody over their own assets. (*Id.* at 3). The FAC alleges a successful phishing attack on a bZx developer allowed a hacker to gain access to all of the funds supposedly in Plaintiffs' custody, (FAC ¶¶ 47, 52, 54, 56–57), rendering the distinction between custodial and non-custodial meaningless here. Second, the Leveragebox Defendants argue the FAC doesn't allege transactions between Plaintiffs and Defendants. (Dkt. 43 at 3–4). The FAC does, however, allege transactions between the named Plaintiffs *1114 and the bZx Protocol that were precisely the sort of transactions Fulcrum was intended to facilitate. (FAC ¶ 1).

2. Breach

[9] The Leveragebox Defendants next contend that, even if

they owed Plaintiffs a duty of care, the FAC doesn't allege facts plausibly stating that Defendants breached that duty. (Dkt. 27-1 at 17–18). Citing this Court's order in Razuki v. Caliber Home Loans, Inc., No. 17-cv-1718-LAB-WVG, 2018 WL 6018361, at *1 (S.D. Cal. Nov. 15, 2018), Defendants argue Plaintiffs can't state a claim by "simply asserting that a hack occurred, and therefore people were negligent." (Dkt. 27-1 at 17–18). However, Plaintiffs allege breach with more specificity than the complaint in Razuki. While the complaint in Razuki offered conclusory statements without supporting facts, see 2018 WL 6018361, at *1, Plaintiffs

here allege sufficient factual matter to support their claim.

The FAC alleges that on November 5, 2021, "[a] bZx developer was sent a phishing email to his personal computer with a malicious macro in a Word document that was disguised as a legitimate email attachment, which then ran a script on his Personal Computer. This led to his personal mnemonic wallet phrase being compromised." (FAC ¶ 52). The developer's personal wallet contained "private keys (or passcodes or passphrases) that enabled [the hacker to access bZx Protocol] users' funds" and that "those keys were [the developer's] only means of accessing the protocol and making necessary changes to it." (Id. ¶ 56). The FAC further alleges that these private keys had been used to successfully target the Protocol in other, similar hacks, (id. ¶ 61); the bZx Protocol made specific assurances about security, (id. ¶¶ 46, 48-50); and the Protocol failed to implement security measures that would've prevented Plaintiffs' injuries, (id.

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¶¶ 54, 57–59, 61); see also id. ¶ 57 ("The problem, as the company reported it, was that—despite the protocol's promises to the contrary—the protocol's implementation on two of the three blockchains on which it operated was insecure. That is, the protocol was designed to work on the Ethereum blockchain, the Polygon blockchain, and the Binance Smart Chain blockchain, but only its operations on the Ethereum blockchain were secure."). Accepting the allegations in the FAC as true, the Court finds that Plaintiffs have stated sufficient factual matter to plausibly allege Defendants breached their duty care.

C. Partnership Liability

Plaintiffs' theory of liability is premised on the existence of a general partnership among all persons holding BZRX tokens. The FAC contends Defendants are partners of the purported bZx DAO general partnership, (FAC ¶¶ 22–25, 72–75), and, therefore, jointly and severally liable for Plaintiffs' injuries, (id. ¶¶ 99–102). The Leveragebox Defendants argue the FAC fails to plausibly demonstrate the existence of a general partnership. (Dkt. 27-1 at 18–22). Additionally, they argue the FAC doesn't sufficiently allege Defendants are members of the purported general partnership. (Id. at 22).

The Court first considers whether the FAC includes sufficient factual matter to plausibly allege that the bZx DAO is a general partnership, and then considers whether the FAC sufficiently alleges that each Defendant is a partner in such a partnership.

1. bZx DAO General Partnership Formation

[10] [11] California law provides that the "association of two or more persons to carry on as coowners a business for profit forms a partnership, whether or not the persons intend to form a partnership." *1115 Cal. Corp. Code § 16202(a). "Under the Corporations Code, unless persons associated to do business together establish a formal entity like a corporation, the association is deemed to be a partnership regardless of the parties' intent." *Jones v. Goodman*, 57 Cal. App. 5th 521, 538 n.19, 271 Cal.Rptr.3d 487 (2020); see also § 16202(b) ("[A]n association formed under a statute other than this chapter, a predecessor statute, or a comparable statute of another jurisdiction is not a partnership under this chapter."). "[P]ersons may unintentionally create a partnership where their actions and behavior demonstrate an intent to engage in business together."

of Geraci, 144 Cal. App. 4th 1278, 1292, 51 Cal.Rptr.3d 234 (2006) (noting that courts consider the surrounding circumstances to determine the parties' intent). "It is well-settled that the existence of a partnership is a question of fact."

Persson v. Smart Inventions, Inc., 125 Cal. App. 4th 1141, 1157, 23 Cal. Rptr.3d 335 (2005) (citing Holmes v. Lerner, 74 Cal. App. 4th 442, 445, 88 Cal. Rptr.2d 130 (1999)).

[12] [14] A plaintiff can plead the existence of a partnership by making specific factual allegations demonstrating: (1) the right of the purported partners to participate in the management of the business; (2) the sharing of profits and losses among the purported partners; and (3) contributions of money, property, or services by the purported partners to the partnership. See Ramirez v. Sotelo, No. ED CV 13-2155 SJO (MRWx), 2014 WL 12586445, at *3 (C.D. Cal. May 8, 2014). "To participate to some extent in the management of a business is a primary element in partnership organization, and it is virtually essential to a determination that such a relationship existed." Dickenson v. Samples, 104 Cal. App. 2d 311, 315, 231 P.2d 530 (1951). Importantly, "the distinguishing feature of partnership is association to carry on business together, not [an] agreement to share profits." Holmes, 74 Cal. App. 4th at 454, 88 Cal.Rptr.2d 130 (noting that the California legislature removed profit sharing from the statutory definition of a partnership, indicating that the legislature "intend[ed] profit sharing to be evidence of a partnership, rather than a required element of the definition of a partnership"); see also id. at 456, 88 Cal.Rptr.2d 130 ("Ordinarily the existence of a partnership is evidenced by the right of the respective parties to participate in profits and losses and in the management and control of the business."); Cal. Corp. Code § 16202(c)(3) ("A person who receives a share of the profits of a business is presumed to be a partner in the business.").

The FAC alleges that "the bZx protocol purports to be a DAO, a de-centralized autonomous organization, that lacks any legal formalities or recognition." (FAC ¶ 2). Plaintiffs allege that "[g]iven their structures and the way they operate, the bZx and Ooki DAOs are general partnerships among tokenholders." (*Id.* ¶ 71). Plaintiffs contend the DAOs should be recognized as general partnerships, and each partner should be jointly and severally liable for the torts of the DAO. (*Id.* ¶ 2) The Leveragebox Defendants contend that the FAC asserts legal conclusions and fails to allege facts sufficient to

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demonstrate the existence of general partnership. (Dkt. 27-1 at 18–23).

[15] To plausibly allege the existence of a general partnership, the FAC must plead sufficient facts to demonstrate that the bZx DAO is (1) an association of two or more persons (2) carrying on as co-owners of (3) a business for profit. See Cal. Corp. Code § 16202(a). As a starting point, the FAC alleges that the DAO is an "association[] of two or more persons (the tokenholders and investors)." (FAC ¶ 71). The FAC also alleges that the bZx DAO generates *1116 profits through its margin trading and lending products, Fulcrum and Torque. (Id. ¶¶ 43–44, 71). The Leveragebox Defendants don't appear to dispute either allegation. (See Dkt. 27-1 at 18–23). The Court finds that the FAC sufficiently alleges that the DAO is an association of two or more persons and that it operates as a business for profit.

[16] The Court next considers whether Plaintiffs sufficiently allege that the BZRX tokenholders carry on as co-owners of the DAO. See Cal. Corp. Code § 16202(a). The FAC alleges that "bZx outlined plans to transition both revenue from the protocol and control of aspects of the protocol to the bZx DAO. That is, 'armed with tens of millions of dollars, [the DAO] will take up the task of maintaining the protocol, building new products, marketing the brand, and managing the community.' " (FAC ¶ 68). Plaintiffs allege that "when the transition was completed, 'the legal entity bZeroX LLC [ceased] to exist, and in its place the DAO ... remained." (Id.).

The FAC alleges the "bZx DAO is controlled by those who hold the BZRX token" and that tokenholders have governance rights in the DAO. (FAC ¶¶ 41, 69). "That is, 'the keys to the bZx treasury, [were] turned over to the DAO, and [BZRX] tokenholders [became] the main drivers of governance and decision making of the bZx platform going forward.' " (*Id.* ¶ 69). Specifically, they allege that tokenholders can both suggest and vote on governance proposals. (*Id.* ¶¶ 41, 69). Tokenholders can propose "spending treasury funds to hire people; changing organizational goals and policies; and even distributing treasury assets to tokenholders, like how corporations can authorize dividends." (*Id.*). If a proposal receives the required number of votes, the DAO or Protocol will take the proposed action. (*Id.* ¶ 41).

[17] The Leveragebox Defendants concede that BZRX tokenholders possess some governance rights, but argue these rights are too limited to establish the existence of a general partnership. (Dkt. 27-1 at 22 ("BZRX tokens provide owners")

only some fraction of governance rights which relate to only a narrow set of parameters of the protocol.")). But limited governance rights don't divest a partnership of its essential nature—a partnership can still exist when individual partners only control a part of the enterprise. *See Singleton v. Fuller*, 118 Cal. App. 2d 733, 741, 259 P.2d 687 (1953) ("The fact that no complete control of any part of a partnership venture is vested in each partner does not [negate] the existence of a partnership since, by agreement, one partner may be given the duty of management of the enterprise or any part thereof."). The Court finds the FAC plausibly alleges that the BZRX tokenholders possessed governance rights over the DAO.

[18] Plaintiffs also allege that tokenholders can share in the DAO's profits. (FAC ¶ 41). The Leveragebox Defendants dispute this characterization, arguing the FAC doesn't sufficiently allege the existence of profit and loss sharing. (See Dkt. 27-1 at 20–21). They contend that Plaintiffs merely "speculat[e] that BZRX token holders could share profits," but that this allegation "fall[s] far short of alleging that the [tokenholders] agreed to share profits and losses." (Id. at 21 (emphasis in original)). "The actual sharing of profits ... is prima facie evidence, which is to be considered, in light of any other evidence, when determining if a partnership exists."

Holmes, 74 Cal. App. 4th at 457, 88 Cal.Rptr.2d 130; see also Nelson v. Abraham, 29 Cal. 2d 745, 749, 177 P.2d 931 (1947) ("A partnership connotes coownership in the partnership property with a sharing in the profits and losses of a continuing business."). "The *1117 fact, however, that profits and losses are not shared equally does not necessarily compel a conclusion that no partnership existed." Constans v. Ross, 106 Cal. App. 2d 381, 389, 235 P.2d 113 (1951).

[19] Here, the FAC alleges that tokenholders "can vote to 'distribut[e] treasury assets to tokenholders, like how corporations can authorize dividends.' " (FAC ¶ 41). Also relevant here is the Commodity Future Trading Commission's ("CFTC") Order Instituting Proceedings, which the Court has already judicially noticed. The CFTC found that the "bZx Protocol liquidity pool['s] ... assets were supplied by liquidity providers who, in exchange, had received interest-generating tokens, as well as BZRX Protocol Tokens ('BZRX Tokens') conferring voting rights on certain matters relevant to bZx Protocol governance." *In re bZeroX*, *LLC*, 2022 WL 4597664, at *2. The CFTC's findings reinforce the FAC's allegations that tokenholders can share in the DAO's profits either by voting to distribute treasury assets among themselves or via an interest-generating token.

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[20] The Leveragebox Defendants argue that Plaintiffs "allege no facts suggesting that defendants (let alone all BZRX token holders) agreed to bear any and all losses suffered by a partnership." (*Id.*). However, "[a]n agreement to divide profits implies an agreement for a corresponding division of losses, unless otherwise expressly stipulated." *Nat'l Bank of Com. in Pasadena v. Thompson Advert. Co.*, 114 Cal. App. 327, 329–30, 299 P. 802 (1931) (citations omitted); *see also Brown v. Fairbanks*, 121 Cal. App. 2d 432, 440, 263 P.2d 355 (1953) ("A provision to share losses may be implied in a partnership or joint venture agreement."). On balance, the Court finds the allegation that BZRX tokenholders may share profits weighs in favor of treating the DAO as a general partnership. ³

The Leveragebox Defendants further argue that finding "that each and every BZRX token holder plausibly could be a co-owner of a business with management authority and unlimited personal liability for any losses connected to the platform, and thus subject to full discovery into their potential liability ... [would be a] radical expansion and alteration of long-standing principles of partnership law [and] should not be countenanced." (Dkt. 27-1 at 22-23). However, when transitioning control of the bZx Protocol from bZerox LLC to the bZx DAO, the partners elected to forgo registering the DAO as an LLC or other legal entity with limited liability. In fact, the CFTC concluded that "Bean and Kistner determined that transitioning to a DAO would insulate the bZx Protocol from regulatory oversight and accountability for compliance with U.S. law." In re bZeroX, LLC, 2022 WL 4597664, at *4. In a public call describing the pending transition, Kistner stated:

It's really exciting. We're going to be really preparing for the new regulatory environment by ensuring bZx is future-proof. So many people across the [cryptocurrency] industry right now are getting *1118 legal notices and lawmakers are trying to decide whether they want DeFi companies to register as virtual asset service providers or not—and really what we're going to do is take all the steps possible to make sure that when regulators ask us to comply, that we

have nothing we can really do because we've given it all to the community.

Id. Given this context, the Court disagrees that recognizing the bZx DAO as a general partnership would be a "radical expansion and alteration of long-standing principles of partnership law [that] should not be countenanced." (Dkt. 27-1 at 22–23); see also Nat'l Bank of Com., 114 Cal. App. at 329–30, 299 P. 802 ("Courts do not countenance partnerships which attempt to afford all the advantages of commercial intercourse without corresponding liabilities, and an agreement which contemplates such evasion will be construed and enforced as a general partnership.").

Accepting the allegations in the FAC as true, the Court finds that Plaintiffs have stated facts sufficient to allege that a general partnership existed among the BZRX tokenholders.

2. Partnership Allegations Against Each Defendant

The Court next considers whether the FAC makes sufficient factual allegations to demonstrate that each individual defendant is a partner of the bZx DAO general partnership. Because anyone holding a BZRX token is a partner in the partnership, Plaintiffs can make this showing by specifically alleging that each Defendant held BZRX tokens.

[21] As for Kistner and Bean, the FAC alleges that they cofounded the bZx Protocol and initially controlled in through bZeroX LLC, which they also co-founded and controlled. (FAC ¶¶ 22–23, 67). Although the FAC doesn't specifically allege that Kistner or Bean held BZRX tokens, it does allege that they participated in Protocol decision making and that the only way to participate in such decision making is by holding and voting BZRX tokens. (*Id.* ¶¶ 69, 72–73). These allegations support the reasonable inference that Kistner and Bean necessarily held BZRX tokens when they participated in protocol decision making. ⁴ The FAC also alleges that Kistner is still listed as an employee of bZx. (*Id.* ¶ 67). The Court finds the FAC makes sufficient allegations to permit the reasonable inference that Kistner and Bean hold BZRX tokens.

[22] As for Leveragebox LLC, the FAC alleges that Leveragebox operated the Fulcrum trading platform when the phishing attack and hack occurred. (*Id.* ¶ 78). The FAC doesn't allege that Leveragebox LLC held governance tokens, participated in the management of the bZx DAO, or shared in

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the profits of the DAO. The Court finds the FAC fails to allege that Leveragebox LLC was a general partner of the bZx DAO.

[23] As for bZeroX LLC, the FAC alleges that bZeroX created and controlled the protocol until August 2021, at which time bZeroX transferred its assets to the bZx DAO and dissolved. (*Id.* ¶ 79). At the time of the hack, bZeroX didn't exist as a legal entity. The FAC doesn't contain any allegations suggesting that bZeroX held BZRX tokens, participated in the management of the bZx DAO, or shared in the profits of the DAO. The Court finds the *1119 FAC fails to allege that bZeroX was a general partner of the bZx DAO.

[24] As for Hashed International LLC and AGE Crypto GP, LLC, the FAC alleges both entities were investors in the bZx Protocol and members of the DAO and general partnership. (Id. ¶¶ 22–25). The FAC alleges that Hashed has "publicly disclosed that it 'supported the [bZx] team' .. and invested in the protocol and the BZRX token." (Id. ¶ 74). The FAC doesn't explicitly allege that AGE held governance tokens, but does allege that both entities participated in protocol decision making. (Id. ¶¶ 74–75). As previously discussed, these allegations support the reasonable inference that Hashed and AGE necessarily held BZRX tokens when they allegedly participated in protocol decision making. The Court finds Plaintiffs' allegations sufficient to permit the reasonable inference that Hashed and AGE hold governance tokens.

* * *

The motion to dismiss for failing to allege facts sufficient to demonstrate the existence of a general partnership is **GRANTED IN PART** and **DENIED IN PART**, and the claims against Leveragebox LLC and bZeroX LLC are **DISMISSED**.

D. Corporate Veil Piercing

[25] Bean and Kistner argue that Plaintiffs plead no facts that warrant piercing the corporate veil of the Leveragebox and bZeroX LLCs. (Dkt. 27-1 at 8-9). However, the FAC alleges Bean and Kistner are liable as partners of the bZx DAO general partnership, not as members of their LLCs. (FAC ¶¶ 22-23, 72-73). Therefore, the Court **DENIES** Bean and Kistner's motion to dismiss to the extent it argues Bean and Kistner are shielded from liability by their LLCs.

E. Terms of Use

[26] The Leveragebox Defendants argue Plaintiffs' negligence claim is barred by the Terms of Use they agreed to when they accessed the Protocol via the Fulcrum website. (Dkt. 27-1 at 9–10). "Contracts formed on the Internet come primarily in two flavors: 'clickwrap' (or 'click-through') agreements, in which website users are required to click on an 'I agree' box after being presented with a list of terms and conditions of use; and 'browsewrap' agreements, where a website's terms and conditions of use are generally posted on the website via a hyperlink at the bottom of the screen."

Nguyen v. Barnes & Noble Inc., 763 F.3d 1171, 1175–76 (9th Cir. 2014). Fulcrum's Terms of Use were hyperlinked on the bottom of the Fulcrum homepage and users weren't required to click "I agree" before accessing the platform. (Dkt. 27-1 at 9; Dkt. 27-2 Ex. 2). Therefore, Fulcrum's Terms of Use are a "browsewrap" agreement.

[27] [28] Under California law, browsewrap agreements are binding on a website user only when the user has "actual or constructive knowledge of a website's terms and conditions."

Long v. Provide Com., Inc., 245 Cal. App. 4th 855, 863, 200 Cal.Rptr.3d 117 (2016) (quoting Nguyen, 763 F.3d at 1176), see, e.g., Cairo, Inc. v. Crossmedia Servs., Inc., No. 04-cv-4825, 2005 WL 756610, at *5 (N.D. Cal. Apr. 1, 2005) (finding website's browsewrap terms of use were binding on plaintiff when he admitted he had actual knowledge of the terms). "[W]here a website makes its terms of use available via a conspicuous hyperlink on every page of the website but otherwise provides no notice to users nor prompts them to take any affirmative action to demonstrate assent, even close proximity of the hyperlink to relevant buttons users must click on—without more—is *1120 insufficient to give rise to constructive notice." Nguyen, 763 F.3d at 1179–80; see also Long, 245 Cal. App. 4th at 864–67, 200 Cal.Rptr.3d 117 (adopting Nguyen's reasoning).

[29] Here, a hyperlink to the Terms of Use is located at the bottom of Fulcrum's homepage and appear to be visible only if a user scrolls through other material, including the "Start Now" buttons used to access the platform's trading and lending features. (See Dkt. 27-2 Ex. 2 at 21–23). Additionally, the Terms of Use are displayed in small font located below at least eighteen other hyperlinks. (Id. at 22–23). The FAC contains no allegations suggesting that Plaintiffs had actual knowledge of the Terms of Use when they accessed the Protocol. The Court finds Plaintiffs had neither actual nor

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constructive notice of the Terms of Use and, therefore, aren't bound by them. The Court further finds that the Terms of Use don't bar Plaintiffs' claim against any of the Leveragebox Defendants. The Leveragebox Defendant's motion to dismiss is **DENIED** to the extent to seeks to dismiss Plaintiffs' claims based on Leveragebox's Terms of Use.

III. RULE 12(b)(2) MOTION TO DISMISS

The Leveragebox Defendants move to dismiss all claims against Bean, arguing the Court lacks personal jurisdiction over him. (Dkt. 27-1 at 24–25). Although the motion to dismiss doesn't invoke Rule 12(b)(2), the Court will construe it as 12(b)(2) motion to dismiss for lack of personal jurisdiction.

A. Legal Standard

[30] [31] Rule 12(b)(2) governs motions to dismiss for lack of personal jurisdiction. *See* Fed. R. Civ. P. 12(b)(2). The plaintiff must establish that the court has personal jurisdiction over the defendant by "mak[ing] only a prima facie showing of jurisdictional facts to withstand the motion to dismiss."

Cove v. Assoc'd. Newspapers, Ltd., 611 F.3d 601, 608 (9th Cir. 2010); see also Pebble Beach Co. v. Caddy, 453 F.3d 1151, 1154 (9th Cir. 2006). To make this showing, "the plaintiff need only demonstrate facts that if true would support jurisdiction over the defendant." Ballard v. Savage, 65 F.3d 1495, 1498 (9th Cir. 1995). "Uncontroverted allegations in the

complaint must be taken as true, and conflicts over statements contained in affidavits must be resolved in [plaintiffs'] favor."

Love, 611 F.3d at 608.

[32] [33] [34] "Federal courts ordinarily follow state law in determining the bounds of their jurisdiction over persons."

Paimler AG v. Bauman, 571 U.S. 117, 125, 134 S.Ct. 746, 187 L.Ed.2d 624 (2014) (citing Fed. R. Civ. P. 4(k)(1) (A)). "California's long-arm statute allows the exercise of personal jurisdiction to the full extent permissible under the U.S. Constitution," the inquiry centers on whether exercising jurisdiction over a particular defendant comports with due process. Id.; see also Cal. Civ. Proc. Code § 410.10 ("A court of this state may exercise jurisdiction on any basis not inconsistent with the Constitution of this state or of the United States."). "Due process requires that the defendant 'have certain minimum contacts' with the forum state 'such

that the maintenance of the suit does not offend traditional

notions of fair play and substantial justice." Picot v. Weston, 780 F.3d 1206, 1211 (9th Cir. 2015) (quoting Int'l Shoe Co. v. Washington, 326 U.S. 310, 316, 66 S.Ct. 154, 90 L.Ed. 95 (1945)).

[35] [36] [37] [38] [39] Federal courts may exercise either general or specific jurisdiction over nonresident defendants. *1121 Helicopteros Nacionales de Colombia, S.A. v. Hall, 466 U.S. 408, 414, 104 S.Ct. 1868, 80 L.Ed.2d 404 (1984). General jurisdiction exists when a defendant has "substantial" or "continuous and systematic" contacts with the forum state. Id. at 415, 104 S.Ct. 1868. If a defendant's contacts are insufficient to establish general jurisdiction, specific jurisdiction might still exist. A three-part test determines whether a non-resident defendant has sufficient contacts to be subject to specific jurisdiction:

- (1) The non-resident defendant must purposefully direct his activities or consummate some transaction with the forum or resident thereof; or perform some act by which he purposefully avails himself of the privilege of conducting activities in the forum, thereby invoking the benefits and protections of its laws;
- (2) the claim must be one which arises out of or relates to the defendant's forum-related activities; and
- (3) the exercise of jurisdiction must comport with fair play and substantial justice, i.e. it must be reasonable.

Picot, 780 F.3d at 1211 (quoting Schwarzenegger v. Fred Martin Motor Co., 374 F.3d 797, 802 (2004)). The plaintiff must prove the first two prongs, CollegeSource, Inc. v. AcademyOne, Inc., 653 F.3d 1066, 1076 (9th Cir. 2011), then the burden shifts to the defendant to "set forth a 'compelling case' that the exercise of jurisdiction would not be reasonable," id. (quoting Burger King Corp. v. Rudzewicz, 471 U.S. 462, 477, 105 S.Ct. 2174, 85 L.Ed.2d 528 (1985)). "For claims sounding in tort, [the Ninth Circuit] appl[ies] a 'purposeful direction' test and look[s] to evidence that the defendant has directed his actions at the forum state, even if those actions took place elsewhere." Picot, 780 F.3d at 1212.

B. Specific Personal Jurisdiction over Bean

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[40] [41] [42] The FAC alleges that the Court specific personal jurisdiction over all Defendants because they purposefully entered the general partnership which: was controlled from California; has at least one member conducting partnership business in California; and directed at least some activities at California. (FAC ¶ 33). Specifically, the FAC alleges that the Court has specific personal jurisdiction over Bean only because he is a general partner in the bZx DAO general partnership. (*Id.*). However, "[1]iability and jurisdiction are independent. Liability depends on the relationship between the plaintiff and the defendants and between the individual defendants; jurisdiction depends only upon each defendant's relationship with the forum."

Sher v. Johnson, 911 F.2d 1357, 1365 (9th Cir. 1990). "Jurisdiction over a partnership does not necessarily permit a court to assume jurisdiction over the individual partners," and "California court[s] 'ha[ve] jurisdiction over only those individual partners who personally established the requisite minimum contacts with California.' "Goehring v. Superior Ct. of San Diego Cnty., 62 Cal. App. 4th 894, 904–05, 73 Cal.Rptr.2d 105 (1998); see also Sher, 911 F.2d at 1366 ("[A] partner's actions may be imputed to the partnership for the purpose of establishing minimum contacts, but ordinarily may not be imputed to the other partners.").

[43] Bean argues the Court lacks personal jurisdiction over him because the FAC fails to plausibly allege that he was a member of a general partnership controlled from California. (Dkt. 27-1 at 24–25). Even if he were a general partner, Bean contends he lacks sufficient minimum contacts with California to establish specific personal jurisdiction. (Dkt. 43 at 9–10). Although the Court has found that Plaintiffs sufficiently allege Bean is a partner of the bZx DAO general partnership, Plaintiffs only allege that Bean "was aware that Kistner moved to California and intentionally *1122 communicated with Kistner in California about partnership business." (FAC ¶ 73). That fact alone is insufficient to make a prima facie showing of personal jurisdiction over Bean. See, e.g., Sher, 911 F.2d at 1366 (finding a law firm partner

e.g., Sher, 911 F.2d at 1366 (finding a law firm partner who represented a California resident, made phone calls and sent letters to California in the course of representation, and travelled to California on several occasions to service the client didn't have the requisite minimum contacts to establish

purposeful availment); see also Data Disc, Inc. v. Sys. Tech. Assocs., Inc., 557 F.2d 1280, 1285 (9th Cir. 1977). The Court finds it lacks specific personal jurisdiction over Bean. The Court GRANTS Bean's motion to dismiss for

[42] The FAC alleges that the Court has lack of personal jurisdiction, and the claim against him is jurisdiction over all Defendants because y entered the general partnership which:

DISMISSED WITH LEAVE TO AMEND to add additional facts demonstrating the requisite minimum contacts.

IV. RULE 12(f) MOTION TO STRIKE

[44] [45] [46] [47] The Leveragebox Defendants next move to strike the FAC's class allegations pursuant to Rule 12(f). (Dkt. 27-1 at 23-24). They argue the Court should strike the class allegations because the named Plaintiffs aren't "adequate" class representatives under Rule 23. (Id.). Rule 23(a)(4) requires that class representatives "fairly and adequately protect the interests of the class." Fed. R. Civ. P. 23(a)(4). The adequacy inquiry "serves to uncover conflicts of interest between named parties and the class they seek to represent." Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 625, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997) (citing Gen. Tel. Co. of the Sw. v. Falcon, 457 U.S. 147, 157–58 & n.13, 102 S.Ct. 2364, 72 L.Ed.2d 740 (1982)). "[A] class representative must be part of the class and 'possess the same interest and suffer the same injury' as the class members." E. Tex. Motor Freight Sys., Inc. v. Rodriguez, 431 U.S. 395, 403, 97 S.Ct. 1891, 52 L.Ed.2d 453 (1977) (quoting Schlesinger v. Reservists Comm. to Stop the War, 418 U.S. 208, 216, 94 S.Ct. 2925, 41 L.Ed.2d 706 (1974)). "To assure 'adequate' representation, the class representative's personal claim must not be inconsistent with the claims of other members of the class." In re Beer Distrib. Antitrust Litig., 188 F.R.D. 549, 554 (N.D. Cal. 1998). "Where the complaint demonstrates that a class action cannot be maintained on the facts alleged, a defendant may move to strike class allegations prior to discovery." Sanders v. Apple Inc., 672 F. Supp. 2d 978, 990 (N.D. Cal. 2009).

[48] Here, the putative class includes "[a]ll people who delivered cryptocurrency tokens to the bZx protocol and had any amount of funds stolen in the theft reported on November 5, 2021, except for people whose only cryptocurrency stolen was the BZRX token." (FAC ¶ 80). The FAC also provides that "[n]one of the Plaintiffs or proposed class held meaningful stakes of BZRX token." (Id. ¶ 64). The Leveragebox Defendants contend this allegation is essentially an admission the class representatives held some BZRX tokens, (Dkt. 43 at 10), and are therefore general partners of the bZx DAO and "equally liable under Plaintiffs' own general partnership theory," (id. at 23–24).

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While the Leveragebox Defendants are correct that, under Plaintiffs' general partnership theory, anyone holding BZRX tokens at the relevant time is jointly and severally liable for the torts of the DAO, the FAC doesn't clearly demonstrate a conflict of interest between the named Plaintiffs and the putative class. Specifically, the allegation that "[n]one of the Plaintiffs or proposed class held meaningful stakes of BZRX token," (id. ¶ 64), doesn't clearly demonstrate that the named Plaintiffs necessarily held BZRX tokens. This *1123 allegation can also be interpreted to mean the named Plaintiffs held no BZRX tokens. Accordingly, the Court finds the FAC doesn't demonstrate an irreconcilable conflict of interest between the named Plaintiffs and the putative class.

WITHOUT PREJUDICE. If discovery reveals actual conflicts of interest between the named Plaintiffs and the putative class, Defendants can renew their motion to strike at that time. Additionally, Plaintiffs can opt to revise the class definition when filing their Second Amended Complaint to attempt to correct any potential Rule 23(a)(4) problems. See Hawkins v. Comparet-Cassani, 251 F.3d 1230, 1238 (9th Cir. 2001) (quoting U.S. Parole Comm'n v. Geraghty, 445 U.S. 388, 408, 100 S.Ct. 1202, 63 L.Ed.2d 479 (1980)) ("The district court is not 'to bear the burden of constructing subclasses' or otherwise correcting Rule 23(a) problems; rather, the burden is on Plaintiffs to submit proposals to the court."); see also Andrews Farms v. Calcot, Ltd., 268 F.R.D. 380, 388–89 (E.D. Cal. 2010) (collecting cases).

V. RULE 12(b)(4) MOTION TO DISMISS

The Hashed Defendants move to dismiss the entire action because the FAC incorrectly names Hashed and AGE as defendants when they didn't hold BZRX tokens. (Dkt. 31-1 at 6). Specifically, they move to dismiss for insufficient process under Rule 12(b)(4) and contend Plaintiffs violated Rule 11 because a reasonable inquiry would have revealed Hashed and AGE weren't tokenholders. ⁵ (Id.).

[49] [50] A Rule 12(b)(4) motion to dismiss is technically "proper only to challenge noncompliance with the provisions of Rule 4(b) or any applicable provision incorporated by Rule 4(b) that deals specifically with the content of the summons." 5B Wright & Miller, *Federal Practice and Procedure* § 1353 (3d ed. 2022). Rule 4(a)(1)(A) and (B) require that a summons must include the correct names of the parties and be directed at the correct defendant. Fed. R. Civ. P. 4(a)(1)(A),

(B). If a summons doesn't include the correct information, dismissal is proper under Rule 12(b)(4). See J.L. v. Best W. Int'l, Inc., 521 F. Supp. 3d 1048, 1073 (D. Colo. 2021). When a defendant asserts the plaintiff named the wrong party, dismissal under Rule 12(b)(4) is inappropriate if the plaintiff subsequently states they named the defendant they intended to. See, e.g., id. at 1074 (denying Rule 12(b)(4) motion to dismiss and rejecting defendant entity's argument that plaintiff should have sued a subsidiary when plaintiff stated they intended to name the defendant entity and not the subsidiary).

[51] The Hashed Defendants don't challenge the form of process, the content of the summons, or the manner in which service of process was delivered. (See Dkt. 7 (service on AGE); Dkt. 8 (service on Hashed). Nor do they challenge that Plaintiffs *1124 intended to sue Hashed and AGE. Instead, Hashed and AGE assert they never held BZRX tokens. Specifically, Hashed asserts an unidentified South Korean natural citizen invested in the tokens, (Dkt. 31-1 at 3), and AGE asserts it entered a Simple Agreement For Future Tokens, but doesn't state whether it ever received BZRX tokens, (id.). Beyond these assertions, the Hashed Defendants don't provide any evidence supporting their assertion that they didn't hold BZRX tokens. In contrast, the FAC alleges Hashed and AGE were investors in the bZx Protocol and participated in protocol decision making, allowing the reasonable inference they possessed BZRX tokens. (FAC ¶¶ 22-23, 74-75).

At the motion to dismiss stage, the Court is bound by the allegations in the FAC. —al-Kidd, 580 F.3d at 956. The Hashed Defendants can't defeat those allegations by simply asserting conflicting facts without supporting evidence or affidavits. The Hashed Defendants' motion to dismiss under 12(b)(4) is **DENIED**.

[52] The question of whether the Hashed Defendants held tokens will likely be resolved by discovery. However, if Hashed and AGE didn't hold BZRX tokens and are in fact erroneous defendants, the Court might lack jurisdiction over them. See Direct Mail Specialists, Inc. v. Eclat Computerized Techs., Inc., 840 F.2d 685, 688 (9th Cir. 1988) (quoting Benny v. Pipes, 799 F.2d 489, 492 (9th Cir. 1986)) ("[W]ithout substantial compliance with Rule 4 'neither actual notice nor simply naming the defendant in the complaint will provide personal jurisdiction."); Fed. R. Civ.

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P. 4(a) (a summons must name the correct defendant). When parties dispute facts bearing on jurisdiction, a court may allow limited jurisdictional discovery to resolve the dispute.

See LNS Enterprises LLC v. Cont'l Motors, Inc., 22 F.4th 852, 864 (9th Cir. 2022) (quoting Laub v. U.S. Dep't of Interior, 342 F.3d 1080, 1093 (9th Cir. 2003)) ("Jurisdictional discovery 'should ordinarily be granted where pertinent facts bearing on the question of jurisdiction are controverted or where a more satisfactory showing of the facts is necessary."). Therefore, the Court will permit either party to file a motion requesting limited jurisdictional discovery to determine whether Hashed and AGE actually held BZRX tokens.

VI. RULE 12(b)(1) MOTION TO DISMISS

[53] The Hashed Defendants move to dismiss the claims against them because Plaintiffs lack of Article III standing. (Dkt. 31-1 at 6–7). A motion to dismiss for lack of standing is "properly raised in a Rule 12(b)(1) motion to dismiss."

Chandler v. State Farm Mut. Auto. Ins. Co., 598 F.3d 1115, 1122 (9th Cir. 2010) ("[S]tanding ... pertain[s] to federal courts' subject matter jurisdiction."). Although the Hashed Defendants don't invoke Rule 12(b)(1), the Court will construe this argument as a motion to dismiss for lack of subject matter jurisdiction.

[54] [55] To establish standing, a plaintiff must show: (1) injury in fact, (2) causation, and (3) redressability. **Lujan v.* Defenders of Wildlife, 504 U.S. 555, 560–61, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992). The Hashed Defendants challenge only causation, arguing that the FAC doesn't plead a causal nexus between their alleged conduct and Plaintiffs' injury. (Dkt. 31-1 at 7). To satisfy the causation prong of the standing inquiry, a plaintiff must demonstrate that their injury is fairly traceable to the defendant. **Simon v. E. Ky. Welfare Rts. Org., 426 U.S. 26, 41–42, 96 S.Ct. 1917, 48 L.Ed.2d 450 (1976).

[56] [57] Here, the FAC alleges Plaintiffs were injured due to the negligence of *1125 the bZx DAO general partnership. (FAC ¶¶ 99–101). As previously discussed, the FAC's allegations support the reasonable inference that the Hashed Defendants held BZRX tokens and were therefore members of the general partnership. Under California partnership law, "all partners are jointly and severally liable

for partnership obligations." Myrick v. Mastagni, 185 Cal. App. 4th 1082, 1091, 111 Cal.Rptr.3d 165 (2010); see also Cal. Corp. Code § 16306(a) ("[A]II partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law."); § 16307(b) ("[A]n action may be brought against the partnership and any or all of the partners in the same action or in separate actions.").

The Court finds that Plaintiffs' injury is fairly traceable to the bXz DAO general partnership and that they have standing to sue the alleged general partners Hashed and AGE. The Hashed Defendants' motion to dismiss for lack of standing is **DENIED**.

VII. CONCLUSION

For the forgoing reasons, the Court **GRANTS IN PART** and **DENIES IN PART** the Leveragebox Motion, (Dkt. 27), and **DENIES WITHOUT PREJUDICE** the Hashed Motion, (Dkt. 31). The claims against Tom Bean, bZeroX LLC, and Leveragebox LLC are **DISMISSED WITHOUT PREJUDICE**. To the extent Plaintiffs wish to amend their claims, they may do so by filing a Second Amended Complaint by **April 10, 2023**, in accordance with the Southern District's Civil Local Rules and this Court's Civil Standing Order.

IT IS SO ORDERED.

All Citations

664 F.Supp.3d 1100, 115 Fed.R.Serv.3d 935

Footnotes

The Court takes judicial notice of the Commodity Future Trading Commission's ("CFTC") Order Instituting Proceedings in *In re bZeroX*, *LLC*; *Tom Bean*; *and Kyle Kistner*, CFTC No. 22-31, 2022 WL 4597664 (Sept. 22, 2022). In ruling on a Rule 12(b)(6) motion, courts may consider relevant matters subject to judicial

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notice. See Swartz v. KPMG LLP, 476 F.3d 756, 763 (9th Cir. 2007). A court may "judicially notice a fact that is not subject to reasonable dispute because it: (1) is generally known within the trial court's territorial jurisdiction; or (2) can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b). Proper subjects of judicial notice include administrative materials. See, e.g., Barron v. Reich, 13 F.3d 1370, 1377 (9th Cir. 1994). The CFTC Order Instituting Proceedings is an administrative material properly subject to judicial notice.

- 2 A phishing attack occurs when a bad actor sends the target a digital message containing malicious content. (FAC ¶ 53). Once opened, a phishing message can allow a bad actor to install malware on the target's device or capture sensitive information from the target's device. (Id.).
- 3 The CFTC Order Instituting Proceedings indicates one way to obtain BZRX tokens was to invest in the bZx Protocol, supporting the reasonable inference that tokenholders made contributions to the DAO. See In re bZeroX, LLC, 2022 WL 4597664, at *2 (describing the "bZx Protocol liquidity pool, whose assets were supplied by liquidity providers who, in exchange, had received interest-generating tokens, as well as [BZRX Tokens] conferring voting rights on certain matters relevant to bZx Protocol governance"). Such contributions support treating the DAO as a general partnership. See Ramirez, 2014 WL 12586445, at *3 (noting contributions of money, property, or services to the partnership by the purported partners supports the existence of a general partnership).
- 4 In CFTC v. Ooki DAO—a case involving the Ooki DAO, which succeeded the bZx DAO—the Court noted that "the CFTC stated that Tom Bean and Kyle Kistner, the founders of bZeroX LLC, are [BZRX] Token Holders." CFTC v. Ooki DAO, No. 22-CV-5416-WHO, 2022 WL 17822445, at *4 (N.D. Cal. Dec. 20, 2022).
- 5 It appears the Hashed Defendants' Rule 11 motion didn't conform with that Rule's procedural requirements. Specifically, Plaintiffs contend the Hashed Defendants didn't provide the 21 day period to correct or withdraw the challenged paper. (See Dkt. 38 at 7-8); Fed. R. Civ. P. 11(c)(2). And the Rule 11 motion wasn't made separately from all other motions. (See Dkt. 31-1); Fed. R. Civ. P. 11(c)(2). Additionally, the Hashed Defendants now appear to abandon their motion. (Dkt. 42 at 4 ("Age and Hashed intend to move for Rule 11 sanctions because of the frivolous factual and legal basis for which the lawsuit was filed against Age and Hashed including plaintiffs' persistent refusal to cure the party defects.")). The Hashed Defendants' motion to dismiss is **DENIED WITHOUT PREJUDICE** to the extent it relies on Rule 11.

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2024 WL 4815022

Only the Westlaw citation is currently available. United States District Court, N.D. California.

Andrew SAMUELS, Plaintiff,

V.

Lido DAO, et al., Defendants.

Case No. 23-cv-06492-VC

Signed November 18, 2024

Synopsis

Background: Investor in cryptocurrency tokens on crypto exchange in secondary market filed putative class action claiming that decentralized autonomous organization (DAO) that issued cryptocurrency tokens violated Securities Act by selling unregistered securities and that four large institutional investors were jointly and severally liable for investor's losses as alleged members of issuer's general partnership. Defendants moved to dismiss for failure to state claim.

Holdings: The District Court, Vince Chhabria, J., held that:

- [1] investor plausibly alleged that issuer was legal entity that could be sued;
- [2] investor plausibly alleged issuer was general partnership not immune from suit;
- [3] investor plausibly alleged three institutional investors were general partners;
- [4] investor did not plausibly allege fourth institutional investor was general partner;
- [5] investor plausibly alleged issuer was statutory seller of unregistered securities; and
- [6] issuer's sales of tokens without public offering did not fall outside Securities Act.

Motions granted in part and denied in part.

Procedural Posture(s): Motion to Dismiss for Failure to State a Claim.

West Headnotes (24)

[1] Securities Regulation Persons Subject to Regulation or Liability

Investor's putative class action complaint plausibly alleged that decentralized autonomous organization (DAO) that issued cryptocurrency tokens was not merely autonomous software that ran without human management, but rather was legal entity that could be sued for allegedly violating Securities Act by selling unregistered securities, since investor alleged that issuer made decisions through tokenholder votes, maintained treasury where it kept its retained percentage of staking rewards, and hired over 70 employees.

Securities Act of 1933 §§ 5, 12, 15 U.S.C.A. §§ 77e(a), 77I(a).

[2] Federal Courts • Investment, finance, and credit

Issuer of cryptocurrency tokens that allegedly sold unregistered securities was within Securities Act's nationwide personal jurisdiction for investor's putative class action, since issuer was legal entity that could be sued, rather than merely autonomous software, and investor's claim that issuer violated Securities Act by selling unregistered securities arose out of minimum contacts with United States. Securities

Act of 1933, §§ 5, 12, 22(a), 15 U.S.C.A. §§ 77e(a), 77I(a), 77v(a).

[3] Partnership 🕪 Questions of law or fact

Under California law, the existence of a partnership is a question of fact. Cal. Corp. Code § 16202(a).

[4] Partnership Particular agreements and transactions

Investor's putative class action complaint claiming that issuer of cryptocurrency tokens violated Securities Act by selling unregistered securities plausibly alleged that issuer was subject to suit as general "partnership," within meaning of California law, providing that association of two or more persons to carry on as coowners a business for profit formed a partnership, whether or not persons intended to form partnership; although investor did not comprehensively identify every single partner and when they joined or name every partner as defendant, investor alleged that issuer's founders formed it to run cryptocurrency staking service that kept percentage of staking rewards, and that founders planned to ultimately distribute that revenue to themselves and other tokenholders.

Securities Act of 1933 §§ 5, 12, 15 U.S.C.A. §§ 77e(a), 77*I*(a); Cal. Corp. Code § 16202(a).

[5] Securities Regulation Persons in pari delicto

The "in pari delicto doctrine," meaning in equal fault, provides a defense where a plaintiff who is an active, voluntary participant in the unlawful activity that is the subject of a securities action bears at least substantially equal responsibility for the underlying illegality.

Securities Regulation Persons in pari [6] delicto

Investor's putative class action claim that issuer of cryptocurrency tokens violated Securities Act by selling unregistered securities was not barred by doctrine of in pari delicto, providing defense where plaintiff who was active, voluntary participant in unlawful securities activity bore at least substantially equal responsibility for underlying illegality, since complaint did not allege that investor jointly carried on issuer's cryptocurrency staking business, so investor would not be considered partner, and he was not at least equally responsible for actions that rendered sale of unregistered securities illegal.

Securities Act of 1933 §§ 5, 12, 15 U.S.C.A. §§ 77e(a). 77*l*(a).

[7] **Partnership** Sharing Profits and Losses

Under California law, profit sharing is evidence of a partnership, rather than a required element of the definition of a partnership. Cal. Corp. Code § 16202(a).

Joint Ventures ightharpoonup In profits and losses [8] **Partnership** Sharing Profits and Losses Partnership 👺 Business or profit motive Partnership 📂 Intent

Under California law, while partnerships and joint ventures may be similar, to the extent a difference exists, it pertains to the significance of profit sharing, which is a requisite element of joint ventures, whereas, with respect to partnerships, it is evidence of a partnership but not a necessary element of one; rather, the essential requirement for a partnership is association with the intent to carry on a business for profit. Cal. Corp. Code § 16202(a).

[9] general

Securities Regulation Persons Subject to Regulation or Liability

Under California law, investor's putative class action complaint plausibly alleged that crypto investment firm, as large institutional investor that bought 10% of decentralized autonomous organization (DAO) that issued cryptocurrency tokens, was general partner that jointly carried on issuer's general partnership business for profit, as required to hold firm jointly and severally liable for issuer's alleged violation of Securities Act by selling unregistered securities, since investor's complaint alleged that firm helped influence and guide issuer's development and that DAO's website heralded firm's ability to lend its expertise to issuer's governance. Securities

Act of 1933 §§ 5, 12, 15 U.S.C.A. §§ 77e(a), 77*I*(a); Cal. Corp. Code § 16306(a).

[10] **Partnership** > Joint and several liability in

Securities Regulation Persons Subject to Regulation or Liability

Under California law, investor's putative class action complaint plausibly alleged that venture capital firm, as large institutional investor that bought \$70 million worth of cryptocurrency tokens from decentralized autonomous organization (DAO) issuer, was general partner that jointly carried on issuer's general partnership business for profit, as required to hold firm jointly and severally liable for issuer's alleged violation of Securities Act by selling unregistered securities, since investor's complaint alleged that firm itself announced that it would contribute to DAO as governance participant and that in at least one instance did express view on DAO governance. Securities Act of 1933 §§ 5, 12, 15 U.S.C.A. §§ 77e(a), 77*I*(a); Cal. Corp. Code § 16306(a).

[11] **Partnership** Soint and several liability in general

Securities Regulation Persons Subject to Regulation or Liability

Under California law, investor's putative class action complaint plausibly alleged that venture capital firm, as large institutional investor that initially bought \$25 million worth of cryptocurrency tokens from decentralized autonomous organization (DAO) issuer, was general partner that jointly carried on issuer's general partnership business for profit, as required to hold firm jointly and severally liable for issuer's alleged violation of Securities Act by selling unregistered securities; complaint alleged that when firm purchased even more tokens, it noted that it was looking forward to being more active in governance of DAO and was uniquely positioned to lend its expertise to DAO governance, and that firm was able to purchase tokens because it voted for them to be sold to itself. Securities Act of 1933 §§ 5, 5,

U.S.C.A. §§ 77e(a), 77e(a)(1); Cal. Corp. Code § 16306(a).

[12] Partnership 📻 Joint and several liability in

Securities Regulation Persons Subject to Regulation or Liability

Under California law, investor's putative class action complaint plausibly alleged that investment vehicle, as large institutional investor that together with others bought \$30 million worth of cryptocurrency tokens from decentralized autonomous organization (DAO) issuer, was not general partner that jointly carried on issuer's general partnership business for profit, and thus, vehicle could not be held jointly and severally liable for issuer's alleged violation of Securities Act by selling unregistered securities; complaint did not plausibly allege vehicle meaningfully participated in issuer's governance, but only alleged that one of vehicle's partners praised issuer and that vehicle was chosen to get involved with issuer to add its expertise in successfully developing distributed protocols. Securities Act of 1933 §§ 5, 12, 15 U.S.C.A. §§ 77e(a)(1), 771(a); Cal. Corp.

Code § 16306(a).

[13] Partnership 🗪 Sharing control or management of business

California law requires that each member of a partnership has the right of joint participation in the management and control of the business. Cal. Corp. Code § 16202(a).

[14] **Partnership** > Nature and Extent of Partnership Liabilities

Securities Regulation Persons Subject to Regulation or Liability

Even though a partner cannot be directly liable for a partnership's violation of the Securities Act provision creating liability for any person who offers or sells an unregistered security,

the partnership can still be a co-obligor, under California law, for the partnership's liability. Securities Act of 1933 §§ 2, 12, 15 U.S.C.A. §§ 77b(a)(2), 77l(a); Cal. Corp. Code § 16306(a).

[15] Partnership • Joint and several liability in

Partnership ← Liability of Partners for Partnership Debts and Acts

Partnership ► Liability for debts and acts of partnership

Under California law, partners may structure their partnerships so as not to create joint and several liability, whether through the partnership agreement or by forming limited or limited liability partnerships, and thereby avoid liability. Cal. Corp. Code § 16306(a).

[16] Securities Regulation → Persons Subject to Regulation or Liability

A defendant may be liable as a seller, under the Securities Act, allowing a buyer to recover consideration paid for selling unregistered security, where the defendant either passes title or other interest in the security directly to the buyer, or where the defendant successfully solicits someone else to buy a security motivated in part by a desire to serve the defendant's own or the security owner's financial interests. Securities

Act of 1933 § 12, 15 U.S.C.A. § 77*I*(a).

[17] Securities Regulation • Persons Subject to Regulation or Liability

A person "solicits" the purchase of a security, and thus, may be liable as a statutory seller, under the Securities Act, where she petitions, entices, lures, or urges another to purchase a security. Securities Act of 1933 § 12, 15 U.S.C.A. § 771(a).

[18] Securities Regulation • Persons Subject to Regulation or Liability

Solicitation of the purchase of a security as a statutory seller is broadly construed, under the Security Act, and can include various mechanisms used to urge or persuade another to buy a particular security. Securities Act of 1933 § 12, 15 U.S.C.A. § 771(a).

[19] Securities Regulation Persons Subject to Regulation or Liability

Investor's putative class action complaint plausibly alleged that issuer of cryptocurrency tokens was statutory "seller" of unregistered securities, within meaning of Securities Act, allowing recovery of consideration paid for selling unregistered security, since complaint plausibly alleged that issuer solicited investors' purchases of tokens by being comprehensively involved in their creation and issuance and in efforts to get investors to purchase them, and that issuer worked to get crypto exchanges to list tokens, promoted listings and increases in price through posts on social media, and encouraged investors to participate in issuer's governance, which required investors to purchase tokens.

Securities Act of 1933 §§ 5, 12, 15 U.S.C.A. §§ 77e(a), 77I(a).

[20] Securities Regulation • Cause of injury or loss

A plaintiff does not need to plead either reliance or causation to state a claim for violation of the Securities Act by selling unregistered securities.

Securities Act of 1933 §§ 5, 12, 15 U.S.C.A. §§ 77e(a), 77*I*(a).

[21] Securities Regulation Prospectuses and Communications

Investor's putative class action claim that issuer of cryptocurrency tokens sold unregistered securities on crypto exchange in secondary market was within scope of Securities Act allowing recovery of consideration paid for selling unregistered security, even though prohibition on sale of unregistered securities applied to sales made through use or medium of any prospectus or otherwise, since sale through use of prospectus did not require that investor buy tokens in public offering. Securities Act of 1933 §§ 5, 12, 15 U.S.C.A. §§ 77e(a),

[22] Securities Regulation ← Pleading Securities Regulation ← Evidence

It is a defendant's burden to prove that an exemption from the Security Act's prohibition against selling unregistered securities applies; a plaintiff does not need to plead that none does. Securities Act of 1933 §§ 4, 5, 15 U.S.C.A. §§ 77d(a), 77e(a).

[23] Securities Regulation Restitution or rescission; interest

Securities Act provisions, allowing recovery of consideration paid for selling unregistered security, do not only apply to sales made in public offerings. Securities Act of 1933 §§ 5, 12, 15 U.S.C.A. §§ 77e(a), 771(a).

[24] Statutes 🕪 Context

Generally, in interpreting a statute the term "otherwise" must be interpreted in light of the words preceding it.

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ORDER RE MOTIONS TO DISMISS

Re: Dkt. Nos. 60, 61, 62, 63, 82

VINCE CHHABRIA, United States District Judge

*1 Andrew Samuels is an investor who bought cryptocurrency tokens on an exchange. The tokens were originally issued by an entity called Lido DAO. Samuels lost money on his investment, and he has sued to recover his losses. He asserts that the tokens are "securities" within the meaning of federal law, which means that Lido DAO was required to register them with the Securities and Exchange Commission. Samuels contends that because Lido DAO never registered the securities, it is liable for his losses under Section 12(a)(1) of the Securities Act.

Thus far, nobody has seriously disputed that the crypto tokens are, in fact, securities. And everyone agrees that Lido never registered them. So at first glance, this seems like a relatively straightforward case. But it's not. It presents several new and important questions about the ability of people in the crypto world to inoculate themselves from liability by creating novel legal arrangements to profit from exotic financial instruments.

The first question is whether Lido DAO is capable of being sued. The complaint alleges that it was founded by three investors whose whereabouts are either remote or unknown, and who apparently cannot be hauled into court in the United States. "DAO" stands for Decentralized Autonomous Organization—a type of organization that seems designed, at least in part, to avoid legal liability for its activities. As discussed in Section II of this ruling, Samuels has adequately alleged that Lido DAO is not immune from suit. Specifically, he has alleged that Lido is a general partnership within the meaning of California law.

The second question is whether four large institutional investors in Lido—Paradigm Operations, Andreessen Horowitz, Dragonfly Digital Management, and Robot Ventures—are members of the general partnership. If they are, they can be held liable under California law for the activities of the partnership—including for Lido's failure to register its crypto tokens as securities. As discussed in Section III, Samuels has adequately alleged that all the investors except Robot Ventures are general partners and therefore liable for Lido's conduct.

The third question involves whether Lido (and by extension, the partners) could be liable for the particular losses Samuels incurred. As previously noted, it seems clear that Lido was required to register its crypto tokens as securities. But under Section 12(a)(1), liability for losses incurred from the purchase of unregistered securities only attaches to someone who "offers or sells" those securities. Lido did not actually "sell" the tokens to Samuels; he bought them on the secondary market, on the cryptocurrency exchange Gemini. But the courts have construed the statutory phrase "offers or sells" broadly, to cover someone who "solicits" the purchase of securities. And as discussed in Section IV, Samuels has adequately alleged that Lido indeed solicited the purchase of these tokens on crypto exchanges.

The fourth question is related to the third. The defendants argue that a person can only be liable under Section 12(a) (1) for the sale of an unregistered security if the sale is made in a public offering. And they contend that because Samuels bought his tokens in the secondary market, this means he did not buy them in a public offering. But as explained in Section V, Section 12(a)(1) is not, by its terms, limited to sales made in public offerings. So even if an exchange sale like this one categorically falls outside the scope of the term "public offering," the defendants are wrong to argue that it falls outside the scope of Section 12(a)(1).

*2 The upshot is that the motion to dismiss filed by Robot Ventures is granted, because Samuels has not adequately alleged that Robot Ventures is a member of the Lido general partnership. All other motions to dismiss are denied.

I. FACTS AND PROCEDURAL HISTORY

The facts described in this section are based on the allegations in the complaint—which the Court must assume are true for purposes of ruling on the motions to dismiss—and on materials properly subject to judicial notice. Andreessen Horowitz's and Dolphin's requests for judicial notice are granted.

A. Crypto Staking and Lido DAO's Origins

Lido DAO's service runs on the Ethereum blockchain. The Ethereum blockchain is, essentially, a digital ledger that people can use to record and execute certain financial transactions without going through a central authority such as a bank. Information in the ledger is stored in "blocks," which are connected to prior and later blocks to form a "chain." Transactions are verified through a process called "proofof-stake," in which people called validators run computer programs to confirm the validity of new blocks. Validators receive rewards in the form of Ether, a cryptocurrency associated with and traded through the Ethereum blockchain. But to participate in the proof-of-stake process and receive that reward, validators must put up as collateral-"stake"their own Ether. Validators bid for the opportunity to participate, and are selected and rewarded in proportion to the amount of Ether they stake. In exchange for the rewards, validators run the risk of their stake being forfeited if they dishonestly or incorrectly validate transactions. Because validating can be technologically difficult and requires a minimum per-validator stake of 32 Ether (worth over USD \$99,000 as of November 2024, according to Google Finance), some companies began offering staking services in which they would pool users' cryptocurrency, stake it, receive the payout, keep a fee, and pay the rest of the proceeds to the users.

In 2020, Vasiliy Shapovalov, Konstantin Lomashuk, and Jordan Fish created Lido, one such staking service. Shapovalov lives in Cyprus and Lomashuk in the Cocos (Keeling) Islands, an Australian external territory; Fish's whereabouts are apparently unknown. Although these founders incorporated "some legal entities" to operate a website to "facilitate the creation of Lido," these entities

apparently do not control Lido itself, as they "vigorously repeat in their legal documentation." Am. Compl. ¶ 28, ECF No. 54. As a Decentralized Autonomous Organization, Lido has no formal corporate structure or centralized leadership. Rather, holders of a cryptocurrency token issued by Lido, "LDO," have voting power in proportion to their token holdings and can make governance decisions by proposing and voting on governance actions to be taken by Lido.

Most importantly, LDO tokenholders vote to choose who will serve as the actual validators for the Ether that Lido stakes. Once chosen, those validators stake the Ether pooled by Lido and perform the validations. The Ether rewards are sent back to Lido, which keeps 5%, gives 5% to the validator, and gives the remaining 90% back to the users. Lido's staking operation has been successful: according to the complaint, it stakes the equivalent of more than \$30 billion at once, meaning that it would be making approximately \$50 million a year in staking fees. This money is used to pay operating costs, and Lido DAO has also expressed its intent to upgrade and further develop its technology, hire and pay employees and contractors, and conduct marketing campaigns (in addition to various promotional activities it has already undertaken). And although this hasn't happened yet, the money that Lido DAO keeps could also be distributed to LDO tokenholders as profit.

B. Venture Capital Firms' Investments in Lido DAO

*3 When the Lido founders established the DAO in 2020, they generated one billion LDO tokens. They put 36% of these tokens into Lido's treasury and gave the other 64% to themselves and early investors. Over the next few years, various investment firms bought in. In April 2021, Paradigm Operations, a crypto investment firm, bought 10% (or 100 million LDO). About a year later, venture capital firm Andreessen Horowitz bought an unknown but presumably substantial amount of LDO for \$70 million, and Dragonfly Digital Management, another venture capital firm, similarly bought an undisclosed amount of LDO for \$25 million. Another 30 million LDO were sold, in another transaction, to purchasers including Robot Ventures (an investment vehicle for its two cofounders), although the specifics of that transaction are uncertain. It appears that these entities—all of whom are defendants in this lawsuit-aren't the only institutional investors in Lido DAO: The complaint notes that "a collection of other venture capitalists" bought 3% of Lido's then-outstanding supply of LDO in April 2021, and refers as well to other "insiders." See id. ¶¶ 38, 110. Nevertheless, it's unclear exactly who else might hold a large amount of LDO, how much they might hold, or when or how they might have bought in.

Although the complaint doesn't contain every detail about the DAO's operations and interactions with these investment firms, it appears that each of them, with the possible exception of Robot, took an active role in its management or intended to do so. According to a blog post by a separate cryptocurrency investment firm, Paradigm "influenced and even guided the development route of Lido Finance on the key decentralization issue of Lido Finance." *Id.* ¶ 40. And according to a post on Lido's own website, Paradigm was "uniquely positioned to lend its expertise to LidoDAO governance and serve as a liaison to other [decentralized finance] project teams who can help further decentralize LidoDAO's community," and "actively contributes to protocol research, ... writing code, and, in some cases, auditing codebases." *Id.* ¶ 41.

Andreessen Horowitz planned to be similarly hands-on. When it announced its investment in Lido DAO, it said it "actively contribute[s] to the networks and communities in" its portfolio, and that it would "contribute, as both a staker and governance participant." *Id.* ¶ 43. In one instance, it also expressed an opinion on what Lido's focus should be. More generally, it states that it supports the crypto businesses in which it invests on issues including research, engineering, security, legal and regulatory, and recruiting.

While the complaint provides less detail about Dragonfly's involvement, it also appears to have actively participated in Lido DAO to at least some degree. In July 2022, "[a]fter conversation with the Lido team," it "used its LDO tokens to vote to sell itself even more" tokens, noting that it was "looking forward to being more active in governance." *Id.* ¶¶ 46–47. The corresponding proposal on Lido DAO's site said that Dragonfly, like Paradigm, was "uniquely positioned to lend its expertise to LidoDAO governance and serve as a liaison to other [decentralized finance] project teams who can help further decentralize LidoDAO's community." *Id.* ¶ 78.

The allegations regarding Robot's involvement are much sparser. The complaint notes only that Lido "publicly identified" it as a "key 'strategic partner' "; that one of Robot's founders praised Lido for "securitiz[ing] something prelaunch"; that Lido DAO chose Robot as a partner for "a number of reasons," including its "expertise in the successful development of distributed protocols"; and that it participated

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—alongside other entities—in a sale of 30 million LDO. *Id.* ¶¶ 9, 34, 45, 96.

C. LDO's Listing on Public Exchanges

The founders and early investors weren't the only LDO tokenholders for long. In February 2022, a tokenholder posted on the Lido DAO website a proposal to list LDO on crypto exchanges. (A crypto exchange allows users to trade cryptocurrencies or other crypto assets through a centralized platform, and using a crypto exchange is technologically easier than trading a crypto asset directly through its respective blockchain.) Two Lido DAO representatives responded to the post. One of them worked for both Lido and Paradigm. The other was Jacob Blish, Lido DAO's Business Development Lead, who noted in his response that he was "looking at how we can work with exchanges and would love any insight you might have on the matter." *Id.* ¶ 52. Blish also encouraged the public to ask exchanges to list LDO and fielded inquiries from exchanges that reached out.

*4 These efforts paid off. Over the course of 2022, LDO was added to several major exchanges, including Gemini, Coinbase, Crypto.com, and Kraken. At some point, it was also added to Binance and FTX. Although exact requirements vary, many exchanges require cryptocurrency issuers to actively participate in the listing process, such as by assisting with the exchange's diligence process or otherwise giving the exchange information on the crypto asset to be listed and the technology underlying it.

As LDO was added to new exchanges, Lido DAO—through Blish, its Chief Marketing Officer Kasper Rasmussen, and some of the DAO's other 70-plus employees—promoted the new listings in public posts on Discord (a messaging and social platform) and on Lido's official Twitter account. These posts generally advertised that LDO could be purchased on the relevant exchange; for example, one post announced: "LDO is coming to Coinbase [beach emoji] Deposits/withdrawals are live, with trading to go live at 9AM PT on 17 November." Id. ¶ 59. Lido also posted about increases in LDO's price and about high LDO trading volumes.

Lido's website also promotes LDO holders' ability to participate in Lido DAO's governance (which they can only do by buying LDO tokens) and encourages such participation. It states, for instance, that holding LDO "gives DAO members a vote in the future of Lido, allowing each DAO member to have a personal say in the community" and "in the direction and growth of the Lido DAO." *Id.* ¶ 69. However, according

to the complaint, the founders and early institutional investors own the majority of LDO tokens, making their decisions controlling.

D. Samuels's Purchases of LDO and this Lawsuit

In April and May 2023, Samuels bought approximately 132 LDO tokens through the crypto exchange Gemini. He sold those tokens for a loss in June 2023. In December 2023, he brought this suit against Lido DAO, alleging that it had violated Section 12(a)(1) of the Securities Act of 1933 by selling LDO, an unregistered security, in interstate commerce. He also sued Paradigm, Andreessen Horowitz, Dragonfly, and Robot (collectively, the investor defendants), alleging that they are members of the Lido DAO general partnership and thus are jointly and severally liable for its misconduct. He seeks to represent a class comprising everyone who purchased or obtained LDO on or after December 16, 2022.

In April 2024, the investor defendants moved to dismiss. Lido DAO did not respond to the complaint or otherwise appear in the lawsuit. Thus, Samuels moved for entry of default against Lido DAO, or otherwise for alternative service. In June, the Court heard oral argument on the investor defendants' motions to dismiss and on Samuels's motions, and granted Samuels's motion for alternative service. After that motion was granted, an entity named Dolphin CL, LLC, appeared in the lawsuit and moved to dismiss as to Lido DAO, purporting to make a limited appearance to prevent entry of default judgment against Lido. As discussed later, it's not clear how Dolphin has standing to appear in court to argue on Lido DAO's behalf. But Samuels did not object to it for purposes of the motion to dismiss, and so the Court agreed to hear Dolphin's motion, deferring ruling on the investor defendants' motions in the meantime. In September, after briefing on Dolphin's motion was completed, the Court heard further oral argument.

II. LIDO DAO'S CAPACITY TO BE SUED

Dolphin argues that Lido is not a legal entity, and that therefore it can't be sued at all. The investor defendants argue that whatever Lido is, it is *not* a general partnership, which means that the investors can't be liable as general partners for Lido's conduct.

A

*5 [1] Dolphin argues that Lido is just autonomous software that runs without human management. Specifically, according to Dolphin, Lido is

of executable software programs ... stored at and openly accessible on a specific set of public addresses on the Ethereum blockchain.... The Lido system identified in the Complaint is not owned or operated by any particular entity or group and is not authoritative or exclusive. The source code for Lido is made up of the 'Lido protocol,' which is available under a free open source license and publicly hosted on GitHub. Anyone can deploy copies of this source code ... and each such deployment would constitute an instance of Lido similar to the one alleged in the complaint.... Although the Complaint alleges a particular Lido deployment is a business run by Lido DAO, the Complaint does not allege who deployed this system, nor that the Lido DAO did such deployment. Lido DAO could not have done this, as Lido DAO is another smart contract system, not a legal entity or natural persons.

Dolphin's Mot. to Dismiss 3-4, ECF No. 82.

But Lido's alleged actions are not those of an autonomous software program—they are the actions of an entity run by people. According to the complaint, Lido makes decisions through tokenholder votes, maintains a treasury where it keeps its retained percentage of staking rewards, and has hired over 70 employees. Dolphin responds that the votes are just "polls," and somewhat circularly contends that Lido cannot have employees because it isn't a legal entity. But these factual assertions contradict the well-pled allegations in the complaint.

Moreover, even if Dolphin is right that Lido is a "protocol" that can be deployed by anyone, Samuels is not suing that protocol—he is suing the entity that operates the "particular Lido deployment" identified in the complaint and referred

to by Dolphin. And Dolphin is incorrect that the complaint does not allege who deployed this system: it alleges that the Lido founders did so when they created Lido DAO. Dolphin's response that Lido DAO couldn't have deployed any software because it is not a legal entity is, like its argument that Lido can't have employees, both circular and in contradiction to the well-pled allegations in the complaint.

[2] Incidentally, because the complaint adequately alleges that Lido is a legal entity, it's not clear that it's proper for Dolphin to appear on Lido's behalf-or, as Dolphin puts it, "with respect to" Lido. Id. at 1. Dolphin claims that its limited appearance is justified because Lido is just software and so can't appear itself. In support of this argument, Dolphin cites to Banks.com v. Keery, in which individual defendants moved to dismiss on behalf of domain names also named as defendants. No. C 09-6039, 2010 WL 727973, at *7-8 (N.D. Cal. Mar. 1, 2010). Even if that case is right, it's not clear that it should apply here. For one thing, unlike the plaintiff in Keery, Samuels has adequately alleged that Lido is a legal entity (and not just software). For another, the individuals who moved to dismiss the claims against the domain names in *Keery* were alleged to have created or been otherwise connected to those domain names—while here, Dolphin seems to disclaim that it has any connection to Lido, suggesting that it was created by "unaffiliated LDO token holders." Dolphin's Mot. to Dismiss 1 n.2, ECF No. 82. In any event, although Samuels has reserved the right to contest the legitimacy of Dolphin's maneuver and argue that Lido has failed to appear, he responded to Dolphin's motion on the merits (with his lawyer noting at the hearing that he needed to win on the merits anyway to succeed on his theory of joint and several liability). So it is unnecessary to address at this point whether Dolphin's appearance is sufficient to prevent the entry of default against Lido. 1

В

*6 Although the investor defendants don't have the audacity to argue that Lido is just software, they do argue (along with Dolphin) that Samuels hasn't adequately alleged that it's a general partnership. California law applies to this question because the law of the state where a federal court is located governs the capacity to be sued of a party that is not an individual or a corporation. Fed. R. Civ. P. 17(b) (3); see alsoCFTC v. Ooki Dao, No. 22-cv-5416, 2022 WL

17822445, at *5–8 (N.D. Cal. Dec. 20, 2022) (applying California law to determine whether a different DAO was an unincorporated association and could be sued). And nobody argues that another state or country's law should apply: Samuels makes arguments under both "California law and the general partnership law of other jurisdictions," Dolphin states that California law applies, Paradigm assumes it does, and the remaining investor defendants all cite cases applying it (while in some cases also citing to the Revised Uniform Partnership Act or observing that Samuels has failed to state what law applies).

more persons to carry on as coowners a business for profit forms a partnership, whether or not the persons intend to form a partnership." Cal. Corp. Code § 16202(a). The existence of a partnership is a question of fact. Person v. Smart Inventions, Inc., 125 Cal. App. 4th 1141, 1157, 23 Cal.Rptr.3d 335 (2005). The complaint alleges that Lido DAO's founders formed it to run an Ethereum staking service that keeps a percentage of the staking rewards and that they plan to ultimately distribute this revenue to themselves and other tokenholders—in other words, to carry on, as coowners, a business for profit.

[3] [4] Under California law, "the association of two or

It's not clear at this point who exactly might be a member of the partnership. Samuels's partnership theory is that Lido DAO "is jointly operated by 'large' holders of LDO voting those tokens to cause the DAO to make business decisions," such that "Lido DAO's partners are those that have the capacity to meaningfully participate in Lido DAO's business." Pl.'s Opp'n to Dolphin's Mot. to Dismiss 6, ECF No. 97. In other words, Samuels alleges that only those entities with the capacity for meaningful participation in management of the DAO were admitted as partners by the founders (and, for later-joining partners, by any other then-existing partners) and are jointly carrying on the Lido DAO's staking service for profit. As additional facts are uncovered by discovery, it may become clear that the Lido DAO general partnership is narrower (for instance, including only the founders) or broader (for instance, including everyone who has voted on a governance proposal or who holds any LDO). 2

But at the pleading stage, it is enough for Samuels to adequately allege that some general partnership exists. He has done so. The complaint alleges that some number of people got together and agreed to create and operate an Ethereum staking service because they thought they could make money doing that. Samuels has therefore pled sufficient facts to allow

the reasonable inference that a Lido DAO general partnership was formed. *Cf.Houghton v. Leshner*, No. 22-cv-7781, 2023 WL 6826814, at *3 (N.D. Cal. Sep. 20, 2023) ("The exact contours of liability ... [are] more appropriately tested on a full evidentiary record at summary judgment or trial."). ³

*7 [5] [6] Because this is all that is required at this stage, the argument advanced in various forms by the investor defendants that Samuels "does not plead any coherent theory of partnership, including when it formed, how it formed, or why Defendants are the only 'partners' in it' fails. Paradigm's Mot. to Dismiss 1, 8-9, ECF No. 60. Fairly read, the complaint does not allege that the investor defendants are the only members of the Lido general partnership. Instead, it alleges that the founders got together and formed the Lido partnership. Later on, the investor defendants "joined [that] general partnership" and began to jointly carry on the business with the preexisting partners. See Am. Compl. at 34, ECF No. 54. Other entities may also have joined at various points. But every LDO holder, on the other hand, hasn't automatically joined the partnership because they don't all necessarily have the ability to meaningfully participate in DAO governance and thus haven't all necessarily begun to jointly carry on the DAO's business. No defendant cites any authority holding that a plaintiff must identify when a defendant allegedly joined a partnership, or that a plaintiff seeking to hold members of a partnership liable for a claim against the partnership must name every single partner as a defendant. To the extent that there are other Lido general partners, they would also be jointly and severally liable for any judgment against it, and the investor defendants are free to implead them—or, if any of the investor defendants are ultimately forced to pay a judgment against the DAO, to later seek contribution from them. But the fact that Samuels has not comprehensively identified every single Lido partner and when they joined and named every partner as a defendant—does not mean that he has not sufficiently alleged a partnership. 4

The defendants also argue that Lido cannot be a partnership because its structure and operations are inconsistent with various aspects of partnerships under California law. For instance, they note that anyone can buy LDO tokens and thus participate in the management of Lido's business, while California law provides that a "person may become a partner only with the consent of all of the partners." Cal. Corp. Code § 16401(i). Similarly, anyone can sell their tokens on an open exchange, while under California law, a partnership must repurchase a dissociating partner's interest. *Id.* § 16701(a).

But these are only default rules that can be displaced by a partnership agreement. *Id.* § 16103(a). And that partnership agreement can be oral or implied. *Id.* § 16101(a)(10). Lido is structured such that anyone who holds LDO can participate in the DAO's governance. It can only work this way because its founders (possibly in concert with other early collaborators) set it up to work this way. Therefore, it is reasonable to infer that, at some point, the DAO's founders or early partners made an agreement (whether written, oral, or implied) to modify these default rules and allow for people to become partners by purchasing LDO and for dissociating partners to be able to sell their "interest" to anyone in the form of LDO.

The same is true if the partnership is construed more narrowly, in line with Samuels's theory, as only including those who can meaningfully participate in Lido governance because they hold a large number of tokens (as opposed to including every LDO holder who votes or has the capacity to vote). In that case, it's reasonable to infer that at some point, the founders—possibly in conjunction with other early partners —agreed to structure the DAO to allow for new partners to join by purchasing enough LDO tokens. Or, conceivably, the founders might have decided to sell large quantities of LDO to certain hand-picked entities, ensuring that the founders and these selected entities would hold enough tokens to control votes themselves. Again, it's not clear at this point what the founders might have agreed to, and the exact contours of the Lido general partnership are better determined "on a full evidentiary record at summary judgment or trial." Houghton, 2023 WL 6826814, at *6. But Samuels has made sufficient allegations to draw the reasonable inference that the Lido founders (and possibly other early investors) agreed to displace California's default partnership rules governing partners' entrance into and exit from the partnership.

*8 [7] [8] Dolphin, Dragonfly, and Robot next argue that Lido cannot be a general partnership because the plaintiffs do not allege an explicit agreement for the sharing of profits and losses. But under California law, profit sharing is "evidence of a partnership, rather than a required element of the definition of a partnership." Holmes v. Lerner, 74 Cal. App. 4th 442, 453–54, 88 Cal.Rptr.2d 130 (1999). Although Dragonfly cites Simmons v. Ware for the proposition that "[a]greement to share in the profits and losses of the enterprise is ... essential to a joint venture," that language concerned a joint venture. 213 Cal. App. 4th 1035, 1054, 153 Cal.Rptr.3d 178 (2013). While partnerships and joint ventures may be similar, to the "extent a difference exists, it pertains to the

significance of profit sharing. In particular, profit sharing is a requisite element of joint ventures, whereas, with respect to partnerships," it is evidence of a partnership but not a necessary element of one. *Beautiful Slides, Inc. v. Allen*, No. 17-cv-1091, 2017 WL 11829657, at *1 (N.D. Cal. Dec. 4, 2017) (cleaned up) (discussing *Holmes* and *Simmons*). Rather, the "essential requirement for a partnership" is "association with the intent to carry on a business for profit." *Holmes*, 74 Cal. App. 4th at 454, 88 Cal.Rptr.2d 130. That members of a certain partnership may not have made an explicit agreement regarding profit sharing does not mean that their goal in running a business together was not to make money. Here, as discussed above, Samuels has adequately

alleged an association to carry on a business for profit.

Finally, both Dolphin and Paradigm make arguments based on

the principle that the affirmative choice of another corporate form weighs against the existence of a partnership. See, e.g., Eng v. Brown, 21 Cal. App. 5th 675, 694–95, 230 Cal.Rptr.3d 771 (2018). Dolphin notes that separate entities were "formed for the purposes of facilitating the Lido DAO software." Dolphin's Mot. to Dismiss 11, ECF No. 82. But the complaint alleges that those separate entities were only formed to operate a website and do not control Lido itself -and in fact that these entities' "legal documentation" disclaims any control over the DAO. Am. Compl. ¶ 28, ECF No. 54. Paradigm argues that the fact that the investor defendants themselves chose other corporate forms means that they are not members of a partnership. But California law expressly provides that corporations and other corporate entities can be members of general partnerships. Cal. Corp. Code § 16101(a)(13). And the investor defendants' individual businesses are different from the business they allegedly jointly carry on as Lido. 5

III. SAMUELS'S CLAIMS AGAINST THE INVESTOR DEFENDANTS

Samuels concedes that the investor defendants did not directly violate the Securities Act. Rather, he seeks to hold them liable as members of the Lido general partnership. Under California law, general partners "are liable jointly and severally for all obligations of the partnership unless otherwise agreed." Cal. Corp. Code § 16306(a). So the investors are proper defendants only to the extent Samuels has adequately alleged that they are Lido general partners.

[9] [10] The complaint easily alleges that Paradigm and Andreessen Horowitz are partners. It says that Paradigm has helped "influence[]" and "guide[]" the development of Lido and that the DAO's website heralded Paradigm's ability to "lend its expertise to LidoDAO governance." Am. Compl. ¶¶ 40-41. Andreessen Horowitz, for its part, announced itself that it would contribute to Lido DAO as a "governance participant," and in at least one instance did express a view on DAO governance. Id. ¶ 43. Considering also the allegation that it purchased \$70 million worth of LDO, it is reasonable to infer that it was capable of meaningfully participating in the DAO's governance. Because the complaint alleges that Paradigm and Andreessen Horowitz participated in Lido DAO governance, it plausibly alleges that they (possibly alongside others) jointly carried on the DAO's business for profit.

*9 [11] Although it's a closer call, the complaint also includes sufficient allegations to support an inference of partnership on the part of Dragonfly. After an initial purchase of \$25 million worth of LDO, Dragonfly purchased even more tokens, noting that it was "looking forward to being more active in governance" and that it was "uniquely positioned to lend its expertise to LidoDAO governance." *Id.* ¶¶ 46, 78. And it was able to purchase these tokens because it voted for them to be sold to it. So, drawing reasonable inferences in Samuels's favor, it is plausible that Dragonfly, too, has meaningfully participated in Lido DAO governance and thus carried on its business for profit.

[12] On the other hand, the complaint does not contain sufficient allegations to infer that Robot meaningfully participated in Lido DAO governance. It notes only that one of Robot's partners praised Lido DAO, that Robot was chosen to get involved with the DAO because it could add its "expertise in the successful development of distributed protocols" to the DAO, and that it participated in a sale in which it-along with other entities-purchased 30 million LDO. Id. ¶ 45. It does not allege that Robot participated in Lido DAO governance or made any statements about doing so. Samuels argues that it is reasonable to infer that Robot, having been brought in for similar reasons as the other investor defendants, would have a similar role and similar active participation in governance. But while it might be true that Robot did or intended to have such a role, the complaint doesn't actually allege that Robot did or said anything other than purchase some unknown quantity of LDO. So, at this juncture, Samuels has not pled that Robot is a member of the Lido DAO partnership; should discovery reveal that Robot

was actually an active participant in governance, Samuels is free to seek leave to add it back as a defendant.

Notwithstanding the complaint's allegations of the investor defendants' involvement with Lido DAO, Dragonfly and Robot argue that the investor defendants cannot be partners because partners are those who "each have the power of ultimate control" over a business, but the complaint does not allege that the investors completely control Lido DAO or "consistently vote in unison." Dragonfly's Mot. to Dismiss 6, 8, ECF No. 63; Robot's Mot. to Dismiss 7–8, ECF No. 63 (emphasis added). They note that the Revised Uniform Partnership Act, on which California's partnership law is based, imposes this requirement.

[13] But the defendants do not cite to any place where the requirement that "each" partner have the "power of ultimate control" can be found in California law. And partners obviously do not need to always agree on everything to be partners. To the contrary, as Dragonfly itself notes, California law requires that each party have the "right of joint participation in the management and control of the business." Bank of California v. Connolly, 36 Cal. App. 3d 350, 364, 111 Cal. Rptr. 468 (1973) (emphasis added). It is the partnership as a whole that must ultimately control the business, as Samuels has alleged the Lido DAO partnership does. So whether Samuels has plausibly alleged that the investor defendants are members of that partnership hinges not on whether he has alleged that they each control Lido, but on whether he has made sufficient allegations that each of them has agreed to jointly participate in its management alongside other partners.

Paradigm and Andreessen Horowitz argue that, even if they are members of the Lido general partnership, they are not properly defendants in this case for other reasons. First, both argue that partners cannot be derivatively liable for a partnership's violations of Section 12—the section of the Securities Act under which this lawsuit is brought. In support of this argument, they note that Section 12 only creates liability for "any person" who "offers or sells a security."

15 U.S.C. § 77/(a). Section 11 of the Act, meanwhile, also extends liability to "every person who was" a "partner in the issuer" of a false registration statement. 15 U.S.C. § 77k(a)(2). According to the defendants, the fact that partners were expressly included in Section 11 but not in Section 12 indicates that Section 12 precludes partnership liability.

*10 [14] It's true that a partner cannot be directly liable for a violation of Section 12 simply by virtue of their being a

partner in an entity that violates that provision (as they could be for a violation of Section 11). But the Act clearly defines "person" to include "a partnership." 15 U.S.C. § 77b(a) (2). And under California law, general partners are jointly and severally liable for the obligations of the partnership. Cal. Corp. Code § 16306(a). So even though a partner cannot be directly liable for a partnership's violation of Section 12, the partnership can still be a co-obligor, under state law, for the partnership's liability.

[15] This is not a meaningless distinction: partners may structure their partnerships so as not to create joint and several liability (whether through the partnership agreement or by forming limited or limited liability partnerships) and thereby avoid liability under state partnership law. If, on the other hand, Section 12 provided for partner liability the way Section 11 does, partners could presumably be subject to Section 12 suits regardless of how their partnerships were structured under state law.

Nor does Schneider v. Traweek, cited by the defendants, change this conclusion. No. CV 88-0905, 1990 WL 169856 (C.D. Cal. Sep. 5, 1990). In that case, the court held that the alleged status of one defendant, Fainsbert, as a "secondary general partner" did not make him a statutory seller subject to liability under Section 12. Id. at *17. The court thus dismissed the Section 12 claim against him. Id. What claims were brought against whom is somewhat unclear; the opinion notes, for instance, that the defendant "Bell Firm is not named as a Defendant in the Plaintiff's [Section 12(a)(2)] and RICO claims," but also that the court had "previously ruled that the Plaintiffs have sufficiently stated a [Section 12(a)(2)] claim against the Defendant Bell Firm." Compare id. at *3, with id. at *16. Nevertheless, it appears that the plaintiffs did not actually bring a Section 12 suit against the entity of which Fainsbert was a general partner: the opinion discusses a Section 12 claim only against Fainsbert, and discusses only Section 10(b), Rule 10b-5, and RICO claims against the partnership. See id. at *2-3, *16-17. Schneider therefore does not stand for the proposition that a defendant cannot be held jointly and severally liable, under state partnership law, for a partnership's alleged violation of Section 12; it does not even address this point or discuss partnership liability under California law.

Andreessen Horowitz also argues that it is not a proper defendant because joint and several liability merely "relates to the apportionment of damages once a party has been found liable." Andreessen Horowitz's Reply 5, ECF No. 67 (quoting Staefa Control-System Inc. v. St. Paul Fire & Marine Insurance Co., 847 F. Supp. 1460, 1471 (N.D. Cal. 1994)). It's true that Andreessen Horowitz will only be liable if Lido is. But under Federal Rule of Civil Procedure 20(a) (2), multiple parties can be joined as defendants if "any right to relief is asserted against them jointly [or] severally." See also Sarcuni v. bZx DAO, 664 F. Supp. 3d 1100, 1125 (S.D. Cal. 2023) (allowing claims against defendants that were allegedly members of DAO general partnership to proceed on grounds that those defendants could be jointly and severally liable for DAO's negligence). Andreessen Horowitz can be joined as a defendant because Samuels has adequately alleged that it is a Lido general partner jointly and severally liable for any judgment against the DAO.

IV. LIDO DAO AS A STATUTORY SELLER

*11 Section 12(a)(1) provides that any person who "offers or sells a security in violation of" Section 5 of the Act "shall be liable" to "the person purchasing such security from him, who may sue" to "recover the consideration paid for such security." 15 U.S.C. § 77*l*(a). Section 5 provides that it "shall be unlawful for any person" to sell a security in interstate commerce unless "a registration statement is in effect as to" that security. 15 U.S.C. § 77e(a); see also Pinter v. Dahl, 486 U.S. 622, 627 n.4, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988). Therefore, Section 12(a)(1) and Section 5(a)(1) together allow someone who purchases an unregistered security to bring a suit for rescission against that security's seller.

[16] Paradigm, Andreessen Horowitz, and Dolphin argue that Samuels has failed to plead that Lido DAO is a statutory seller (that is, one who "offers or sells a security" under Section 12). But the case law gives a broad definition to this statutory phrase. A defendant may be liable as a seller under Section 12 "where they either pass title or other interest in the security directly to the buyer, or where they 'successfully solicit' someone else to buy a security motivated in part by a desire to serve their own or the security owner's financial interests." *Houghton v. Leshner*, No. 22-cv-7781, 2023 WL 6826814, at *2 (N.D. Cal. Sep. 20, 2023) (quoting *Pinter*, 486 U.S. at 646, 108 S.Ct. 2063). Samuels does not allege

that Lido passed him title to the LDO tokens he purchased; he argues only that Lido DAO is a statutory seller because it solicited his and others' purchases of LDO.

[17] [18] A person "solicits" the purchase of a security "where she petitions, entices, lures, or urges another to purchase a security." *In re Genius Brands International, Inc. Securities Litigation*, 97 F.4th 1171, 1182 (9th Cir. 2024) (cleaned up). "Solicitation is broadly construed in the Ninth Circuit," *Houghton*, 2023 WL 6826814, at *3, and can include "various mechanisms used to 'urge or persuade another to buy a particular security,' " *Genius Brands*, 97 F.4th at 1182 (quoting *Pino v. Cardone Capital LLC*, 55 F.4th 1253, 1258 (9th Cir. 2022)).

Most relevant here, courts in this district have held that a plaintiff has adequately pled solicitation where they have stated that the defendant has been "comprehensive[ly] involve[d] with the design, operation and monetization of a cryptocurrency enterprise." Houghton, 2023 WL 6826814, at *3 (citing In re Tezos Securities Litigation, No. 17-CV-6779, 2018 WL 4293341, at *9 (N.D. Cal. Aug. 7, 2018)). In *Tezos*, for instance, Chief Judge Seeborg held that allegations of a defendant's "creation of the [relevant] technology, establishment of a legal entity to monetize [that defendant's] interest in that technology, development of a platform to facilitate said monetization, and minute-to-minute oversight of the monetization process itself" made that defendant more than a "collateral participant" in the sale of the crypto assets at issue and thus potentially liable as a statutory seller. 2018 WL 4293341, at *9. Similarly, in *Houghton*, Judge Orrick held that the plaintiffs' "numerous allegations regarding the Partner Defendants' roles with [a DAO and that DAO's founder], including their design and governance decisions, their efforts to successfully monetize [that DAO's

[19] Here, Samuels has likewise pled solicitation because he has alleged that Lido DAO was comprehensively involved in the creation and issuance of LDO and in efforts to get people to purchase it. He alleges that Lido worked to get crypto exchanges to list LDO; that Lido promoted the listings and increases in LDO's price through posts on social media; and that Lido encouraged people to participate in Lido governance, which requires them to purchase LDO. The alleged statements about LDO's price and availability

token] and bring it to secondary markets, and their public comments, plausibly [pled] solicitation." 2023 WL 6826814,

at *3.

on exchanges and about participation in DAO governance are plausibly encouragements to purchase LDO. These allegations are nearly identical to those held sufficient for solicitation in *Houghton*, where the plaintiff alleged that the defendants "were involved in creating, designing, and then opening the market for [the DAO's business, analogous to Lido's staking service], including efforts to persuade exchanges to offer [the DAO's token], paying exchanges to carry promotional videos, and encouraging investors to purchase [the token] and play a role in governance." *Id.* at *5.

*12 [20] The defendants argue that Lido DAO could not have solicited Samuels's purchase because he does not specifically allege that he saw any of Lido DAO's promotional social media posts. But the Ninth Circuit has held that solicitation does not need to be "direct or personal to a particular purchaser," or akin to "contractual privity." Pino, 55 F.4th at 1259-60. Moreover, a plaintiff does not need to plead either reliance or causation to state a Section 12 claim. Seeid. at 1260; In re Daou Systems, Inc., 411 F.3d 1006, 1029 (9th Cir. 2005), abrogated on other grounds by Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 131 S.Ct. 1309, 179 L.Ed.2d 398 (2011); Houghton, 2023 WL 6826814, at *4 n.5. Given that reliance is not required, that a solicitation must be "successful" is better understood as requiring that "a sale has taken place." Pinter, 486 U.S. at 644, 108 S.Ct. 2063. So if solicitation can be achieved through mass communications, and individual plaintiffs do not need to have relied on or had their purchases caused by these communications, it is unclear why a plaintiff would need to have seen them. See also Tezos, 2018 WL 4293341, at *3, *9-10 (holding that a plaintiff adequately alleged solicitation as to certain defendants even where the plaintiff did not allege that he had any "awareness of any of the defendant-specific promotional or procedural activity"). 6

Andreessen Horowitz and Paradigm next argue that Lido DAO was not motivated by a desire to serve its financial interests. But Lido would benefit financially from sales of LDO—even sales in which it did not literally pass title—because the LDO tokens owned by it and its partners and investors are only valuable if there is a liquid market on which to sell them, and because the tokens can be sold for more if LDO's market price is driven higher by high demand. Andreessen Horowitz argues that Supreme Court precedent limits the sorts of financial interests that suffice for solicitation, contending that a defendant must specifically

for LDO and raising its price.

receive a financial benefit from the sale to the plaintiff (such as a commission) to qualify. Andreessen Horowitz's Mot. to Dismiss 5, ECF No. 61 (citing Pinter v. Dahl, 486 U.S. 622, 654-55, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988)). In its view, Samuels's purchase fails because Lido's financial interest is in the token price generally rather than in his transaction specifically. But while the Supreme Court may have used commissions and profit-sharing arrangements as examples of financial interests a soliciting seller might have in a sale, it did not say that these were the only sufficient interests. See Pinter, 486 U.S. at 654, 108 S.Ct. 2063. Although these might be the only interests that would make sense for certain brokers to have, that doesn't mean they are the only interests that make sense for an issuer accused of solicitation to have in the sale of its own security. And while Lido's financial interest might not manifest on a saleby-sale basis the way a commission would, it still has a financial interest in every transaction because every purchase contributes to demand—creating, in the aggregate, a market

Paradigm similarly cites Risley v. Universal Navigation *Inc.* for the proposition that an interest in seeing the price of a security increase does not count for solicitation. 690 F. Supp. 3d 195 (S.D.N.Y. 2023). But that is not what Risley said. In *Risley*, the defendants operated a cryptocurrency exchange that could be used to trade cryptocurrency without going through an intermediary. Id. at 200, 205. Like Lido DAO, the exchange had a "governance token." That token could be purchased on the exchange and its holders could make governance decisions for the exchange. Id. at 208– 09. The plaintiffs lost money on "scam tokens" that they bought on the exchange. at 200. Unable to identify the issuers of the scam tokens, they instead sued developers of and investors in the exchange.
Id. The court held that the plaintiffs had failed to allege that the defendants had solicited their purchases of the scam tokens. Id. at 221-23. In addition to holding that the defendants had not actually solicited buyers to purchase the scam tokens, the court held that the plaintiffs had not adequately alleged that the defendants were motivated by the prospect of financial gain. The plaintiffs had argued that the defendants "ultimately profited themselves by, at the least, increasing the value" of the governance token. Id. at 223. The court

held that this wasn't enough, saying that "Plaintiffs' citation to SEC Chair Gensler's conclusory statement that '[t]here's some incentive structure for those promoters and sponsors in the middle of' the decentralized software, cannot support a claim that Defendants had a financial interest in the particular transactions at issue here.... Instead, Plaintiff's allegations that [defendants] either directly solicited the transactions or did so as a means of obtaining a profit are entirely conclusory and devoid of factual support." *Id.* (internal citations omitted).

*13 Risley is thus distinguishable in two ways. First, the court didn't hold that increasing the value of a security could never be enough to constitute a financial interest sufficient for solicitation. It held more narrowly that the plaintiffs hadn't explained in a non-conclusory way how the defendants in that case would actually benefit from the plaintiffs' purchases. Unlike in Risley, Samuels explains clearly enough how Lido would benefit from sales of LDO, and does not rely on conclusory statements about cryptocurrency exchanges generally. Second, and more importantly, the security whose value the Risley defendants had allegedly sought to increase—the exchange's governance token—was a different security than the ones the plaintiffs had purchased. The tokens the plaintiffs had actually purchased, meanwhile, were not issued by the defendant exchange. Therefore, as the court noted, the plaintiffs' suit was akin to suing the New York Stock Exchange after losing money "due to an issuer's fraudulent schemes." [1d. at 222. Here, by contrast, the alleged security that Samuels purchased is the same one whose price he argues Lido has a financial interest in: LDO. And he is suing LDO's issuer, not the exchange on which he purchased it.

V. SECONDARY MARKET TRANSACTIONS

[21] The defendants contend that even if Lido has "solicited" the purchase of the tokens by Samuels, its conduct falls outside the scope of the Securities Act for a different reason. To recall, Section 12(a)(1) of the Act imposes liability on a person who "offers or sells" a security in violation of Section 5. 15 U.S.C. § 77l(a)(1). As relevant here, Section 5(a) (1) makes it unlawful to sell a security unless it is registered. Id. 77e(a)(1). And the prohibition on the sale of unregistered securities applies to sales that are made "through the use or medium of any prospectus or otherwise." Id. The defendants attach significance to the word "prospectus" in Section 5. They say that the use of a prospectus connotes

an initial public offering, and that Congress, by using the phrase "prospectus or otherwise," was referring only to a prospectus or other types of communications one would make in connection with an initial public offering. The defendants further contend that Samuels did not buy his tokens in a public offering, and so Lido's conduct falls outside the scope of Section 12(a)(1) and Section 5(a)(1).

[22] But as a textual matter, the phrase "prospectus or otherwise" seems designed to ensure that the sale of any unregistered security is covered by Section 5(a)(1): no matter what medium you're using to sell the security, you can only sell it if it's been registered. This is bolstered by a review of Section 4 of the Act, which exempts certain sales from Section 5. This includes exemptions for "transactions by any person other than an issuer, underwriter, or dealer," and "transactions by an issuer not involving any public offering." *Id.* § 77d(a) (1)–(2). If Section 5(a)(1) were limited to sales of securities in public offerings, there would presumably be no reason to include these exemptions. But the defendants don't argue, at least at this stage, that their conduct falls within one or more of Section 4's exemptions. They argue instead that Section 5(a)(1)—and by extension, Section 12(a)(1)—applies only to public offerings in the first place. 7

In support of their position, the defendants invoke Gustafson v. Alloyd Co., Inc., 513 U.S. 561, 115 S.Ct. 1061, 131 L.Ed.2d 1 (1995). In Gustafson, the Supreme Court considered the scope of the provision that immediately follows Section 12(a)(1), which creates liability for people who sell a security "by means of a prospectus or oral communication" that includes a material misstatement or omission. 15 U.S.C. § 77l(a)(2). The Court held that this provision—Section 12(a)(2)—is limited to statements made in public offerings. A "prospectus," the Court explained, is "confined to documents related to public offerings by an issuer or its controlling shareholders." Gustafson, 513 U.S. at 569, 115 S.Ct. 1061. And the phrase "or oral communication" should be understood, in context, as referring to a communication that's not a prospectus but that's made in connection with a public offering. Therefore, because secondary market transactions do not occur by means of documents relating to public offerings, the Court held that they are not sales done "by means of a prospectus or oral communication," and cannot give rise to liability under Section 12(a)(2). Id. at 567-73, 576-78, 584, 115 S.Ct. 1061.

*14 [23] It's not clear whether the approach to statutory interpretation employed by the majority roughly thirty years ago in Gustafson is consistent with the Court's current approach. In any event, it does not follow from Gustafson that Sections 12(a)(1) and 5(a)(1) apply only to sales made in public offerings. First, in terms of plain text, Sections 12(a)(1) and 5(a)(1) contemplate a broader scope than does Section 12(a)(2). Section 12(a)(2) covers sales "by means of a prospectus or oral communication." 15 U.S.C. § 77*l*(a) (2). Sections 12(a)(1) and 5(a)(1) cover sales "through the use or medium of any prospectus or otherwise." (emphasis added). - Id. §§ 77l(a)(1), 77e(a)(1). Second, in terms of structure, Section 4 exempts many secondary market transactions-including transactions by entities other than issuers, underwriters, and dealers, and transactions by issuers "not involving any public offering"—from Section 5 and thus Section 12(a)(1) liability. But Section 4 does not exempt these transactions from Section 12(a)(2) liability.

Therefore, as Justice Thomas noted in his dissent in Gustafson, reading Section 12(a)(1) and Section 5(a)(1) as limited to public offerings "would render § 4 superfluous": if Section 12(a)(1) and Section 5(a)(1) were limited to public offerings by their own language, "this would have precluded any need to include § 4 at all." Gustafson, 513 U.S. at 591, 115 S.Ct. 1061 (Thomas, J., dissenting). Justice Thomas would have applied this concept to Section 12(a) (2) as well. But the majority reasoned that reading Section 12(a)(2) as limited to public offerings did not create the same superfluity because Section 4 does not apply to Section 12(a) (2). Id. at 573, 115 S.Ct. 1061 (majority opinion). Given this exchange, there is no reason to believe that any member of the Court in Gustafson—whether in the majority or the dissent—thought that Section 12(a)(1) and Section 5(a)(1) are limited to public offerings by their own terms. Reading these provisions to apply to secondary market transactions (to the extent those transactions are not exempted by Section 4) ensures that Section 4 serves a purpose and gives meaning to Section 5(a)(1)'s use of "or otherwise"; the defendants' reading, on the other hand, treats Section 4 as surplusage and largely reads "or otherwise" out of the statute. So even if the defendants are ultimately correct that Samuels's secondary market transaction was not part of a public offering (or, in the language of Section 4(a)(2), was a transaction "not involving any public offering"), they "should look to Section 4, not

Gustafson," to dispose of his claim on that basis. Owen v. Elastos Foundation, No. 19-cv-5462, 2021 WL 5868171, at *14 (S.D.N.Y. Dec. 9, 2021).

The defendants insist that, under their reading, Section 4 is not surplusage but rather part of a "belt and suspenders" burdenshifting approach. Under their theory, a plaintiff bringing a Section 12(a)(1) claim has the initial burden (under Section 12(a)(1) and Section 5(a)(1)) to plead that they purchased the unregistered security in a public offering, and then the burden shifts to the defendant to show that the transaction did not involve a public offering (under Section 4). The defendants are correct that the Section 4 exemptions are affirmative defenses that a defendant bears the burden of establishing. But then it seems even less plausible that the purchase of a security in a public offering is an element of a Section 12(a)(1) claim: if purchase in a public offering were an element of the claim, there would be no need to establish a similar requirement as a separate affirmative defense. To make something both an element and an affirmative defense is not "belt and suspenders." It's irrational, and there's no reason to ascribe such irrationality to the Securities Act.

[24] Relatedly, the defendants argue that "or otherwise," as used in Section 5(a)(1), must be read narrowly and in light of "prospectus," which precedes it. It's true as a general matter that "otherwise" must be interpreted in light of the words preceding it. See, e.g., Fischer v. United States, 603 U.S. 480, 144 S. Ct. 2176, 2182-86, 219 L.Ed.2d 911 (2024). But the statute's definition of "prospectus" already includes "any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale." 15 U.S.C. § 77b(a) (10). So if all Congress wanted to do was cover "prospectuslike documents" in situations where a formal prospectus hasn't been filed, there would have been no need to add "or otherwise." It could have just referred, as it did in Section 12(a)(2), to a "prospectus or oral communication." This would have covered any "notice," "advertisement," or "oral communication" that offered a security for sale in connection with a public offering. That Section 5(a)(1) instead refers to sales by "prospectus or otherwise" indicates that it is intended to apply more broadly than just to things included in the definition of a "prospectus"—in other words, more broadly than something that "describes a public offering of securities," as prospectus was defined in Gustafson, 513 U.S. at 584, 115 S.Ct. 1061—and thus more broadly than Section 12(a)(2).

*15 The defendants cite Kainos Laboratories, Inc. v. Beacon Diagnostics, Inc., in which the court held that Section 12(a)(1) is limited to public offerings. No. C-97-4618, 1998 WL 2016634, at *6-7 (N.D. Cal. Sep. 14, 1998). For one thing, at least two other district courts have since held that Section 12(a)(1) and Section 5(a)(1) cover secondary market transactions. See, e.g., Zakinov v. Ripple Labs, Inc., No. 18-cv-06753, 2020 WL 922815, at *11-12 (N.D. Cal. Feb. 26, 2020); Owen, 2021 WL 5868171, at *12–14. More importantly, Kainos reached its conclusion based on a footnote in Justice Ginsburg's Gustafson dissent, which stated that there "is no dispute that" Section 12(a)(1) applies "only to public offerings-or, to be precise, to transactions subject to registration." Kainos, 1998 WL 2016634, at *6– 7 (citing Gustafson, 513 U.S. at 600 n.4, 115 S.Ct. 1061 (Ginsburg, J., dissenting)). But Justice Ginsburg also joined Justice Thomas's dissent, which stressed that Section 5 (and thus Section 12(a)(1)) is only limited to initial offerings by Section 4 and noted that "Congress left the job of exempting certain classes of transactions to §§ 3 and 4." Gustafson, 513 U.S. at 586, 115 S.Ct. 1061 (Thomas, J., dissenting). So in context, it's clear that Justice Ginsburg meant that Section 12(a)(1) and Section 5(a)(1) are limited by Section 4. Kainos is also undercut by the Ninth Circuit's statement, made in a different context, that "[b]y its terms, Section 5 ... creates liability for any securities sale for which 'a registration statement is [not] in effect;' it does not limit liability to initial distribution"—in other words, that any limitations on Section 5 (and thus Section 12(a)(1)) must come from Section 4. SEC v. Phan, 500 F.3d 895, 902 (9th Cir. 2007) (third alteration in original).

VI. CONCLUSION

For the foregoing reasons, Robot's motion to dismiss is granted. The motions to dismiss by Dolphin, Paradigm, Andreessen Horowitz, and Dragonfly are denied. Discovery against the remaining defendants can proceed immediately. A case management conference is set for 10am on December 6, 2024, to set a schedule for the rest of the case. Because of the Thanksgiving holiday, the parties need not file their joint case management statement until December 3.

IT IS SO ORDERED.

All Citations

--- F.Supp.3d ----, 2024 WL 4815022

Footnotes

- Dolphin also argues that there is no personal jurisdiction over Lido because Lido is not a legal entity and because Lido does not have minimum contacts with the United States. But for the reasons already discussed, Dolphin is wrong that Lido is not a legal entity. Moreover, Samuels has pled sufficient facts to show that his claim arises out of Lido's minimum contacts with the United States, which is all that is required given that the Securities Act provides for nationwide personal jurisdiction over anyone with such contacts.

 **SEC v. Ross, 504 F.3d 1130, 1139 (9th Cir. 2007).
- Samuels does not contend that the partnership comprises every single person who holds even a single LDO token, or—given the allegations in the complaint that people who hold LDO through certain exchanges cannot vote on Lido DAO governance proposals—every single person who has the capacity to use their LDO to vote or who has actually voted. In this regard, his partnership allegations are different from those accepted in Sarcuni v. bZx DAO, which held that the plaintiff had adequately alleged a partnership comprising every holder of the defendant DAO's token.
- Similarly, it may be that any defendant ultimately found to be a general partner of Lido DAO nevertheless cannot be liable for acts that predate their entry into the partnership. SeeCal. Corp. Code § 16306(b). The extent to which individual partners' liability must be reduced on this basis is also better determined at a later stage in the case. SeeHoughton, 2023 WL 6826814, at *6.
- The argument advanced by some of the defendants that Samuels's claim is barred by the doctrine of *in pari delicto* ("in equal fault") fails for similar reasons. This doctrine provides a defense where a plaintiff who is an "active, voluntary participant in the unlawful activity that is the subject of" a securities action "bears at least substantially equal responsibility for the underlying illegality." *Pinter v. Dahl*, 486 U.S. 622, 635–36, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988). The defendants argue that this doctrine applies to Samuels because he became a Lido DAO partner by purchasing LDO, so he is equally responsible for the partnership's wrongdoing. But the complaint includes no allegation that indicates that Samuels jointly carried on the Lido business, so as discussed, there's no reason he should be considered a partner at this point. Moreover, there is no indication whatsoever that he "is at least equally responsible for the actions that render[ed] the sale of the unregistered securities illegal." *Pinter*, 486 U.S. at 636, 108 S.Ct. 2063.
- Even if Lido DAO is not a general partnership, it might still be capable of being sued under some other theory—for instance, as an unincorporated association or to enforce a substantive federal right. See, e.g., CFTC v. Ooki DAO, No. 22-cv-5416, 2022 WL 17822445, at *4–8, *8 n.10 (N.D. Cal. Dec. 20, 2022) (holding that the plaintiff had adequately alleged that a different DAO was an unincorporated association under California law—and noting that, even if the plaintiff hadn't done so, the defendant could be sued under Rule 17 because the plaintiff was seeking to enforce federal law and the defendant met the federal law definition of an unincorporated association).

Samuels v. Dao, --- F.Supp.3d ---- (2024)

- Dolphin cites Hollifield v. Resolute Capital Partners Ltd., in which a district court held that the plaintiffs had not pled solicitation because they did not allege that they attended any of the seminars or dinners, or listened to any of the radio shows, through which some of the defendants allegedly engaged in solicitation. No. 22-cv-7885, 2023 WL 4291524, at *6 (C.D. Cal. May 12, 2023). But Hollifield did not discuss or distinguish Pino in reaching this conclusion, so this Court declines to follow it.
- It is a defendant's burden to prove that a Section 4 exemption applies; a plaintiff does not need to plead that none does. See, e.g., Western Federal Corp. v. Erickson, 739 F.2d 1439, 1442 (9th Cir. 1984). Samuels appears prepared to argue, in response to the assertion of any Section 4 defense, that his purchase of the tokens was in a public offering. But in response to the motion to dismiss, he simply argues (correctly) that Sections 12(a)(1) and 5(a)(1) are not limited to sales made in public offerings.

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The District of Non-

Order Filed on July 16, 2024 by Clerk U.S. Bankruptcy Court

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY
Caption in Compliance with D.N.J. LBR 9004-1(b)

In re:

Case No. 24-16067 (MBK)

Hearing Date: July 15, 2024

ORDER GRANTING VERIFIED PETITION FOR RECOGNITION OF FOREIGN PROCEEDING UNDER CHAPTER 15 AND MOTION IN SUPPORT OF VERIFIED PETITION AND FOR RELATED RELIEF

The relief requested on the following pages is hereby ORDERED.

DATED: July 16, 2024

Honorable Michael B. Kaplan United States Bankruptcy Judge

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Upon the Verified Petition for Recognition of Foreign Proceeding Under Chapter 15 [Dkt. No. 1] (the "Verified Petition"), the Motion in Support of the Verified Petition for Recognition of Foreign Proceeding and for Related Relief [Dkt. No. 4] (the "Motion"), and the Reply of the Receivers of Hector DAO in Support of Request for Relief Under Bankruptcy Code Section 1521(a) Staying or Enjoining the Prosecution of Hector DAO Claims Against Protected Parties [Dkt. No. 32] (the "Reply")¹ filed by the Petitioners, who are the receivers and duly-authorized foreign

¹ Capitalized terms not defined in this Order shall have the meanings ascribed to such terms in the Motion and the Reply.

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representatives for Hector DAO, and upon consideration of the Drury Declaration, the Pease Declaration, and the Supplemental Drury Declaration; and the Court having determined that the relief sought in the Verified Petition and the Motion is in the best interests of Hector DAO, its creditors, and all parties in interest; and the Court having considered the evidence and statements regarding the Verified Petition in the documents filed with the Court and at the July 15, 2024 hearing on the Verified Petition and the Motion (the "Hearing"); and the Court having determined that the legal, evidentiary and factual bases set forth in the documents filed with the Court establish just cause for the relief granted herein; and after due deliberation and sufficient cause appearing therefor, it is HEREBY FOUND AND DETERMINED THAT:

- A. The findings and conclusions set forth herein constitute the Court's findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), made applicable to these proceedings pursuant to Bankruptcy Rule 9014. To the extent any of the following findings of fact constitute conclusions of law, they are adopted as such. To the extent any of the following conclusions of law constitute findings of fact, they are adopted as such.
- B. This Court has jurisdiction pursuant to 28 U.S.C. §§ 157 and 1334 and the Standing Order of Reference, dated September 18, 2012 (D.N.J. Sep. 18, 2012) (Simandle, C.J.). The Verified Petition and the Motion constitute core proceedings pursuant to 28 U.S.C. § 157(b)(2)(P). Venue is proper in this District pursuant to 28 U.S.C. § 1410.
- C. This case was commenced properly pursuant to sections 1504, 1509, and 1515 of the Bankruptcy Code.

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- D. The Verified Petition and Motion satisfy the requirements of section 1515 of the
 Bankruptcy Code.
 - E. Notice of the Hearing was in compliance with Bankruptcy Rule 2002(q).
- F. The BVI Receivership Proceeding is a "foreign proceeding" within the meaning of section 101(23) of the Bankruptcy Code.
- G. The BVI Receivership Proceeding is entitled to recognition by this Court pursuant to sections 1515 and 1517(a) of the Bankruptcy Code.
- H. Hector DAO's "center of main interests" is located in the British Virgin Islands and, therefore, the BVI Receivership Proceeding is entitled to recognition as a "foreign main proceeding" pursuant to sections 1502(4) and 1517(b)(1) of the Bankruptcy Code.
- I. The Petitioners are "persons" as defined in section 101(41) of the Bankruptcy Code and the duly appointed "foreign representatives" of Hector DAO within the meaning of section 101(24) of the Bankruptcy Code.
- J. The relief granted herein is necessary to effectuate the purpose of chapter 15, and to protect Hector DAO, its assets, and the interests of its creditors and other parties in interest.
- K. The Petitioners are entitled to the benefit of the relief conferred under section 1520(a) of the Bankruptcy Code, including, without limitation, the automatic stay imposed pursuant to section 362 of the Bankruptcy Code.
- L. The relief granted herein (i) is necessary and appropriate in the interests of the public and international comity; (ii) is consistent with the public policy of the United States; (iii) is available and warranted pursuant to sections 1521(a), 1517, 1515, 1507(a), 1525(a), 105(a), and

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362(a) of the Bankruptcy Code; and (iv) will not cause the Debtor's creditors or other parties in interest any hardship that is not outweighed by the benefits of granting the relief herein.

- M. For purposes of this Order, (i) the term "Hector DAO Claims" means any claims or causes of action relating in any way to HEC tokens, the Treasury Wallet, the Treasury Assets, or the Hector Network that are asserted against Hector DAO and/or the Protected Parties, were formerly asserted against Hector DAO and/or the Protected Parties, or that could have been asserted against Hector DAO and/or the Protected Parties, on any theory of liability, whether direct, derivative, joint and several, successor liability, vicarious liability, fraudulent or voidable transfer or conveyance, alter ego, breach of fiduciary duty, or otherwise; and (ii) the term "Protected Parties" means (a) any current or former HEC Tokenholders, including but not limited to any member or former member of Hector DAO's Liquidation Committee, Steering Committee, Core 5 group, or Future Group, and (b) any third parties whom Hector DAO has indemnified contractually.
- N. Hector DAO Claims against Protected Parties asserting fraudulent transfer or voidable transfer or conveyance claims, or alter ego, successor liability, vicarious liability or other theories of recovery through which claimants would seek to assert Hector DAO Claims against a Protected Party constitute Hector DAO's property. Section 362(a)(3) of the Bankruptcy Code applies to stay such actions while the Chapter 15 Case remains pending.
- O. Staying, pursuant section 1521(a) of the Bankruptcy Code, the Hector DAO Claims against the Protected Parties while the Chapter 15 Case remains pending is warranted. Unusual circumstances exist justifying such a stay because (i) an identity of interests exists between the

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Debtor and each of the Protected Parties and (ii) continued litigation of the Hector DAO Claims outside of this Chapter 15 Case will have an adverse impact on the Debtor, the Receivers, and the BVI Receivership Proceeding. Such a stay is also warranted under the four-prong test for the issuance of a preliminary injunction in the Third Circuit.

- P. Enjoining, pursuant to sections 1521(a) and 105(a) of the Bankruptcy Code, the continuation or commencement of any Hector DAO Claims against the Protected Parties while the Chapter 15 Case is pending is warranted under the four-prong test for the issuance of a preliminary injunction in the Third Circuit.
- Q. Notice of the Hearing and the relief requested in the Verified Petition and the Motion at the Hearing was proper, adequate, sufficient, and comported with due process under the circumstances, and no other or future notice is or shall be required.

NOW, THEREFORE, it is hereby **ORDERED THAT**:

- 1. The Verified Petition and the Motion are GRANTED as set forth herein.
- 2. All objections and reservations of rights, if any, relating to the Verified Petition and the Motion that have not been withdrawn, waived, or otherwise resolved are overruled and denied.
- 3. The BVI Receivership Proceeding is recognized as a "foreign main proceeding" pursuant to section 1517(b)(1) of the Bankruptcy Code.
- 4. The Petitioners are recognized as the "foreign representatives" (as defined in section 101(24) of the Bankruptcy Code) of Hector DAO.

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5. Pursuant to section 1520(a) of the Bankruptcy Code, the automatic stay under section 362 of the Bankruptcy Code applies with respect to Hector DAO and the property of Hector DAO that is within the territorial jurisdiction of the United States.

- 6. Pursuant to section 1521(a) and 105(a) of the Bankruptcy Code, all entities (as that term is defined in section 101(15) of the Bankruptcy Code) subject to this Court's jurisdiction, other than the Petitioners and their expressly authorized representatives and agents, are stayed and enjoined from commencing or continuing to prosecute any Hector DAO Claim against any of the Protected Parties, on any theory of liability, whether direct, derivative, joint and several, successor liability, vicarious liability, fraudulent or voidable transfer or conveyance, alter ego or otherwise, while the Chapter 15 Case is pending (the "Stay of Hector DAO Claims"). Without limitation, the activities prohibited by the foregoing Stay of Hector DAO Claims include: (i) the pursuit of discovery from the Protected Parties or their officers, directors, employees or agents with respect to Hector DAO Claims; (ii) motions practice related to the foregoing; and (iii) collection activity on account of a Hector DAO Claim against any Protected Party or its officers, directors, employees or agents or its respective assets.
- 7. Notwithstanding anything to the contrary herein, with respect to Newton AC/DC Fund L.P. ("Newton") only, the Stay of Hector DAO Claims shall remain in effect until the earlier of January 1, 2025 or the termination of the BVI Receivership Proceeding, at which point the Stay of Hector DAO Claims shall no longer apply to prevent Newton from commencing or continuing to prosecute any Hector DAO Claim against any of the Protected Parties. Notwithstanding the foregoing, (i) the duration of the Stay of Hector DAO Claims as to Newton may be extended upon

Case 24-16067-MBK Doc 35 Filed 07/16/24 Entered 07/16/24 14:44:41 Desc Main Document Page 8 of 8

(Page | 8)

Debtors: Hector DAO Case No. 24-16067 (MBK)

Caption of Order: ORDER GRANTING VERIFIED PETITION FOR RECOGNITION OF

FOREIGN PROCEEDING UNDER CHAPTER 15 AND MOTION IN SUPPORT OF VERIFIED PETITION AND FOR RELATED RELIEF

the Receivers' receipt of Newton's written consent and the Court's entry of an Order consistent therewith; or (ii) upon further Order by this Court after notice to Newton and Newton having the opportunity to be heard.

- 8. The Petitioners are entitled to conduct discovery, examine witnesses, seek and take evidence, and obtain information concerning Hector DAO's assets, affairs, rights, obligations, or liabilities pursuant to section 1521(a)(4) of the Bankruptcy Code.
- 9. The Petitioners are authorized to take all actions necessary to effectuate the relief granted by this Order without notice or further order of the Court.
- 10. This Court retains jurisdiction with respect to any matters, claims, rights, or disputes arising from or related to this Order, its implementation, or otherwise arising from or related to this chapter 15 case.
 - 11. This Order shall be effective and enforceable immediately upon its entry.

	HCCW 18/2019
	[2023] HKCFI 914
HONG KONG SPE	HIGH COURT OF THE CIAL ADMINISTRATIVE REGION
	I OF FIRST INSTANCE NG-UP) PROCEEDINGS NO 18 OF 2019
_	
	IN THE MATTER of GATECOIN LIMITED (in liquidation)
	and
	IN THE MATTER of the Companies (Winding Up and Miscellaneous
	Provisions) Ordinance (Cap. 32)
_	
Before: Hon Linda Chan J in	Chambers
Date of Hearing: 23 February	7 2023
Date of Decision: 31 March 2	2023
	DECISION
	he court an application made by Ms Chi Lai Man Igai both of Kroll (HK) Limited, the joint and
,	n Limited (" Liquidators ") under s.200(3) of the
Companies (Winding up and	Miscellaneous Provisions) Ordinance (Cap. 32)
(CWUNIFO) for directions	s on (1) the characterisation of cryptocurrencies

and fiat currencies ¹ (together "Currencies") held by Gatecoin Limited ("Gatecoin"); and (2) the allocation of the Currencies to the customers. 2. Having regard to the nature of the application, the complex legal and factual issues raised by the Liquidators some of which have never been determined in Hong Kong, and the number of customers whose interest would be affected by the determination, this Court gave directions on the further conduct of the application on 5 December 2022 (reproduced in the Schedule hereto) so that any stakeholders may file evidence and participate in the application if they want to do so. 3. At the hearing, the Liquidators are represented by Mr Justin Ho, who is led by Ms Eva Sit SC in the skeleton submissions originally lodged with the court. Cumberland DRW LLC, a Group A customer (as defined in §24 below), is represented by Mr Eric Chan of Messrs. Simmons & Simmons. 4. Overview 4. The Liquidators seek directions or determinations on the following questions: (1) Question 1: Gatecoin had 3 different sets of terms and conditions ("T&Cs") at various times. ² The question is whether the Currencies are held on trust for each type of "Group A", "Group B" and "Group C" customers (as defined in §24 below) (collectively "Customers"). The Liquidators' position is that the Currencies of Group A and B customers were held on trust,	("Gatecoin"); and (2) the allocation of the Currencies to the customers. 2. Having regard to the nature of the application, the complex legal and factual issues raised by the Liquidators some of which have never bee determined in Hong Kong, and the number of customers whose interest would be affected by the determination, this Court gave directions on the further conduct of the application on 5 December 2022 (reproduced in the Schedul hereto) so that any stakeholders may file evidence and participate in the application if they want to do so. 3. At the hearing, the Liquidators are represented by Mr Justin Howho is led by Ms Eva Sit SC in the skeleton submissions originally lodged with the court. Cumberland DRW LLC, a Group A customer (as defined in §2 below), is represented by Mr Eric Chan of Messrs. Simmons & Simmons. 4. Overview 4. The Liquidators seek directions or determinations on the following questions: (1) Question 1: Gatecoin had 3 different sets of terms and condition ("T&Cs") at various times. ² The question is whether the Currencies are held on trust for each type of "Group A", "Group B" and "Group C" customers (as defined in §24 below (collectively "Customers"). The Liquidators' position is that the Currencies of Group A and B customers were held on trust. 1. That is, legal tender issued by governments such as USD, GBP, EURO		- 2 -
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			Currencies of Group A and B customers were held on trust,

A		- 3 -	A
В			В
C		whereas Group C customers only have a contractual claim against Gatecoin for the Currencies.	C
D	(2)	Question 2: Whether the Currencies in the accounts of Blue Fire	D
E		Capital, LLC (a US company) or Blue Fire Capital Europe	E
F		Coöperatief U.A. (a Dutch company) (" BlueFire ") form part of Gatecoin's general assets.	F
G	(3)	Question 3: Given the Currencies in the Liquidators' hands cannot	G
Н		satisfy all the trust claims of Group A and B customers, how	Н
I		should their claims be met. The Liquidators' position is:	I
J		(a) Group A and B customers are beneficial tenants-in- common in the pool of a specific type of Currency in	J
K		proportions to their account balances in the "Exchange	K
L		Ledger" (as defined in §22(2) below).	L
M		(b) Where there is no shortfall, each Customer should be entitled to his entitlement subject to the Liquidators' costs,	M
N		fees and expenses ("Expenses") being borne by trust assets	N
0		pro rata.	0
P		(c) Where there is shortfall, the "pools" should be shared amongst Group A and B customers <i>pari passu</i> , subject to	P
Q		the Expenses being borne by such trust assets pro rata, with	Q
R		the remaining claims being treated as unsecured claims.	R
S	(4)	Question 4: The mechanics of effecting allocation of trust assets, given the practicalities and expense involved in making allocation	s
T		in specie. The Liquidators' position is that:	T
U			U
V			V

A	- 4 -	A
В		В
C	(a) If allocation <i>in specie</i> is impracticable, the Liquidators be empowered to sell the Currencies and distribute the	C
D	proceeds after deduction of the Expenses.	Ε
E	(b) The share of unidentified and uncontactable Group A and	F
F	Group B customers' assets be dealt with pursuant to ss.62 and 67 of the Trustee Ordinance (Cap. 29).	F
G	5. Upon determination of Questions 1 and 2, the Liquidators will	(
Н	know whether the Currencies (or any part thereof) are held by Gatecoin on	H
Ι	trust for the Customers or any of them. This, in turn, will determine whether Gatecoin has any assets which can be deployed by the Liquidators to pay the	I
J	Expenses and make distribution to the unsecured creditors. If and to the extent	J
K	that there are assets not held by Gatecoin on trust for the Customers, it may not	ŀ
L	be necessary for the court to determine Questions 3 and 4. For these reasons, in this Decision, only Questions 1 and 2 will be determined.	I
M		N
N	B. BackgroundB1. Gatecoin	N
O	6. Gatecoin is a Hong Kong company founded and beneficially	C
P	owned by Mr Aurelien Pierre Georges Menant ("Mr Menant").	P
Q	7. Gatecoin was wound up by the court on 13 March 2019. The	C
R	Liquidators were appointed on 20 March 2019.	F
S	8. From January 2015, Gatecoin operated a cryptocurrency	S
T	exchange platform at https://gatecoin.com/ ("Platform") through which it provided all the services to the customers. To access and use the Platform, a	Т
U	customer had to open and register an account with Gatecoin and deposit	τ
V		

A	- 5 -	
В		
C	cryptocurrencies or fiat currencies for trading or withdrawal purposes. There were more than 45 types of cryptocurrencies trading carried on through the	
D	Platform. ³ In addition, Gatcoin also engaged in trading of cryptocurrencies in	
E	its own right including trading with its customers ⁴ . Other than the Platform, Gatecoin did not operate its business in any other form.	
F	9. As regards fiat currencies, they were pooled together and kept in	
G	the accounts held by Gatecoin at 3 payment service providers ("PSPs") ⁵ and	
Н	the total amount recovered by the Liquidators as at 31 October 2022 was HK\$11,589,477 ⁶ . In addition, the Liquidators were able to secure over 50	
I	types of cryptocurrencies which had an aggregate value of HK\$140,390,667	
J	as at 31 October 2022 ⁷ .	
K	10. The Liquidators have contacted over 102,600 creditors but only	
L	1,132 of them have lodged proofs of debt (" PODs "). This represents 75% of the amount owed to the creditors as recorded in Gatecoin's books and records,	
M	which stood at HK\$249,905,111 (as at 13 March 2019)8. Apart from Mr	
N	Menant, all the creditors are customers with positive account balances in their accounts at Gatecoin. Amongst them, 316 (35% by number and 42% by value)	
O	preferred allocation in specie instead of cash dividend9.	
P		
Q		
R		
S	Chi 2 nd §§5, 7.2. Report of Ms Jesse Co, the expert engaged by the Liquidators (" Report "), §80. Namely Nederlandsche Betaal & Wissel Maatschappij N.V., International Business Settlement and BD	
T	Multimedia 6 Chi 2 nd §§60-64. 7 Chi 2 nd §\$20-21; Summary of Currencies secured by the Liquidators.	
U	8 Chi 2 nd §23. 9 Chi 2 nd §19.7.	

	- 6 -
D2 C	ata a companya ang I Dia aka karin
B2. Cryp	ptocurrency and Blockchain
11.	Before considering the facts of this case, it is necessary to
understand	the nature of cryptocurrency and blockchain technology which lie
at the very	heart of Gatecoin's business and operation.
12.	Cryptocurrency is a digital asset based on blockchain technology,
	rds transaction data in a list of records (a block) with a time stamp, ock is linked to the next by cryptography. The blockchain contains
all transact	tions processed, with each transaction cryptographically linked to
the previou	s one. The data stored can only be changed when all the participants
agree. Thi	s ensures that blockchain is not controlled by any single authority,
and the dat	a stored in the blockchain is immutable (Sarra and Gullifer, Crypto-
claimants d	and Bitcoin Bankruptcy Challenges for Recognition and Realisation
(2019) 28 1	IIR 233, 235-236; UK Jurisdictional Taskforce, Legal Statement on
Cryptoasse	ets and Smart Contracts, November 2019, §§28-29).
13.	As explained by Ms Jesse Co 10, the expert engaged by the
Liquidators	s, blockchain and cryptocurrency have the following features.
14.	First, a cryptocurrency can only be transferred from one user to
another us	er through a cryptocurrency network, and the transfer must be
initiated an	d approved by the owner of that cryptocurrency:
(1)	Each user of a cryptocurrency network owns a "wallet". Each
(1)	wallet has a unique address and is associated with 2 distinct keys:
	a "public key" (akin to a bank account) and a "private key" (akin
	a paone key (akiii to a bank account) and a private key (akiii
	anager of Blockchain Solutions Ltd, a blockchain consultancy service company based in Hong ch provides end-to-end blockchain technology solutions.

A		- 7 -	A
В			В
C		to a PIN). The private key is used to transfer cryptocurrency from a user's wallet to the wallet of another user ¹¹ .	C
D	(2)	To effect a transfer, the transferor creates a record of the transfer	D
E		by modifying the public key of his wallet, and digitally signing it	E
F		with his private key. The cryptocurrency then becomes linked to the wallet address of the transferee ¹² .	F
G	15.	Second, the cryptocurrencies received by a user in a particular	G
Н	transaction	are <i>indivisible</i> and must be fully consumed in a single setting:	Н
I	(1)	Thus, if a user received 10 cryptocurrencies in an inbound	I
J		transaction but only wants to transfer 1 cryptocurrency to another user, he needs to make a composite outbound transaction by	J
K		transferring 1 cryptocurrency to the transferee and 9	K
L		cryptocurrencies back to himself as "change".	L
M	(2)	Conversely, a user may amalgamate the cryptocurrencies received in a few inbound transactions and transfer them out of his wallet ¹³ .	M
N	16.	Third area the arrest common size received from an inhound	N
0		Third, once the cryptocurrencies received from an inbound are transferred out of a user's wallet, that inbound transaction	0
P	(which ren	nains recorded on the blockchain) ceases to have any value in the	P
Q	wallet and	cannot be used as an "input" transaction in another transaction 14.	Q
R	17.	Fourth, a user cannot select which inbound transaction he would	R
S	like to use	for a transfer/withdrawal, as the system would do the matching and	s
T	11 Report §§1		Т
U	12 Report §15 13 Report §\$1 14 Report §19	7-19	U
v			v

A	- 8 -	A
В		В
C	select the inbound transaction (with the specific wallet address and the amount of cryptocurrency held) and use it as "input" for a transfer/withdrawal. The	C
D	cryptocurrency in that "input" would be fully utilised and transferred to other	Ε
E	wallets and shown as "outputs" in that transaction (or the fee charged by the operator/exchange if there was such fee) ¹⁵ .	E
F	18. <u>Fifth</u> , blockchain is a publicly available ledger containing a record	F
G	of all transactions made in respect of that cryptocurrency ¹⁶ . For example, in	(
Н	respect of Bitcoin, details of all the transactions can be viewed at Wallet.Exlorer.com. A user can trace a cryptocurrency from its creation all the	F
I	way through to each transaction it has gone through.	I
J	19. <u>Sixth</u> , every transaction recorded in the blockchain is <i>unique</i> and	J
K	can be identified:	ŀ
L	(1) For each transaction recorded on the blockchain, apart from date	I
M	and time of the transaction, there is (a) a unique transaction ID; (b) a wallet address of the transferor; (c) a wallet address of the	N
N	transferee; (d) the amount of cryptocurrency transferred; and (e)	N
o	a unique identifier of the previous transaction through which the transferor obtained the cryptocurrency in question ¹⁷ .	C
P	(2) As each transaction is linked to an "input" (akin to a deposit) or a	P
Q	number of "inputs" and an "output" (akin to a withdrawal), one	(
R	can trace any specific cryptocurrency from the date it was first	F
S		s
Т	15 Report \$20	Т
U	Report §20 Report §14 Report §\$14-15	ι
V		•

	- 9 -
	created or "mined" to all the transactions through which it was transferred to various wallets 18.
(3)	Each record of transfer will be added to the blockchain upon being
	checked against all other transactions to ensure there is no double
	spending (Sarra & Gullifer, 236).
20. wallet. The	Seventh, the blockchain does not show the current balance of each e balance of cryptocurrency in a given wallet is simply a reference
	erence between (1) the total amount of cryptocurrencies of all
inbound tra	nsactions (i.e. inputs) and, (2) the total amount of cryptocurrencies
of all outbo	ound transactions (i.e. outputs) ¹⁹ .
B3. Oper	ration of Gatecoin
21.	For the purpose of its business, Gatecoin controlled 4 types of
	d all the transactions conducted with these wallets were recorded
and shown	in the blockchain ²⁰ :
(1)	External Wallets: Wallets designated to receive cryptocurrencies
	deposited by the Customers from their private wallets. Gatecoin
	had thousands of External Wallets.
(2)	Mother Wallets: Each Mother Wallet was used to collect and store
	a type of cryptocurrency. Once the cryptocurrency was received
	through the External Wallet(s), it would be transferred to the
	Mother Wallet and mixed with all cryptocurrencies kept in that
	Mother Wallets. Gatecoin had 18 Mother Wallets.
18 Report §16	<u> </u>
19 Report §20 20 Report §828	

A		- 10 -	
В			
C	(3)	Operational Wallets: Wallets designated to transfer cryptocurrency to the Customers' private wallets in accordance	
D		with their transfer/withdrawal instructions, or to receive the balance of cryptocurrencies not consumed in a single setting.	
E		Gaincoin had 25,408 Operational Wallets ²¹ .	
F	(4)	Multifunction Wallets: Wallets with the functions of Operational	
G		Wallet and Mother Wallet ²² .	
Н	22.	As regards the dealings between Gatecoin and its Customers:	
I	(1)	A Customer had to register an account with Gatecoin, and would	
J		be assigned with a unique customer ID.	
K	(2)	The Customer would deposit or transfer/withdraw cryptocurrency through the Platform. All transactions made by the Customers	
L		through the Platform would <i>only</i> be recorded in Gatecoin's	
M		internal exchange ledger ("Exchange Ledger"). The Exchange Ledger recorded details of the transactions namely, the date,	
N		transaction ID, type of cryptocurrency, amount, transaction type,	
0		transferor address (for deposit into Gatecoin) and transferee	
P	(2)	address (for withdrawal out of Gatecoin).	
Q	(3)	In turn, Gatecoin would carry out the transactions made/approved by the Customers through either (a) its External Wallet and	
R		Mother Wallet (for cryptocurrency deposited by customer), or (b)	
S		its Mother Wallet and Operational Wallet/Multi-function Wallet	
T			
U	21 Report §§2 22 Report §§5		
V			

	- 11 -
	(for cryptocurrency withdrew by customer). All these transactions would be recorded and shown in the blockchain ²³ .
(4)	Where Gatecoin executed the trade made by a customer "in
	house", that is, using the cryptocurrency kept at the Mother Wallet
	it controlled, the transaction would not involve any movement between different wallets and, therefore, would not be recorded
	or shown in the blockchain ²⁴ .
23.	The <i>modus operandi</i> of Gatecoin's business means that:
(1)	Once a customer deposit cryptocurrency at the Platform, it would
	be transferred from the External Wallet to the Mother Wallet (both controlled by Gatecoin) and mixed with the
	cryptocurrencies in that Mother Wallet;
(2)	Gatecoin would be able to apply any cryptocurrencies in the
	Mother Wallet for its purposes including making a transfer in compliance with a withdrawal request made by any customer;
(3)	The customer ceased to have any control over the cryptocurrency
(3)	from the moment it was deposited with Gatecoin ²⁵ ; and
(4)	The information recorded on the Exchange Ledger is not
	sufficient for the Liquidators to trace through the cryptocurrency
	deposited with Gatecoin as most of the trades recorded in the Exchange Ledger were executed by Gatecoin "in house" which
	did not involve any movement between different wallets ²⁶ .
 Report §§2 Report §§7 	25-26, 30, 70, 77-78 77-79
25 Report §71 26 Report §§7	1

24. were		•			ent sets of T& o Gatecoin's 1	
			-	_	ers and the val	
	s are as fo		22, the humb	ci oi custom	ers and the var	uc of the
Ciaiiii	s are as re	mows .				
	Set	Effective	Customers	No. of	Value of	
	"2016	Date 28/1/2015 –	Group A	10,010 ²⁸	claim 205,409,870	
	T&C"	11/2016	-	Í		
			With ETD	401	178,868,991 (valued as at 31/3/2019)	
	"Trust T&C"	11/2016 - ~3/2018	Group B	80,011	170,955,596	
	"2018 T&C"	6/3/2018 – 13/3/2019	Group C	12,697	11,992,862	
25.	Tł	ne <u>2016 T&C</u>	c provides, in	ter alia, that:		
	(1) the	e terms cons	titute "a bind	ing agreemen	t"(p.1);	
	(2)			1:0		
	` /		· ·	to modify t	he terms "wit	hout pric
	no	otice" (p.2); a	and			
	(3) a l	User's acces	s to and use o	of the website	constitutes "a	cceptanc
	of	the 2016 T	&Cs]". Ther	e is no provis	sion which has	the effe
	of	creating a tr	ust over the C	Currencies dep	osited or kept	by Grou
	A	in their acco	ounts at Gatec	oin.		

A		- 13 -	A
В			В
C	26. terms taken	As for the <u>Trust T&C</u> , the Liquidators consider that the following n together have the effect of creating a trust over the Currencies in	C
D	favour of C	Group B customers:	D
E	(1)	Clause 1.1 states that the use of Gatecoin's platform constitutes	E
F		agreement to be bound by the Trust T&C.	F
G	(2)	Clause 1.2.2 reserves Gatecoin's right to change terms, although Users would "have the right to receive prior notice of any material	G
Н		change" and be "asked to agree".	Н
I	(3)	Clause 5.1 provides that Gatecoin maintains an Exchange Ledger	I
J		to track User's ownership of fiat currency and "Digital Assets" reflected in the associated Digital Asset Account.	J
K	(4)	Clause 7.3.1 provides that the Digital Assets would be held in	K
L		"pooled digital wallets" and a User "will have beneficial ownership interest in the Digital Assets".	L
M	(5)		N
N	(5)	Clause 7.3.2 provides that Gatecoin acts as a "custodian" holding the Digital Assets "in trust".	N
0	(6)	Clause 7.4.1 provides that Gatecoin is "fiduciary" and will hold	0
P	(*)	the fiat currency reflected in User's Fiat Account.	P
Q	(7)	Clause 7.4.2 provides that "cash balances held in your Fiat	Q
R		Account will not be treated as general assets".	R
S	(8)	Clause 7.5 provides that all tokens would be registered in Gatecoin's name, although it would credit "all rewards,	s
T			Т
U			U
v			v

	- 14 -	
	distributions and other ²⁹ in respect of tokens" not registered in a User's name into his account.	
(9)	Further, the phrase "your Digital Assets" can be found in Clauses	
	3.3.2, 7.3.1, 7.3.2, 10.2.2.7.	
27.	Under the 2018 T&C, there is no provision which has the effect	
of creating	a trust over the Currencies in favour of Group C customers:	
(1)	Clauses 1.7 and 3.5 provide that Gatecoin is "not" acting in "fiduciary capacity".	
(2)	Clause 12.5 provides a User should "not" expect any new or	
	additional Blockchain Assets created by Forks to be credited, and	
	Clause 13.1 provides a User will "not" receive any tokens or Airdrops;	
(3)	Clause 10.1.1 provides that "Gatecoin maintains a private	
	exchange ledger to track a User's ownership of (a) Fiat Currency reflected in the User's Fiat Account and (b) Blockchain	
	Assets reflected in the User's Blockchain Asset Account"; and	
(4)	Clause 27.1.2 provides that upon closure of an account, a User is required to provide transfer instructions of where to transfer the	
	fiat and Blockchain Assets in his account, and Clause 27.2.4 states	
	that Gatecoin is authorised to send any remaining Currencies or sell them.	
	eference to "airdrops", an accretion of crypto included in the blockchain protocol of that crypto ild be triggered as designed.	

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B5. Blue	eFire	
DJ. DIUE	THE	
28.	BlueFire was a "market maker" which traded in cryptocurrencies	
	of Gatecoin, using the funds provided by Gatecoin. Although eld the largest amount of Currencies at Gatecoin, it has not asserted	
	over the Currencies. Nor has it lodged any POD with the Liquidators	
According to the information provided by Mr Menant, as corroborated by the		
Liquidator	rs' investigation, the Currencies held in BlueFire's accounts	
belonged t	o Gatecoin ³⁰ .	
	N. 1.1. 31	
B6. ETL	O Holders ³¹	
29.	In May 2016, there was a cyberattack on the Platform in which	
	TH ³² held by Gatecoin was stolen (" Hack "). By email dated 17	
August 20	16, Gatecoin informed the Customers affected by the Hack that:	
(1)	All customers who held ETH could withdraw and trade up to 10%	
	of their balances in ETH, and the remaining 90% would	
	thenceforth be recorded as "ETD" (i.e. Ethereum Debt) in their	
	account balance;	
(2)	ETD is simply a record of the debt owed by Gatecoin to the	
	holders of ETD ("ETD Holders"), but the ETD Holders would	
	not be able to withdraw them at that time;	
(3)	The value of ETD would link to the market price of ETH; and	
(4)	The ETD would be "locked until [Gatecoin has] the ETH liquidity	
. ,	to enable full reconciliation of ETD for ETH".	
20		
 Chi 2nd §§ Chi 2nd §§ Ethereum. 	66-73 19.6; 56.3 a type of cryptocurrency	
Ediciouii,	a oppo or orproduction	

		- 16 -
С.	Appl	licable principles
20		The Limiteters and for directions under a 200(2) of the
30. CWI	UMPO	The Liquidators apply for directions under s.200(3) of the b, having regard to the following facts and matters:
	(1)	The existence of 3 different sets of T&Cs, one of which indicates that the Currencies are held on trust;
	(2)	If the Currencies are held by Gatecoin on trust, (a) given the
		diverse nature of cryptocurrencies and their fluctuating value, it may not be practicable or cost effective to distribute them to the
		Customers <i>in specie</i> , and (b) it is necessary to devise a means for
		dealing with the unclaimed Currencies for those Customers who do not come forth to claim their entitlements;
	(3)	Although BlueFire held accounts at Gatecoin, the evidence
		suggests that the Currencies in BlueFire's accounts may be assets belonging to Gatecoin; and
	(4)	The above of the well but one does Commission and the total
	(4)	The substantial shortfall between the Currencies and the total amount owed to the Customers as recorded in Gatecoin's records.
31.		The principles governing an application under s.200(3) are well
	ed. As	submitted by Mr Justin Ho, counsel for the Liquidators:
	(1)	A liquidator should seek directions from the court if there is any
		difficulty at any stage during the course of the administration. However, this does not mean that a liquidator can ask the court to
		approve any decision which appropriateness she is uncertain
		about. In particular, the liquidator should not ask the court to
		approve what is a matter of commercial judgment; it is for the

A			- 17 -	A
В				В
C			liquidator to conduct a liquidation exercising her own professional expertise and judgment.	C
D		(2)	A direction must require something other than general	D
E			endorsement of a proposed cause of action. Normally this will	E
F			require the formulation of a precise issue, commonly legal and of significance.	F
G		(3)	The liquidator bears responsibility of making full and fair	G
Н			disclosure of material facts, and the court is not to resolve factual conflicts.	Н
I				I
J		(4)	It is not for the court to develop alternative proposals, but depending on the issue it may be appropriate for the court to	J
K			suggest changes to the proposed course of action which could	К
L			render it acceptable (McPherson and Keay, Law of Company Liquidation, 5th edn, 2021, §§9-043-9-046; Re a Company	L
M			(Liquidators: Cowley and Lui) [2020] 3 HKLRD 96, §§19-22,	N
N			applied in <i>Re Hsin Chong Construction Company Limited</i> [2021] HKCA 1581, §§15-16).	N
0				0
P	D.	~	tion 1: the Trust Issue	P
Q	<i>D1</i> .	Liqui	idators' view	Q
D	32.		The view of the Liquidators on Question 1 may be summarised as	
R	follo	ws:		R
S		(1)	Group A customers who opened their accounts when the 2016	S
T			T&C was in force have <i>no</i> proprietary claim over the Currencies	Т
U			in their accounts as Gatecoin did not hold the Currencies on trust	U
V				v

	- 18 -
	for them. However, as they subsequently agreed to the Trust T&C, a trust was created over the Currencies in favour of Group A (see
	Section D5.3.1 below);
(2)	Group B customers who opened their accounts when the Trust
	T&C was in force have a proprietary claim over the Currencies in their accounts given that (a) the Trust T&C has the effect of
	creating a trust over the Currencies in favour of Group B; and (b)
	the legal requirements for creating a trust over the Currencies are satisfied (see <u>Section D5.3.2</u> below);
(3)	The nature of each Group A and B customer's beneficial interest
	in the cryptocurrencies in his account is by way of co-ownership
	in a pool of cryptocurrencies of the specific type to which he or she has a credit balance; and
(4)	The cryptocurrencies in the accounts of Group C customer and
	ETD Holders were not subject to any trust arrangement and they
	only have contractual claims against Gatecoin ³³ (see <u>Section</u> <u>D5.3.3</u> below).
D2. WI	hether 2018 T&C applies to Group A and B
33.	In my view, the question whether the Currencies are held by
	on trust for the Customers (be it Group A, B or C) should be ed by construing the terms of the 2018 T&C. The earlier versions of
	s (i.e. 2016 T&C and Trust T&C) have no application for the reasons
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33 Chi 2 nd	
5m 2	o

		- 19 -
34. 2018, and		rding to Mr Menant, the 2018 T&C came into force in March ded the Trust T&C. From that time onwards, all Customers
,	•	A and B customers who registered their accounts when the
		Trust T&C were in force, were <i>required</i> to click to <i>accept</i> the 2018 T&C before they could continue to access
	•	's website (i.e. the Platform) ³⁴ . His statement is consistent
with:		s wessite (ne. the Fintform). This statement is consistent
(1)	the L	iquidators' investigation; and
(2)	the fo	ollowing terms of the 2018 T&C:
	(a)	Clause 1.2.2 and 3.2.2 (which are identical) state that:
		"By visiting, accessing or using Gatecoin Platform, you confirm, represent and warrant that: 1
		 You have the legal capacity to accept these Terms and to agree to be bound by the Terms in their entirety;" (underlined added)
	(b)	Clause 28.2 provides that:
		"These Terms (including any other terms and/or documents incorporated herein by reference) constitutes the entire agreement between you and Gatecoin relating to your use of
		or participation in the Gatecoin Platform and these Terms supersede any and all other agreements, oral or in writing, with respect thereto between you and Gatecoin." (underlined
		added)
35.		Satecoin did not have any physical presence and all the
services w	ere pro	ovided through the Platform, it is reasonable to infer that
Group A a	and B c	ustomers (and each of them) must have accepted the 2018
34 Chi 2 nd §5	4.1-54.2	

A		- 20 -	A
В			В
C		herwise they would not have been able to access their accounts or y transactions in respect of the Currencies in their accounts.	C
D	36.	If and to the extent that Group A and B customers have accepted	D
E	and agreed	to the terms of the 2018 T&C, I do not see why the court should	E
F	-	contractual bargain reached between the parties and allow these to rely on the terms of the Trust T&C.	F
G H I	•	Mr Ho submits that the 2018 T&C does not impact the position of ad B customers (that Gatecoin held the Currencies on trust for them) owing reasons:	G H I
J	(1)	Clause 1.2.2 of the Trust T&C states that <i>prior</i> notice of change	J
K		must be notified, but there is no evidence of notification. Mr Menant only stated that the Customers would have to click on the	К
L		2018 T&C before they could proceed to use the website, not that notification had been given.	L
M		notification had been given.	N
N	(2)	Even if the 2018 T&C purported to supersede the Trust T&C, it is doubtful whether such an amendment was capable of bringing	N
0		the existing trust arrangement to an end without the consent of the	O
P		customer (being the beneficiary of such a trust) given that:	P
Q		(a) A trustee can only disclaim his office if he has not yet done any act showing his acceptance of it (Snell's Equity §27-	Q
R		030). Having expressly agreed to hold (and having held)	R
S		the Currencies on behalf of Group A and Group B customers, it was no longer open to Gatecoin to disclaim its	s
T		obligations as trustee.	Т
U			U
V			T.

A		- 21 -	A
В			В
C		(b) Where a trustee accepts his obligations to act as such, he would only be able to free himself from these obligations	C
D		by varying the terms of the trust or obtaining a release from	D
E		his beneficiaries. However, the variation contemplated by the present facts involves a termination of the trust	E
F		arrangement without the trustee first making a final	F
G		allocation to the beneficiaries (its customers). In other words, it would involve customers transferring their	C
Н		beneficial interest in their Currencies to Gatecoin, in return	H
I		for a personal obligation by Gatecoin to repay the same. Unless Gatecoin obtains its customers' fully informed	I
J		consent to such a course, the transaction would fall foul of	J
К		the fair dealing rule and would be voidable at the instance of the beneficiary (<i>Snell's Equity</i> §7-022).	ŀ
L	(3)	Although Clauses 1.7 and 3.5 of the 2018 T&C contain express	I
M		disclaimer of fiduciary obligations, so long as it is clear that the	N
N		parties intended a trust relationship, the purported exclusion of fiduciary duties would simply be void insofar as it conflicts with	N
0		the "irreducible core" of duties that are owed by trustees to	C
P		fiduciaries (including the obligation to act in good faith) (<i>Armitage v Nurse</i> [1998] Ch 241, 253H-254A, per Millett LJ).	P
Q	(4)	Mr. Manant's reliance on Clauses 10.1.1 and 27.2.4 of the 2019	C
R	(4)	Mr Menant's reliance on Clauses 10.1.1 and 27.2.4 of the 2018 T&C is neither here nor there. Since the contractual provision	F
s		governing change in the Trust T&C had not been observed by Gatecoin at all, the 2018 T&C was simply inapplicable to Group	S
T		A and Group B customers, who continued to be governed by the	Т
U		Trust T&C.	τ

A	- 22 -	
В		
C	38. At the heart of Mr Ho's submissions is that Group A and B customers did not receive any prior notice of the changes nor did they ever	
D	agree to the termination of the trust arrangement over the Currencies in their	
E	accounts. However, as discussed in §§34-35 above, the evidence before the court shows that Group A and B customers must have accepted and agreed to	
F	the 2018 T&C in entirety when they accessed and used the Platform after	
G	March 2018.	
H	While one cannot rule out the possibility that there <i>may</i> be Group	
	A and B customers who had registered their accounts before the 2018 T&C came into effect and did not access or use the Platform from March 2018 up to	
	the date of the liquidation of Gatecoin (such that they did not accept or agree	
ζ.	to the terms of the 2018 T&C) (collectively "Non-consenting Customers"), it is not clear whether there is in fact such customer. When this Court raises the	
_	issue with Mr Ho, he says that the Liquidators do not possess any information	
И	other than what they have already been provided to the court (and shared with the creditors who have been in contact with the Liquidators).	
I	40. It seems to me that the claim of the Non-consenting Customers is	
•	a matter which can be addressed by the Liquidators giving appropriate notice	
	to Group A and B customers of the Court's view on Question 1, and invite them to notify the Liquidators that if they are Non-consenting Customers and	
2	provide evidence in support of their claim within a specified time period. Upon	
	completion of this process, the Liquidators will be in a position to know whether there are Non-consenting Customers and the amount claimed by them.	
3	This, in turn, will determine the extent to which Gatecoin holds the Currencies	
Γ	on trust for the Non-consenting Customers.	
U		

A		- 23 -	A
В	D3. Who	ether the Currencies are held on trust	В
C	D3. Who	ether the Currencies are neta on trust	c
	41.	In my judgment, the Currencies are <i>not</i> held by Gatecoin on trust	
D		ustomers (except the Non-Consenting Customers), but are held by	D
E	Gatecoin i	in its own right for the reasons explained below.	E
F	42.	As rightly pointed out by the Liquidators, the 2018 T&C contains	F
G	no express	s declaration of trust. To the contrary, the following terms make clear	G
	that the C	urrencies in the accounts of the Customers are <i>not</i> held by Gatecoin	
Н	on trust fo	or the Customers:	Н
I	(1)	Clauses 1.7 and 3.5 expressly disclaim any fiduciary relationship	I
J		between Gatecoin and the Customer. Clause 3.5 states that:	J
K		"By using Gatecoin Platform you acknowledge and agree that (a) Gatecoin (and the Gatecoin Group) is <u>not acting</u> as your broker, intermediary, agent or adviser or <u>in any fiduciary capacity</u> "	K
L		(underlined added)	L
M	(2)	Clause 10.1.1 provides that:	M
N		" The account amounts listed in the Exchange Ledger may correspond to funds stored in one or more pooled Blockchain Assets accounts or one or more omnibus fiat accounts"	N
O	(3)	Clauses 12.5 and 13.1 provide that Gatecoin, but the Customers,	0
P		would be entitled to cryptocurrencies created by Forks ³⁵ , or any	P
		accretions to the cryptocurrencies as a result of tokens and/or	
Q		Airdrops ³⁶ , which is consistent with Gatecoin being the beneficial	Q
R		owner of the cryptocurrencies ³⁷ .	R
S			s
Т		here changes to the underlying code of a cryptocurrency results in the creation of a new currency	T
U		ists in parallel with the original cryptocurrency we units of a cryptocurrency are distributed to the existing holders, usually for free 30	U
v			v

	- 24 -
(4)	Clauses 27.1.2, 27.2.4 and 27.3.1 (which deal with account closure and suspension and unclaimed funds) refer to fiat
	currency and cryptocurrency in the same way ³⁸ .
43.	Further, the following objective facts show that the Currencies
have alway for the Cus	rs been treated as Gatecoin's assets, rather than assets held on trust tomers:
(1)	All the cryptocurrencies deposited by the Customers were not
(1)	segregated, but were transferred to, and mixed with those
	cryptocurrencies deposited in, the Mother Wallets. The same applies to the fiat currencies, which were not segregated but
	pooled together with other currencies and kept at the accounts
	maintained by Gatecoin at the PSPs;
(2)	Gatecoin was able to use the cryptocurrencies kept in the Wallets
	it controlled in the way it saw fit including for the purpose of carrying on trades in its own right. The same applies to the fiat
	currencies kept at the PSPs, which Gatecoin was able to use for
	its purposes;
(3)	There was no requirement for Gatecoin to hold any cryptocurrencies in any of the Wallets it controlled on account of
	the Customers or that Gatecoin should hold an amount equivalent
	to the cryptocurrencies recorded in the Exchange Ledger; and
(4)	In Gatecoin's audited financial statements for the years 2016 and
	2017, the cryptocurrencies held by Gatecoin were treated as its assets while the "customer deposits" were treated as liabilities.

A	- 25 -	A
В		В
C	44. Having reached the above conclusion, it is unnecessary to determine whether Gatecoin holds the Currencies on trust for Group A and B	C
D	customers. However, as there may be Non-consenting Customers, I will deal	D
E	with the other issues raised by the Liquidators.	E
F	D4. Whether cryptocurrency is "property"	F
G	45. Mr Ho submits that the starting point is s.197 of the CWUMPO, which imposes an obligation on a liquidator to take into custody all "property"	G
Н	upon a winding-up order. However, the meaning of "property" is not defined	Н
I	in CWUMPO, and s.3 of the Interpretation and General Clauses Ordinance (Cap. 1) defines "property" as "includes (a) money, goods, choses in action	I
J	and land; and (b) obligations, easements and every description of estate,	J
K	interest and profit, present or future, vested or contingent, arising out of or incident to property as defined in paragraph (a) of this definition". The	K
L	question therefore is whether cryptocurrency falls within the meaning of	L
M	"property". ³⁹	N
N	The requirements for "property" were stated by Lord Wilberforce	N
0	in National Provincial Bank v Ainsworth [1965] AC 1175, 1247-1248 as follows:	O
P	"Before a right or an interest can be admitted into the category of	P
Q	property, or of a right affecting property, it must be definable, identifiable by third parties, capable in its nature of assumption by third parties, and have some degree of permanence or stability."	Q
R		R
S		S
T	By way of background, it should be noted that the Hong Kong Government has very recently issued a policy statement signifying the possibility of the introduction of a statutory definition for digital assets as property: see Financial Services and the Treasury Bureau, "Policy Statement on Development of Virtual	Т
U	Assets in Hong Kong" dated 31 October 2022), §8. However, this does not affect the present analysis, which is based upon the prevailing common law definitions of "property".	U
V		v

A	- 26 -	A
В		I
C	47. Mr Ho draws to the court's attention the academic debate on whether cryptocurrencies, which are not choses in possession (as they are	C
D	virtual and cannot be possessed) or choses in action (as they do not embody	Ι
E	any right capable of being enforced by action), constitute property (<i>Legal Statement</i> §§66-68; <i>Sarra and Gullifer</i> 235).	F
F	(1) The debate stems from the traditional view that "property" can	F
G	only be choses in possession and choses. In Colonial Bank v	(
н	Whinney (1885) 30 Ch D 261, Fry LJ said "all personal things are either in possession or action. The law knows no tertium quid	I
I	between the two".	I
J	(2) In the <i>Legal Statement</i> however, UKJT ⁴⁰ considered that <i>Colonial</i>	J
K	Bank is not an authority on the scope on what kinds of things can be property in law. Rather, it is an authority on the question	ŀ
L	whether shares are things in action for the purpose of the	I
M	Bankruptcy Act (§§73-78). The courts have found no difficulty in treating novel kinds of intangible assets as property, both in	N
N	particular statutory contexts and in general. On that basis, while	N
o	a crypto asset might not be a thing in action on the narrower definition of that term, but that does not mean that it cannot be	(
P	treated as property (§§82-84).	F
Q	48. As far as counsel's research goes, the preponderance of	(
R	jurisprudence recognises the proprietary nature of cryptocurrencies.	F
S	49. In <u>Hong Kong</u> , the courts have granted interlocutory proprietary	S
T	injunctions over cryptocurrencies without any party suggesting that	1
U	40 UK Jurisdiction Taskforce	ι
v		,

	- 27 -
cryptocuri	rencies are not "property". See: Nico Constantijn Antonius Samara
v Stive Jed	an-Paul Dan [2021] HKCFI 1078 ⁴¹ ; Yan Yu Ying v Leung Wing Hei
[2021] HI	KCFI 3160; Huobi Asia Limited & Anor v Chen Boliang & Anor
[2020] HK	KCFI 2750.
50.	In England and Wales:
(1)	In AA v Persons Unknown [2019] EWHC 3556 (Comm) [2020] 4
	WLR 35 §§55-61, Bryan J considered the question whether
	Bitcoin is "property" capable of being subject of a proprietary
	injunction. The learned Judge adopted the reasons identified in
	§§71-84 of the Legal Statement and held that Bitcoin meets the 4
	criteria set out in Ainsworth as being definable, identifiable by
	third parties, capable in their nature of assumption by third parties,
	and having some degree of permanence (§59).
(2)	The courts granted proprietary injunctions over cryptocurrencies
(2)	in Toma v Murray [2020] EWHC 2295 (Ch); Zi Wang v Graham
	Darby [2021] EWHC 3054 (Comm) (where AA was followed);
	Sally Jayne Danisz v Persons Unknown [2022] EWHC 280 (QB)
	and Lavinia Deborah Osbourne v Persons Unknown [2022]
	EWHC 1021 (Comm).
51.	In the BVI, in Joint Liquidators of Torque Group Holdings Ltd
	Torque Group Holdings Ltd (In liq) (BVIHC (Com) 0031 of 2021, 2
), the court considered an urgent application made by the liquidator
-	on to convert or exchange the various types of cryptocurrencies to US
ioi sancii	on to convert of exchange the various types of cryptocurrencies to OS
41 This matt	er had proceeded to trial and final judgment has been given in favour of the plaintiff ([2022]
HKCFI 12	254). However the judgment contains no analysis on "property", but only determines the rights intiff and defendant therein <i>inter se</i> and has no impact on the issue before the Court.

	- 28 -
	ing to their volatility. On the question whether cryptocurrencies are hin the meaning of s.2(1) of the BVI Insolvency Act, 2003 ⁴² (which
	ilar to the definition of "property" under s.3 of our Cap 1), Wallbank
	the conclusions in the <i>Legal Statement</i> and in AA and held that ets are assets for the purposes of liquidation (§§23-25).
52.	In <u>Singapore</u> , the courts came to the same conclusion that
cryptocurre	encies meet all the requirements for property:
(1)	In <i>B2C2 Ltd v Quoine Pte Ltd</i> [2019] 4 SLR 17; [2019] SGHC(I) 03, the plaintiff claimed against the defendant (which operated a
	platform for third parties to trade in cryptocurrencies) for breach
	of contract and breach of trust. The defendant did not dispute that
	cryptocurrencies are a specie of property that is capable of being held on trust. Simon Thorley IJ considered that the concession
	was right as cryptocurrencies "do have the fundamental
	characteristic of intangible property as being an identifiable thing of value", and they meet all the requirements for property
	discussed in Ainsworth (§142).
(2)	On appeal, the Court of Appeal considered the <i>Legal Statement</i> 's
	view that (a) cryptocurrencies have all the indicia of property, (b)
	their novel or distinctive features do not disqualify them from being property, and (c) they could be treated, in principle, as
	property. Although the court considered that there may be much
	to commend the view that cryptocurrencies should be capable of assimilation into the general concepts of property, it did not find
wherever s	defined as including "money, goods, things in action, land and every description of property ituated and obligations and every description of interest, whether present or future or vested or arising out of, or incidental to, property" (see §21 of <i>Torque Group Holdings Ltd</i>)

A			- 29 -	A
В				В
C			it necessary to decide what type of property that is involved in respect of cryptocurrency (B2C2 Ltd v Quoine Pte Ltd [2020] 2	C
D			SLR 20; [2020] SGCA(I) 02, §§139-144).	D
E		(3)	In CLM v CLN & Ors [2022] SGHC 46, the court in the context	E
F			of an <i>ex parte</i> application for joinder of parties as defendants and proprietary injunction enjoining such defendants from dealing	F
G			with the cryptocurrencies stolen from the plaintiff, considered the	G
Н			question whether cryptocurrency is capable of giving rise to proprietary right which could be protected through a proprietary	H
I			injunction. Lee J reviewed the cases decided in other common	I
J			law jurisdictions and concluded cryptocurrencies satisfy the definition of a property right in <i>Ainsworth</i> (§§40-46).	J
K	52			K
L	53.		In <u>Canada</u> :	L
M		(1)	In <i>Copytrack Pte Ltd v Wall</i> [2018] BCJ 3325, the plaintiff claimed against the defendant for conversion and wrongful	N
N			detention of certain ETH transferred to the defendant by mistake.	N
o			On the plaintiff's application for summary judgment, the court considered that the proper characterization of cryptocurrency and	O
P			the evidentiary record was not sufficient to permit a summary	P
Q			determination of the issue. However, regardless of the characterisation of the ETH, it was not in dispute that they were	Q
R			the plaintiff's property and had been sent to the defendant in error,	R
S			and the defendant had no proprietary claim to them. The court ordered that the plaintiff was entitled to trace and recover the ETH	s
T			from whatever hands they were currently held in but refused to	Т
U				U
V				X 7

		- 30 -	
		give summary judgment on the other relief such as disgorgement and/or damages.	
	(2)	In Shair.Com Global Digital Services Ltd v Arnold [2018] BCJ	
		3114, the plaintiff claimed against the defendant (a former officer	
		and employee) for conversion and/or misappropriation of certain digital currencies and information related thereto. On the	
		plaintiff's ex parte application, the court was satisfied that the	
		plaintiff had a claim to a proprietary interest in the laptop computer and in any digital currencies purchased by defendant	
		flowing from the plaintiff's initial amount invested in Bitcoin, and	
		granted a preservation order over such currencies and the wallet information in relation thereto (§§13-15, 24).	
54.		In the <u>United States</u> :	
	(1)	In United States v 50.44 Bitcoins, Civil Action No. ELH-15-3692	
	, ,	(D Md 31 May 2016), in the context of an application for default	
		judgment and order of forfeiture over the 50.44 Bitcoins on the	
		ground that they were "property, real or personal, involved in a transaction or attempted transaction in violation of [18 U.S.C.	
		s.1960], or any property traceable to such property" ⁴³ . The federal	
		magistrate judge proceeded on the basis that Bitcoins were property which may be subject to forfeiture and concluded that	
		there was reasonable cause for the seizure of the Bitcoins in	
		question.	
43 S	Section 19	60 – Prohibition of unlicensed money transmitting businesses	

A		- 31 -	A
В			В
C	(2)	In Lagemann v Spence, 2020 U.S. Dist. LEXIS 88066 (SDNY 18 May 2020), the court gave summary judgment against the	C
D		defendant (who did not file any opposition) for inter alia	E
E		conversion of the cryptocurrencies purchased with the plaintiffs' funds. The case was decided on the bases that (a)	F
F		cryptocurrencies are "property"; (b) under New York law,	F
G		"money can be the subject of a conversion action when it can be identified and segregated as a chattel can be", and "intangible	C
Н		rights can form the basis of conversion damages when the	H
I		converted property is a document into which intangible rights have merged" (p.10, section G).	I
J	(3)	Similarly, in Meta-Tech Consultants, LLC v Niu, 2021 US Dist	J
K		LEXIS 209207 (D Nev, 29 October 2021), the court in the context	k
L		of the plaintiff's application for default judgment, held that the defendant's conversion of the Bitcoins (which had been	I
M		purchased by the defendant with the plaintiff's fund but failed to	N
N		return them upon demand) denied the plaintiff the opportunity to sell the Bitcoins at their then high-end value. Judgment was	N
О		entered against the defendant for the amount invested by the	C
P		plaintiff together with loss of profit and fee paid to the defendant.	P
Q	(4)	In <i>BDI Capital v Bulbul Investments LLC</i> 446 F.Supp.3d 1127 (2020), the plaintiff applied for summary judgment for conversion	C
R		of the Bitcoins wrongfully retained by the defendant. On the	F
S		question whether Bitcoins, as a virtual and intangible cryptocurrency, may be the subject of a conversion action, the	S
T			Т
U			ι
X 7			_

A		- 32 -	A
В			В
C		court applied the reasoning in Kleiman v Wright ⁴⁴ , and held that	C
C		Bitcoins are sufficiently identifiable to be considered "specific	C
D		intangible property" and hence are capable of being the subject of	D
E		a conversion action under Florida law (p.8).	E
	(5)	Further, for federal tax purposes, the Internal Revenue Services	
F		has treated virtual currency as property and general tax principles	F
G		apply to transactions using virtual currency (IRS Notice 2014-21).	G
Н	55.	In Australia, in Australian Federal Police v Bigatton [2020]	Н
I	NSWSC 24	15, the court held that there were reasonable grounds to suspect that	I
	the defenda	ant had been "dealing with property reasonably suspected of being	
J	proceeds of	f crime contrary to s.400.9 of the Criminal Code" (§59), and granted	J
K	a freezing of	order and custody and control orders over the defendant's property	K
	including th	ne Bitcoins and ETH in the wallets under its effective control (§§60,	
L	64-66, 79).		L
M	56.	The most detailed analysis on the issue is to be found in <i>Ruscoe v</i>	M
N	Cryptopia [[2020] NZHC 728, where the New Zealand court was asked to give	N
o		under s.284(1)(a) of the Companies Act 1993 45 relating to the ion and distribution of the cryptocurrencies under the control of	o
P	_	Ltd, a company which operated a cryptocurrency trading exchange	P
	** *	aced into liquidation after suffering a serious hack and loss of a	
Q	•	amount of cryptocurrencies. The main issues are (1) whether the	Q
R		encies held by the liquidators is a type of "property" within the	R
S	meaning of	f s.2 of the Companies Act 1993 and can cryptocurrency form the	S
5	subject ma	tter of a trust; and (2) whether the cryptocurrencies are held by	3
T			Т
U		-80176, 2018 WL 6812914, 2018 US Dist. LEXIS 216417 (SD Fla, 27 December 2018) s.200(3) of CWUMPO	U
X 7			

A	- 33 -	A
В		В
C	Cryptopia on trust for the account holders (§§46-47). In essence, the dispute is one between the accountholders and the creditors of Cryptopia, and the court	C
D	had the benefit of the submissions from counsel representing the liquidators,	D
E	the accountholders and the creditors at a hearing which lasted for 4 days.	E
F	57. On the "property" issue, the accountholders contend that cryptocurrency is a form of intangible personal property both at common law	F
G	and within the definition of s.2 of the Companies Act 46 and, even if	G
Н	cryptocurrency is not personal property in the full sense, it is still capable of forming the subject matter of a trust. On the other hand, the creditors contend	Н
I	that cryptocurrency is not property capable of forming the subject matter of a	I
J	trust at common law (§§50-51). All parties agreed that cryptocurrency is a form of "assets" for the purpose of the Companies Act (§61). Gendall J	J
K	considered some of the authorities discussed in §§47-55 above, and concluded	K
L	that cryptocurrency satisfies the 4 criteria for "property" as explained in	L
M	Ainsworth and is a type of intangible property in that:	N
N	(1) It is <u>definable</u> as the public key allocated to a cryptocurrency wallet is readily identifiable, sufficiently distinct and capable of	N
o	being allocated uniquely to individual accountholder (§§104-108).	0
P	(2) It is <u>identifiable by third parties</u> in that only the holder of a private	P
Q	key is able to access and transfer the cryptocurrency from one wallet to another (§§109-113).	Q
R		R
S		s
T	Defined as " property of every kind whether tangible or intangible, real or personal, corporeal or incorporeal, and includes rights, interests, and claims of every kind in relation to property however they arise". It has been held that the definition is a wide one and includes "money" (§§71-74)	Т
U	"Assets" is not defined in the Companies Act but s.129(2) which applies to "major transactions" provides that "assets includes property of any kind, whether tangible or intangible".	U
V		χ.

A		- 34 -	A
В			В
C	(3)	It is <u>capable of assumption by third parties</u> in that it can be and is the subject of active trading markets where (a) the rights of the	C
D		owner in that property are respected, and (b) it is potentially desirable to third parties such that they want themselves to obtain	D
E		ownership of it (§§114-116).	E
F	(4)	It has some degree of permanence or stability as the entire life	F
G		history of a cryptocurrency is available in the blockchain (§§117-119).	G
H I	58.	Further, Gendall J held that:	H I
J	(1)	cryptocurrency, not being tangibles or choses in action, is no bar to recognition of its proprietary status (§§122-125);	J
K	(2)	cryptocurrency is not just information ⁴⁸ , but an item of tradeable	K
L		value which affords exclusivity to its owner (§§127-128); and	L
M N	(3)	there are no public policy objections to the court recognising cryptocurrency to have the status of property (§§129-132).	M N
O	59.	Although the definition of "property" under s.3 of Cap 1 is	0
P		om those adopted in the other jurisdictions considered above, I note ther common law jurisdictions, our definition of "property" is an	P
Q		ne and intended to have a wide meaning. Further, our courts have	Q
R		y applied and followed the principles expounded in <i>Ainsworth</i> when g the question whether a right or interest meets all the requirements	R
S		y. For these reasons, it seems to me that in considering the question	S
Т			Т
U	Which is n (Boardman	ot regarded as property, as "it is normally open to all who have eyes to read and ears to hear" a v Phipps [1967] 2 AC 46, 127)	U
V			V

	- 35 -
•	yptocurrency is "property", it is appropriate to apply and follow the in the <i>Legal Statement</i> and <i>Ruscoe v Cryptopia</i> , and their
	that cryptocurrency is "property", which is capable of forming the
subject ma	tter of a trust.
D5. Whe	ther Gatecoin held cryptocurrencies on trust
60.	Mr Ho submits that to create an express trust, there must be the
	tainties" (Snell's Equity, 34th ed., §22-012). The question is to
	not just the express arrangements as to how property is to be held,
but whethe	er it is held on trust (<i>R v Clowes</i> [1994] 2 All ER 316, 326d).
D5.1 Ce.	ertainty of subject matter
61.	As Mr Ho submits, notwithstanding the lack of segregation of the
• •	encies ⁴⁹ , there is sufficient certainty of subject matter. The law
_	hes between shares and intangibles on the one hand, and chattels on
ì	Re Harvard Securities Ltd [1998] BCC 567,575). While a trust can
•	n to specified and identifiable chattels (<i>Re Goldcorp</i> [1995] 1 AC 74) n is different in respect of intangibles:
(1)	It is possible for a settlor to declare a trust over a part of a bulk of
. ,	identical and interchangeable assets such as shares or securities
	(e.g. Hunter v Moss [1994] 1 WLR 452, 457H-458C; Re CA
	Pacific Finance Ltd [1999] 2 HKLRD 1, 17B-18F).
(2)	A trust of part of a fungible mass without appropriation of any
	specific part does not fail for uncertainty of subject matter,
49 Trust T&C	es cl.5.1 provides "The account amounts listed in the Exchange Ledger may correspond to funds
stored in o	one or more pooled Digital Asset accounts or one of more omnibus fiat accounts"; 2018 T&Cs which is in <i>pari materia</i> .

A		- 36 -	A
В			E
C		provided that the mass is sufficiently identified and the beneficiary's proportionate share of it is not uncertain (Re	C
D		Lehman Brothers Intl (Europe) [2010] EWHC 2914 (Ch),	Γ
E		§225(iii)). Such a trust works by creating a beneficial co- ownership share in the identified fund, instead of having to	F
F		identify a particular part of the fund which the beneficiary owns	F
G		outright (§232).	(
Н	62.	In the present case, certainty of subject matter can be derived from a proportionate share of an undivided bulk:	Н
I	(1)	There is compelling reason to draw an analogy between	I
J	(1)	cryptocurrencies with a trust over shares or securities. In both	J
K		cases, the right conferred upon the beneficiary would not depend	k
L		on the precise identification of the asset owned. As each unit of cryptocurrency is identical to other unit of that kind, it makes no	I
M		difference whether a customer holds the same output that originated from his initial input on the blockchain.	N
N	(2)		N
0	(2)	On the basis that there can be a trust over a proportionate share of all cryptocurrencies, the subject matter of the trust vis-à-vis each	C
P		customer is sufficiently certain, as the account balance represents	P
Q		the proportion of the cryptocurrencies over which such customer has a beneficial interest in the pool.	Ç
R	(3)	Such was the conclusion in <i>Ruscoe</i> , where the court held (§§145,	F
S		147) that the internal ledger clearly recorded the contributions of	s
T		each accountholder which provided sufficient certainty of subject matter. A trust arose whereby the beneficial co-ownership of each	Т
U			τ
V			•

A			- 37 -	A
В				В
C		• •	currency was shared by all account holders in proportion to ount of relevant cryptocurrencies they each contributed.	C
D	(4)	In the	present case, there is certainty of subject matter as the	D
E		amoun	ts of Currencies held by the Customers were recorded in	E
F			change Ledger, and they co-own and share each type of currency and fiat currency in proportion to the credit	F
G		balance	es standing in their accounts.	G
Н	D5.2 C	ertainty o	f object	Н
I	63.	A trust	would be valid so long as there is no conceptual ambiguity	I
J		•	ne definition of the class of beneficiaries (<i>Re Gulbenkian</i>	J
K	[1970] AC	2 508, 524	4E-G; Ruscoe, §149).	К
L	64.	•	there is certainty of object as the beneficiaries of the trust eir claim can readily be seen from the Exchange Ledger.	L
M			,	N
N	D5.3 C	ertainty o	fintention	N
o	65.	-	inciples on certainty of intention have been summarised by	0
P	Briggs J ii	n <i>Re Lehn</i> "(v)	nan Brothers §225(v)-(x) as follows: Subject to the issue of certainty, the question whether B has	P
Q		(*)	a proprietary interest in the property acquired by A for B's account depends upon their <u>mutual intention</u> , to be ascertained by an objective assessment of the terms of the	Q
R			agreement or relationship between A and B with reference to that property.	R
s		(vi)	The words used by the parties such as 'trust', 'custody', 'belonging', 'ownership', 'title', may be persuasive, but they are not conclusive in favour of the recognition of B's	s
T			proprietary interest in the property, if the terms of the agreement or relationship, viewed objectively, compel a	Т
U			different conclusion.	U
v				v

A				- 38 -	A
В					В
C		(vii)	or bi	dentification of a relationship in which A is B's agent toker is not conclusive of a conclusion that A is, in on to the property, B's trustee, although it may be a er towards that conclusion.	C
D E		(viii)	basic incap	ationship which absolves A from one or more of the duties of trusteeship towards B is not thereby rendered table of being a trustee beneficiary relationship, but may be pointer towards a conclusion that it is not.	E
F		(ix)		ial care is needed in a business or commercial context.	F
G H			(a)	The law should not confine the recognition and operation of a trust to circumstances which resemble a traditional family trust, where the fulfilment of the parties' commercial objective calls for the recognition of a proprietary interest in B.	E
I			(b)	The law should not unthinkingly impose a trust where purely personal rights between A and B sufficiently achieve their commercial objective.	I
J		(x)		e is, at least at the margin, an element of policy. For aple, what appears to be A's property should not lightly	J
K L			be rediintere	nade unavailable for distribution to its unsecured tors in its insolvency, by the recognition of a proprietary est in favour of B. Conversely, the clients of mediaries which acquire property from them should be	I.
M			appro	opriately protected from the intermediary's insolvency."	N
N	D5.3.1	During t	he cu	rrency of the 2016 T&Cs	N
0	66.	The 20)16 T	&C is silent on the nature of Gatecoin's holding of the	C
P	Currencie	es for Gro	up A	customers.	P
Q	67.			es, the Liquidators considered that by reason of the ers, Gatecoin did intend to hold the Currencies on trust	Ç
R		A custor		,	F
S	(1)	Mr M	ax Ja	ackowski ("MJ"), the person engaged to "update"	S
T				terms and conditions, was instructed by Gatecoin's	Т
U		repres	entati	ve on 27 October 2016 that "as Gatecoin, we hold the	τ
V					V

A		- 39 -	A
В			В
C		property on behalf of the client", and to incorporate express trust language. On this basis, MJ drafted the Trust T&Cs ⁵⁰ .	C
D	(2)	Gatecoin agreed to compensate the affected Customers of the	D
E		value of ETH stolen as at the time the compensation was paid (as	E
F		opposed to the time of the Hack) ⁵¹ . Such treatment was consistent with Gatecoin holding the ETH in Customers' accounts on trust.	F
G	(3)	The pooling of cryptocurrencies in the wallets controlled by	G
Н		Gatecoin does not mean that no trust was intended as the	Н
I		beneficiaries' interest can be ascertained from the Exchange Ledger.	I
J	(4)	Although Mr Menant in his reply dated 13 May 2022 claimed that	J
K		Gatecoin had no intention to create a trust, that has to be read in	К
L		its context, where Mr Menant continued to say that the earlier versions of T&C had been superseded by the 2018 T&C and	L
M		Clauses 10.1.1 and 27.2.4 of the 2018 T&C show that there was	N
N		no trust intended. The basis of Mr Menant's statement is his belief that the 2018 T&C would apply to all Customers, which the	N
0		Liquidators consider to be incorrect.	0
P	(5)	In any event, even if the 2016 T&C by itself did not create a trust,	P
Q		once the Trust T&C was adopted, they applied to the Group A customers, rendering the relationship they had with Gatecoin to	Q
R		be one of trust. In this regard, the 2016 T&C provided that	R
s		Gatecoin might change the terms at any time without prior notice.	s
T			Т
U	⁵⁰ Chi 2 nd §45 ⁵¹ Chi 2 nd §56		U
V			v

	- 40 -
	In any event, Gatecoin had notified the Group A customers by email when the Trust T&C came into effect.
68.	In respect of the Non-Consenting Customers, I agree that for the
reasons ide	entified by the Liquidators, Gatecoin holds the Currencies on trust
	However, for the reasons stated in <u>Section D2</u> above, I do not agree lationship between Group A customers (and B customers for that
	s governed by the Trust T&C as these customers had accepted and
	he 2018 T&C.
D5.3.2	During the currency of the Trust T&C
69.	The Liquidators consider that there was a trust relationship
between G	atecoin and Group B customers:
(1)	The express trust language in Clauses 7.3.1-7.3.2 and the
	recognition that accretion to cryptocurrencies belonged to the Customers in Clause 7.5;
(2)	The Trust T&C was drafted by MJ on Gatecoin's express
	instructions that the cryptocurrencies were to be held on trust;
(3)	The policy consideration concerning unsecured creditors in insolvency (<i>Re Lehman Brothers</i> §25(x)) cannot override clear
	expression of intention to create a trust for Group B customers;
	and
(4)	the Liquidators' initial view of no trust ⁵² is of no relevance, since
	that view was formed on the basis that the 2018 T&C governed
52 Chi 2 nd §30	<u> </u>
Ü	

A		- 41 -	A
В			В
C		the relationship between Gatecoin and all the Customers and without the benefit of the Trust T&C or the contemporaneous	C
D		evidence of intention referred to above.	D
E	70.	In view of the clear language of the Trust T&C discussed in §26	E
F		the Liquidators that it was the mutual intention of Gatecoin and	F
G	•	ustomers (and Group A customers for the reasons stated in §67(5)	G
Н	above), that	t the Currencies were held by Gatecoin on trust for these customers.	Н
I	D5.3.3 I	During the currency of 2018 T&Cs	I
J	71.	It is clear that from the terms of the 2018 T&C that there was no	J
K	intention to	create any trust for the Customers:	K
L	(1)	In the 2018 T&C, all the trust language in the Trust T&C was removed;	L
M N	(2)	Clauses 1.7 and 3.5 contained express disclaimers of fiduciary obligation;	M N
О	(3)	Clauses 12.5 and 13.1 allow Gatecoin to keep accretion to the	o
P		cryptocurrencies. This is consistent with and reinforces the	P
Q		position that Gatecoin is the beneficial owner of the cryptocurrencies; and	Q
R	(4)	Although Clause 10.1.1, still uses the phrase "the Exchange	R
s		Ledger to track a User's ownership of" the Currencies, this is not	S
T		sufficient to displace the clear intention stated in the other Clauses discussed above.	Т
U			U
V			v

A		- 42 -	
В	D6. Whe	ther first europeies are held on twist	
C	Do. Wne	ther fiat currencies are held on trust	
D	72. kept at the	As stated above, Gatecoin's fiat currencies were also mixed and PSPs. Such pooling of fiat was expressly contemplated in the Trust	
E	1	se 5.1 and the 2018 T&C Clause 10.1.1.	
F	73.	The above analysis applies with equal force to fiat currencies	
G H		credit in the Customers' accounts. It follows that the fiat currencies d by Gatecoin on trust for the Customers, be it Group A, B or C	
I	74.	I should add that Mr Chan contends that:	
J	(1)	As a Group A customer Cumberland agrees with the Liquidators'	
K		analysis that Gatecoin holds the Currencies on trust for Group A customers.	
L		customers.	
M	(2)	Cumberland does not agree with the Liquidators' view that the ETD Holders are unsecured creditors to the extent of the value of	
N		the ETD in their accounts, apparently on the basis that Gatecoin	
O		held the ETH on trust for Group A customers including Cumberland. To the extent that Gatecoin lost the ETH in the Hack,	
P		it acted in "breach of duty and give rise to an action in conversion"	
Q		and Cumberland is entitled to be compensated for the loss of the ETH.	
R	(3)	In any event, the information available is not sufficient for the	
S		Court to determine the question whether the ETH Holders have a	
Т		proprietary claim over the ETH recorded in their accounts or that they only have a non-proprietary claim against Gatecoin.	
U		- -	
V			

A	- 43 -	A
В		В
C	75. In light of my conclusion that the Currencies are not held by Gatecoin on trust for the Customers, the basis for contending that Cumberland	C
D	has a proprietary claim over the ETH recorded in its account no longer exists.	D
E	As to the question whether the ETD Holders have a proprietary claim over the ETH lost in the Hack (that is, the ETD Debt), it will be considered in the next	E
F	stage, after the parties have the opportunity to consider the Court's	F
G	determination on Question 1.	G
Н	E. Question 2: Blue Fire Issue	Н
I	As stated in <u>Section B5</u> above, BlueFire is the largest account	I
J	holder but has not asserted any claim over the Currencies or filed any POD. The evidence shows that BlueFire did not carry on any trade in its own right	J
K	but acted on behalf of Gatecoin in that:	K
L	(1) BlueFire was described as a market maker for Gatecoin;	L
M	(2) Gatecoin had advanced credit lines to BlueFire for the trades it	N
N	carried on through the Platform; and	N
o	(3) Gatecoin's records show that BlueFire did not pay any account fees or charges, unlike the Customers who had to pay fees and	O
P	charges to Gatecoin in return for the services rendered to them. ⁵³	P
Q	77. As Gatecoin acted as agent of Gatecoin in carrying on all the	Q
R	transactions, the Currencies recorded in its accounts must be regarded as assets	R
S	of Gatecoin. The conclusion is consistent with and reinforced by the following facts and matters.	s
T		Т
U	53 Chi 2 nd §70	U
V		v

A	- 44 -	A
В		Е
C	78. <u>First</u> , according to Mr Menant, there was no written agreement entered into between BlueFire and Gatecoin. The Liquidators find no evidence	C
D	of any agreement or documentary record of Gatecoin's arrangements with BlueFire ⁵⁴ .	Γ
E	Diuci ii c	E
F	79. <u>Second</u> , the evidence available to the Liquidators all show that BlueFire acted as a service provider which: (a) used Gatecoin's funds to buy	F
G	and sell cryptocurrencies in accordance with Gatecoin's orders at the crypto	(
Н	clearing house and (b) transferred the cryptocurrencies to Gatecoin's Wallets after completion of these transactions (which Gatecoin recorded in the	H
I	Exchange Ledger under BlueFire name).	I
J	(1) Mr Menant referred to BlueFire as a market maker. This is	J
K	consistent with industry understanding of what this means ⁵⁵ - a market maker upon receiving an order from a buyer would	ŀ
L	immediately sell off its position of cryptocurrency from its own	I
M	inventory and is then compensated with a fee in exchange for providing the market-making service (though it may also profit	N
N	from the difference in the bid-ask spread from the trades it makes.	N
0	(2) The description in the Cheng Report is consistent with news	C
P	report which described BlueFire as a market maker.	P
Q	80. Mr Ho submits that the position that Gatecoin (but not BlueFire)	(
R	has proprietary interest in the Currencies recorded in BlueFire's account is bolstered by the following legal analysis:	F
S	ocioierea of the foliowing legal unuryolo.	S
T		Т
U	Chi 2 nd §19.2 Expert Memorandum of Mr Casper Cheng ("Cheng Report") §§ 1-2, 9-14	τ
V		

	- 45 -
(1)	Since Gatecoin's funds were advanced to BlueFire for the sole purpose of purchasing cryptocurrencies on Gatecoin's behalf ⁵⁶ , a
	Quistclose trust would have arisen whereby BlueFire held the funds Gatecoin advanced on trust for Gatecoin (Twinsectra Ltd v
	Yardley [2002] 2 AC 164, §§68-102).
(2)	Further, a <i>Quistclose</i> trust may be applied to non-loan situations
	such as the present (Twinsectra §99; Typhoon 8 Research Ltd v Seapower Resources International Ltd [2002] 2 HKLRD 660,
	§§18-19, per Le Pichon JA (as she then was)).
(3)	If a Quistclose trust is imposed on the fiat used to acquire
	cryptocurrencies, this adds strength to the conclusion that the
	cryptocurrencies so acquired belong to Gatecoin.
81.	As there is no dispute that BlueFire was the market maker
	y Gatecoin and all the transactions were carried on by BlueFire using provided by Gatecoin, it is indisputable that the Currencies recorded
in its acco	ounts are assets of Gatecoin.
F. Cor	nclusion
82.	For the reasons discussed above, in respect of Question 1, I hold
that:	
(1)	Except the Non-Consenting Customers, the 2018 T&C applied to, and governed the relationship between all the Customers (be it
	Group A, B or C customers) and Gatecoin (<u>Section D2</u> above).
56 Cheng Re	eport §6

A		- 46 -	A
В			В
C	(2)	The terms of the 2018 T&C make clear that the cryptocurrencies are not held by Gatecoin on trust for the Customers. This is	C
D		consistent with and reinforced by the objective facts that the	D
E		cryptocurrencies have always been treated as Gatecoin's assets (Section D3 above).	E
F	(3)	Cryptocurrency is "property" and is capable of being held on trust	F
G		(Section D4 above).	C
Н	(4)	There was certainty of subject matter and object. However, the	Н
I		terms of the 2018 T&C show that there was no certainty of intention to create a trust over the cryptocurrencies held by	I
J		Gatecoin (Section D5 above).	J
K	(5)	Except the Non-Consenting Customers, the fiat currencies are not	K
L		held by Gatecoin on trust for the Customers (Section D6 above).	L
M	83.	As for Question 2, I hold that the Currencies recorded in	N
N	BlueFire's	accounts are assets of Gatecoin (Section E above).	N
O	84.	I give liberty to the parties to apply for further directions.	C
P			P
Q		(Linda Chan) Judge of the Court of First Instance High Court	Ç
R		Thigh Court	R
S	Mr Justin l	Ho, instructed by Clifford Chance, for the Liquidators	s
T	Mr Eric Cl	nan, of Simmons & Simmons, for Cumberland DRW LLC	Т
U			τ
v			V

A		- 47 -	A
В			В
C		Schedule (Directions made on 5 December 2022)	C
D	1.	Notice of the Summons, the 2 nd Affirmation of Chi Lai Man Jocelyn dated 29 November 2022, the Skeleton dated 30 November 2022, and	D
E		the draft Order attached to the Skeleton be uploaded to the website maintained by the Liquidators of Gatecoin:	E
F		https://www.gatecoinliquidation.com/ ("Website") from the date of this order;	F
G	2.	Any former customer or creditor of Gatecoin wishing to be heard by the Court on the Summons do (a) notify the Liquidators of Gatecoin of their	G
Н		intention; (b) provide to the Liquidators (i) an effective means of communication (email address or physical address) and (ii) the names	Н
I		of their legal representatives (if any), and (c) file and serve affidavit evidence (together with any exhibits) (if any) within 4 weeks of this	I
J		order;	J
K	3.	Within 4 weeks thereafter:	K
L		3.1 The Liquidators shall file any affidavit in reply to the affidavit evidence in §2 above (if so advised);	L
M		3.2 Subject to confirmation of identity, the Liquidators shall compile (a) a list of all persons who have given notice in accordance with	M
N		§2 above ("Interested Parties") and (b) a list of issues raised by the Interested Parties, and lodge such lists with the Court and	N
O		upload such lists on the Website;	O
P	4.	A callover hearing of the Summons be fixed on 23 February 2023 at 10am ("Callover Hearing"), at which the Court will consider whether the Summons can be determined summarily, and in the event that the	P
Q		Court so decides the Summons will be determined summarily at the Callover Hearing;	Q
R	5.		R
S	3.	7 days prior to the Callover Hearing, the Interested Parties may (if they so wish) file their skeleton submissions with the Court, and in the event that they choose to file skeleton submissions they must serve a copy on	s
T		the Liquidators. The skeleton submissions of each Interested Party will be limited to 10 pages (using at least size font 14 with normal page	Т
U			U
V			V

A		- 48 -	A
В			В
C		margins, i.e. 2.54 cm on top, bottom, right and left of page), unless leave of the Court is obtained for a higher page limit; and	C
D	6.	3 days prior to the Callover Hearing, the Liquidators do file skeleton submissions in reply (if any) and upload the same to the Website. The	D
E		Liquidators do upload these directions to the Website within 24 hours from the date of this order.	E
F	7.	Costs be in the cause of the Summons.	F
G			G
Н			Н
I			I
J			J
K			K
L			L
M			M
N			N
O			0
P			P
Q			Q
R			R
S			S
T			Т
U			U
V			V

Commodity Futures Trading Commission v. Ooki DAO, Not Reported in Fed. Supp. (2023)

2023 WL 5321527

Only the Westlaw citation is currently available.
United States District Court, N.D. California.

COMMODITY FUTURES TRADING COMMISSION, Plaintiff,

v.
OOKI DAO, Defendant.

Case No. 3:22-cv-05416-WHO | | Signed June 8, 2023

Attorneys and Law Firms

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ORDER GRANTING MOTION FOR DEFAULT JUDGMENT

Re: Dkt. No. 68

William H. Orrick, United States District Judge

*1 The Commodity Futures Trading Commission ("CFTC") filed this action against a decentralized autonomous organization ¹ ("DAO") called Ooki DAO, alleging Ooki DAO is and has been violating the Commodity Exchange Act ("CEA"). The CFTC asserts that Ooki DAO provides a platform and "protocol" by which users can engage in retail

commodity transactions but does not provide protections and other requirements prescribed by the CEA. The CFTC now moves for default judgment. For the following reasons, its motion is GRANTED.

BACKGROUND

The background facts of this case are detailed at length in my prior order concluding that service had been achieved. ("Order") [Dkt. No. 63]. This order assumes familiarity with those facts, with pertinent allegations provided again below. I assume the following well-pleaded facts are true on this motion for default judgment.

bZeroX, LLC operated a blockchain-based software called the "bZx Protocol" from 2019 until August 23, 2021. ("Compl.") [Dkt. No. 1] ¶ 1. The bZx Protocol operated on the Ethereum blockchain through the use of "smart contracts" that permitted anyone with "an Ethereum wallet" to, essentially, make investments and bet on the relative rise and fall of particular virtual currencies. See id. ¶¶ 25-28, 31. As the CFTC explains it, these investments and bets allowed users to "contribute margin (collateral) to open leveraged positions whose ultimate value was determined by the price difference between two digital assets from the time the position was established to the time it was closed." 3 Id. ¶ 28. This technology is functionally the same as using a trading platform and, according to the CFTC, constitutes an "exchange" for commodity derivative transactions. See id. ¶¶ 1, 13-15, 52-60.

bZeroX LLC had a website to market its technology to prospective users, solicit orders, and facilitate access to the software Protocol. Id. ¶ 32. bZeroX LLC also charged and collected fees for access to its technology. Id. ¶ 33. Additionally, bZeroX LLC had a "liquidity pool" that contained assets supplied by "liquidity providers." *Id.* ¶ 28(b). In exchange for supplying liquidity, these providers received both "interest-generating tokens" and "BZRX Tokens," the latter of which conferred voting rights on the holders ("Token Holders") for certain questions related to governance of the Protocol. Id. Finally, bZeroX LLC had "Administrator Keys" which allowed bZeroX to "access and control" the operation of the smart contracts (pieces of software code) and the funds held in those smart contracts, including by updating code, pausing or suspending trading, and directing deposits of funds to users. Id. ¶ 34.

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*2 In August 2021, bZeroX LLC "transferred control" of the software Protocol 4 to "the bZx DAO," which was subsequently renamed "Ooki DAO." *Id.* ¶¶ 38, 46. The CFTC alleges that "the bZx Founders believed that transition to a DAO would insulate the bZx Protocol from regulatory oversight and accountability for compliance with U.S. law" due to its structure and built-in anonymity of users. *Id.* ¶ 40. The DAO continued operating the underlying Protocol software in the same way as the LLC had, permitting users to engage in the same retail commodity transactions and continuing the collection of user fees. *See id.* ¶ 41. Those fees and revenue were collected in a central DAO Treasury. *See id.* ¶¶ 44-45.

Ooki DAO never registered with the CFTC, as required by the CEA for most exchanges that enable commodity derivative transactions. *See id.* ¶¶ 52-67. Ooki DAO also did not implement a Customer Information Program ("CIP") or conduct Know Your Customer ("KYC") or anti-money laundering procedures, all allegedly in violation of the CEA. *See id.* ¶¶ 68-72.

I previously entered an Order permitting alternative service and concluding service had been achieved, finding that Ooki DAO was an unincorporated association as defined by California and federal law. *See* Order. That Order considered four amicus briefs and replies filed by various interested parties. *See* DEF Amicus Br.; Para. Amicus Br.; LeXpunK Amicus Br. [Dkt. No. 36]; a16z Amicus Br. [Dkt. No. 45].

Ooki DAO failed to appear or respond in this court. Subsequently, the CFTC moved for entry of default, [Dkt. No. 64], which the Clerk's office entered, [Dkt. No. 65]. The CFTC then filed its Motion for Default Judgment. ("Mot.") [Dkt. No. 68]. The four amici moved to file an amicus brief responding to the CFTC's motion, [Dkt. No. 70], which I granted, [Dkt. No. 72]. The amicus response is attached as Exhibit A to the motion to file. ("Oppo.") [Dkt. No. 70 Ex. A].

I held a hearing at which counsel for the CFTC and counsel for amici appeared. After the hearing, I ordered the CFTC to submit supplemental briefing on personal jurisdiction and on its requested relief for removal of Ooki DAO's website. [Dkt. No. 74]. The CFTC submitted a supplemental brief. ("Supp. Br.") [Dkt. No. 75].

Federal Rule of Civil Procedure ("FRCP") 55(b)(2) permits a court to enter a final judgment in a case following a defendant's default. Shanghai Automation Instrument Co. v. Kuei, 194 F. Supp. 2d 995, 999 (N.D. Cal. 2001). Whether to enter a judgment lies within the court's discretion. Id. (citing Draper v. Coombs, 792 F. 2d 915, 924-25 (9th Cir. 1986) (subsequent citation omitted)).

Before assessing the merits of a default judgment, "a district court has an affirmative duty to look into its jurisdiction over both the subject matter and the parties." In re Tuli, 172 F.3d 707, 712 (9th Cir. 1999) (citation omitted). If the court finds that it may exercise jurisdiction over the defendant, it turns to the following factors (the "Eitel factors") to determine whether it should grant a default judgment:

(1) the possibility of prejudice to the plaintiff, (2) the merits of plaintiff's substantive claim, (3) the sufficiency of the complaint, (4) the sum of money at stake in the action[,] (5) the possibility of a dispute concerning material facts[,] (6) whether the default was due to excusable neglect, and (7) the strong policy underlying the Federal Rules of Civil Procedure favoring decisions on the merits.

Eitel v. McCool, 782 F. 2d 1470, 1471-72 (9th Cir. 1986) (citation omitted).

Upon entry of default, "the general rule is that well-pled allegations in the complaint regarding liability are deemed true," and district courts are "not required to make detailed findings of fact." Fair Hous. of Marin v. Combs, 285 F.3d 899, 906 (9th Cir. 2002) (citations omitted). Where a default judgment is granted, the scope of relief "must not differ in kind from, or exceed in amount, what is demanded in the pleadings." Fed. R. Civ. Proc. 54(c).

DISCUSSION

I. JURISDICTION

LEGAL STANDARD

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*3 First, I note that I previously found service of process was proper. *See CFTC v. Ooki DAO*, No. 3:22-CV-05416-WHO, 2022 WL 17822445 (N.D. Cal. Dec. 20, 2022).

Second, I have federal question jurisdiction under 28 U.S.C. §§ 1331, 1345, given that the complaint is brought by a federal agency authorized to sue by 7 U.S.C. § 13a-1.

Third, with respect to personal jurisdiction, the CFTC states in the complaint that "the Ooki DAO transacted business in this District and certain transactions, acts, practices, and courses of business in violation of the Act occurred, are occurring, or are about to occur in this District, among other places." Compl. ¶ 9. The CFTC also asserts that Token Holders resided in the United States during the relevant period and conducted Ooki DAO business in the U.S. during that period by voting to govern the Protocol and operating the protocol. Compl. ¶ 49. A declaration submitted with the CFTC's supplemental brief also explains that one of the bZeroX's co-founders, Kyle Kistner, took actions on behalf of Ooki DAO while Kistner was in the United States and during the period alleged in the complaint, and that Kistner knew that the Protocol was being offered to every person in the United States. Supp. Br. Ex. 1 ¶¶ 7-11. Another declaration states that the other co-founder, Tom Bean, advertised the Ooki Protocol via his Twitter account while he was in the United States and during the relevant time period. Supp. Br. Ex. 2 ¶¶ 9-10. The CFTC contends that these allegations are sufficient to establish personal jurisdiction over Ooki DAO because the CEA provides for nationwide service of process and so the CFTC need only show minimum contacts with the United States as a whole. See Supp. Br. 3:24-5:7.

The exercise of personal jurisdiction must comply with constitutional considerations of due process, fair play, and substantial justice. **Action Embroidery Corp. v. Atl. Embroidery, Inc., 368 F.3d 1174, 1180 (9th Cir. 2004) (citations omitted). "[D]ue process is satisfied when the forum state has 'minimum contacts' with a defendant," and where the underlying statute provides for nationwide service, "the inquiry to determine "minimum contacts" is thus "whether the defendant has acted within any district of the United States or sufficiently caused foreseeable consequences in this country." **Id. at 1180 (citing Sec. **Inv. Prot. Corp. v. Vigman, 764 F.2d 1309, 1315-16 (9th Cir. 1985)). This rule stems from the Ninth Circuit's holding in 1985 that "[w]here a federal statute ... confers nationwide service of process, 'the question [of personal jurisdiction] becomes whether the

party has sufficient contacts with the United States, not any particular state.' "Vigman, 764 F.2d at 1315. That case held that "so long as a defendant has minimum contacts with the United States, [Section 27 of the Securities Exchange Act] confers personal jurisdiction over the defendant in any federal district court." Id. at 1316.

The Ninth Circuit later explained that this "national contacts analysis" for personal jurisdiction also applied to suits brought under the Clayton Act because Congress authorized nationwide service and because the language of the Clayton Act's service provision in the act was nearly identical to that of the Exchange Act in Vigman. Go-Video, Inc. v. Akai Elec. Co., 885 F.2d 1406, 1414-15 (9th Cir. 1989) (first citing the Clayton Act, 15 U.S.C. § 22 ("... all process in such cases may be served in the district of which [the defendant] is an inhabitant, or wherever it may be found"); and then citing the Securities Exchange Act, 15 U.S.C. § 78aa(a) ("... process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found"). And in Action Embroidery, 368 F.3d at 1179-80, the Ninth Circuit reaffirmed the holdings of Go-Video and Vigman and explained that "the existence of personal jurisdiction ... does not depend upon there being proper venue in that court."

- *4 Here, the CFTC sued under the CEA, 7 U.S.C. § 13a-1, which provides in relevant part:
 - (e) Venue and process

Any action under this section may be brought in the district wherein the defendant is found or is an inhabitant or transacts business or in the district where the act or practice occurred, is occurring, or is about to occur, and process in such cases may be served in any district in which the defendant is an inhabitant or wherever the defendant may be found.

7 U.S.C. § 13a-1(e) (emphasis added). The service provision in this section is nearly identical to the provisions in the Clayton Act and the Exchange Act, and for the same reasons as explained in **Go-Video*, 885 F.2d at 1414-15, here too the CEA provides for nationwide service of process. See also U.S. Commodity Futures Trading Comm'n v. Oakmont Fin., Inc., 191 F. Supp. 3d 1347, 1350 (S.D. Fla. 2016) (reasoning that the CEA provides for nationwide service of process and applying the national contacts analysis).

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Personal jurisdiction therefore depends on the "existence of sufficient national contacts." Go-Video, 885 F.2d at 1415. The complaint and supplemental brief allege that the DAO offers the Protocol to users in the United States; that Token Holders voted their tokens while in the United States; and that the founders of Ooki DAO's predecessor LLC engaged in acts on behalf of the DAO during the relevant period, including advertising Ooki DAO on Twitter while they were in the United States. See Compl. ¶ 49; Supp. Br. Exs. 1-2. Taken together, this is more than enough to show that Ooki DAO acted in the United States and caused "foreseeable contacts in this country," establishing minimum contacts with the United States. Action Embroidery, 368 F.3d at 1180. Accordingly, I have personal jurisdiction over Ooki DAO.

Because the jurisdiction and service requirements are met, I next turn to the *Eitel* factors.

II. EITEL FACTORS

A. Possibility of Prejudice

This factor favors granting default judgment: If the CFTC's motion is not granted, both the CFTC and the affected public "will likely be without other recourse for recovery."

Pepsico, Inc. v. Cal. Sec. Cans, 238 F. Supp. 2d 1172, 1177 (C.D. Cal. 2002); see also Lawrence v. Commodity Futures Trading Comm'n, 759 F.2d 767, 776 (9th Cir. 1985) ("The [CFTC] ... is the 'statutory guardian' entrusted with the enforcement of the congressional scheme for safeguarding the public interest in commodity futures markets." (citation omitted)). The harm suffered by the CFTC—which is tasked with protecting the public from operations that defy the CEA and federal consumer protection regulations, exactly like this one—outweighs any harm suffered by Ooki DAO in having default judgment entered against it, particularly following a strategic decision to not appear. See Ooki DAO, 2022 WL 17822445, at *5 ("If the DAO fails to appear, it will be because of its strategic decision, not because it was unaware of the lawsuit.").

B. Merits of the Substantive Claims and Sufficiency of the Complaint

The CFTC alleges that Ooki DAO violated the CEA in three ways: (1) engaging in unlawful off-exchange leveraged and margined retail commodity transactions in violation of

U.S.C. § 6(a); (2) engaging in activities that can only lawfully be performed by a registered futures commission merchant, in violation of 7 U.S.C. § 6d; and (3) failing to implement a CIP, KYC, and anti-money laundering procedures, in violation of 17 C.F.R. § 42.2. As discussed in my prior Order on service, the amici previously contested whether Ooki DAO could be subject to liability under the CEA, a question I found went to the merits of the case. *See Ooki DAO*, 2022 WL 17822445, at *5.

*5 The CEA assigns liability to "[a]ny person" who takes particular actions, 7 U.S.C. § 13c(a)-(b), and defines "person" to include "individuals, associations, partnerships, corporations, and trusts," id. § 1a(38); see also id.§ 2(a)(1) (B). The CFTC alleges that Ooki DAO is an unincorporated association and therefore falls within the definition of "person" in the CEA, which encompasses "association." The amici disagree. See DEF Amicus Br. 7:14-9:5 (arguing that the California definition of unincorporated association applies but is not met); LeXpunK Amicus Br. 9:6-19 & n.31 (reasoning that federal rules of statutory interpretation should apply and that the court should "adopt a rule that best comports with the CEA's regulatory scheme" (first citing

then citing PM Grp. Life Ins. Co. v. W. Growers Assurance Tr., 953 F.2d 543, 546 (9th Cir. 1992)); Para. Amicus Br. 5:23-8:3 (applying the federal definition of unincorporated association); a16z Amicus Br. 3:14-8:9 (arguing Ooki DAO is not an unincorporated association under California service law).

The CEA does not further define "association[]" and as noted, the CFTC and amici previously briefed what they believe the proper definition is under the law. Regardless of whether the state or federal definition applies, it is met here. I previously found that the CFTC sufficiently pleaded facts showing that Ooki DAO is an unincorporated association under California law, *Ooki DAO*, 2022 WL 17822445, at *5-8, and also under federal law, *id.* at *8 n.10. Those definitions are not limited to service provisions; they are the definitions provided by each set of laws. Consequently, for those same reasons, the CFTC's complaint contains sufficient well-pleaded factual allegations that, assuming they are true, establish Ooki DAO as an unincorporated association under state and federal law. ⁵ Therefore, given the well-pleaded facts, Ooki DAO is subject to suit under the CEA as an unincorporated association.

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Given that the CFTC sufficiently alleged that Ooki DAO may be held liable under the CEA, I turn to the facts pleaded for each cause of action.

1. Unlawful Off-Exchange Leveraged and Margined Retail Commodity Transactions

The CFTC sufficiently pleads facts that, assumed to be true, show that Ooki DAO engaged in unlawful off-exchange leveraged and margined retail commodity transactions. *See*7 U.S.C. § 6(a). 6 Transactions under § 6(a) include retail commodity transactions as defined by § 2(c)(2)(D). 7

*6 First, the complaint sufficiently establishes that the transactions conducted via the Ooki Protocol were retail commodity transactions as defined by 7 U.S.C. § 2(c)(2)(D), and so were subject to regulation under the CEA. The underlying commodities were digital assets like cryptocurrency tokens, including those on the Ethereum blockchain. See Compl. ¶¶ 15, 26-28. The relevant transactions were the ones conducted via the Ooki Protocol, which functionally served as a trading platform where anyone "with an Ethereum wallet" could bet on the rise or fall of certain virtual currencies by contributing collateral currency via smart contracts to open leveraged positions, borrowing virtual currency from the Protocol's liquidity pool, and exchanging with other currencies. Id. ¶¶ 25-28, 31. The Protocol user then earned profits or lost their collateral currency based on the actual rise or fall of the other currencies. See id. ¶¶ 28-31. Users could also open and profit from short positions. Id. ¶ 31. Ooki DAO, through its Token Holders, controlled the existence and operation of the Ooki Protocol by voting their tokens to take actions such as updating code, pausing and suspending trading, and directing deposits of funds to users. See id. ¶¶ 28, 34, 38, 41.

Taken together, this is enough to show that the transactions were entered into on a leveraged or margined basis, and perhaps to show that they were financed in part by the offeror Ooki DAO, as defined by 7 U.S.C. § 2(c)(2) (D)(i). Consequently, they were subject to the CEA. There are also no facts suggesting that the transactions involved securities or contracts of sale (as opposed to, as alleged in the complaint, the establishment of leveraged positions on anticipated price differences between commodities), or that

any other exceptions outlined in \$\)\(^{\infty}\)\(^{\infty}\)\(^{\infty}\)(ii) apply, and the amici (and CFTC) do not contend otherwise.

Taken as true, then, these allegations show that Ooki DAO, via the Protocol, executed (or confirmed the execution of) contracts for the purchase and sale of commodity futures by controlling the Protocol and providing the platform and liquidity pool that allowed these transactions to occur. *See* 7 U.S.C. § 6(a). Accordingly, the merits of the first cause of action, as well as the sufficiency of the allegations in the complaint, favor entry of default judgment.

2. Activities That Can Only Lawfully Be Performed by a Registered Futures Commission Merchant

Under 7 U.S.C. § 1a(28), in relevant part, a person or association is a futures commission merchant if it engages in soliciting or accepting orders for any transaction described in 7 U.S.C. § 2(c)(2)(D)(i). It is "unlawful for any person to be a futures commission merchant" unless registered with the CFTC. 7 U.S.C. § 6d(a)(1).

The merits of this claim and the sufficiency of the complaint also favor default judgment. First, as explained in the previous section, the CFTC sufficiently pleaded that the transactions on the Ooki Protocol constituted retail commodity transactions as defined by 7 U.S.C. § 2(c)(2)(D)(i). Second, the CFTC pleaded that Ooki DAO "solicited" these transactions via advertising on the public website and social media and through the statements of its founders, and so constitutes a futures commission merchant. *See* Compl. ¶ 32. Third, Ooki DAO did not register as a futures commission merchant. *See* id. ¶ 65. Together, this shows a violation of 7 U.S.C. § 6d(a)(1).

Accordingly, the merits of this claim and the well-pleaded complaint favor default judgment.

3. Failure to Implement CIP, KYC, or Anti-Money Laundering Procedures

Under 17 C.F.R. § 42.2, a futures commission merchant must "comply with the applicable provision of the Bank Secrecy Act" and related regulations, including implementing

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a CIP, facilitating KYC diligence, and other requirements. As discussed, and assuming the well-pleaded facts in the complaint are true, Ooki DAO is a futures commissions merchant under 7 U.S.C. § 1a(28).

The CFTC sufficiently alleges that Ooki DAO did not implement a CIP, did not facilitate KYC diligence, did not institute the required anti-money laundering program, and otherwise failed to comply with 17 C.F.R § 42.2. Compl. ¶¶ 4, 35-37, 70. Accordingly, the CFTC shows that Ooki DAO violated 17 C.F.R. § 42.2 and so the merits of this claim as well as the complaint favor default judgment.

* * *

*7 For those reasons, the merits of the substantive claims favor default judgment.

C. Sum of Money at Stake

"When the money at stake in the litigation is substantial or unreasonable, default judgment is discouraged." *Bd. of Trs. of Laborers Health & Welfare Tr. Fund for N. Cal. v. Cazadores Constr., Inc.*, No. 17-CV-05242-WHO, 2018 WL 986020, at *4 (N.D. Cal. Feb. 20, 2018) (citations omitted). But "where the sum of money at stake is tailored to the specific misconduct of the defendant, default judgment may be appropriate." *Id.* (citations omitted).

The CFTC requests \$643,542 in civil monetary penalties under 7 U.S.C. § 13a-1(d)(1) and 17 C.F.R. § 143.8(b)(1), which authorize a penalty of \$214,514 8 per violation of the Act. The CFTC asserts that Ooki DAO violated three separate provisions of the Act and so should be penalized for three separate violations. *See* Mot. 14:26-15:20. Though this sum is not insignificant, it is tailored to Ooki DAO's specific misconduct because it is what the law authorizes in these situations. It also aligns with penalties provided in other CFTC enforcement actions. *See, e.g., Commodity Futures Trading Comm'n v. Laino Grp. Ltd.*, No. 4:20-CV-03317, 2021 WL 4059385, at *8 (S.D. Tex. June 30, 2021) (entering a penalty of \$374,864 in a default judgment sought by the CFTC). Accordingly, this factor favors default judgment.

D. Possibility of Dispute Concerning Material Facts

Ooki DAO intentionally chose to not appear. The various amici do not contest the underlying material facts about the unlawful operations of the trading platform; their arguments

are limited almost exclusively to those concerning the definition and legal characterization of DAOs more generally. See generally Oppo.; see also [Dkt. Nos. 22, 31, 36, 45]. The only fact that amici appear to contest in their opposition concerns whether Ooki DAO had the ability to operate or control the Ooki Protocol, arguing that the voting rights of Token Holders "do not involve the type of activities that the [CFTC] would deem objectionable ... such as allowing users to open orders or enter positions." Oppo. 6:3-12 (citation omitted). But in my prior Order, I determined otherwise. See Ooki DAO, 2022 WL 17822445, at *4 (reasoning that Ooki DAO Token Holders controlled the Keys, which in turn were used to govern and control the Protocol); see also id. at *6-7.

There is also a prior settlement where Ooki DAO's founders admitted to the unlawful operation of the trading platform, see In the Matter of: bZeroX, LLC; Tom Bean; & Kyle Kistner, Respondents., CFTC No. 22-31, 2022 WL 4597664 (Sept. 22, 2022), as well as other civil suits with similar facts about the underlying protocol and trading platform, see Sarcuni v. bZx DAO, No. 22-CV-618-LAB-DEB, 2023 WL 2657633, *1-3 (S.D. Cal. Mar. 27, 2023). Taken together, the risk of dispute concerning material facts is low and mitigated by the defendant's intentional choice to not contest litigation.

*8 Additionally, I note that the CFTC submitted a detailed proposed order with a section entitled "Findings of Fact." [Dkt. No. 68-1]. While I take well-pleaded allegations as true, I am not required to make detailed findings of fact on a motion for default judgment, *Fair Hous. of Marin, 285 F.3d at 906, so I do not adopt those as "findings."

E. Excusable Neglect

As noted and as I previously found, Ooki DAO's failure to participate in this litigation or this proceeding is due to a "strategic decision" to not appear, not because it was unaware of the litigation. *Ooki DAO*, 2022 WL 17822445, at *5. The basis for its awareness and knowledge was well litigated during prior motions in this case, both by the CFTC and several amici that are apparently powerful players in this field. In that order and those motions, I found the CFTC presented evidence of actual awareness of the litigation and also properly served the DAO. There is no excusable neglect here.

F. Policy Favoring Decisions on the Merits

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Finally, while policy grounds favor a resolution on the merits of this dispute, that policy is outweighed by the resolution of this matter. Ooki DAO has intentionally chosen to not appear, respond, or at all participate in this litigation. Given Ooki DAO's strategic nonparticipation, the CFTC would have no recourse in this matter without default judgment. It also pleads (which I assume to be true for this Order) that Ooki DAO's unlawful behavior continues to this day via operation of the trading platform, and so without default judgment the CFTC would be unable to stop the unlawful acts and protect the public, as it is so charged to do. Accordingly, this factor favors default.

III. RELIEF SOUGHT

First, the CFTC requests a permanent injunction to enjoin Ooki DAO from continuing and further violations of the CEA in the ways alleged in the complaint and found by this Order. "The CFTC is entitled to a permanent injunction upon a showing that a violation has occurred and is likely

to continue unless enjoined." U.S. Commodity Futures Trading Comm'n v. Driver, 877 F. Supp. 2d 968, 981 (C.D. Cal. 2012), aff'd sub nom Commodity Futures Trading Comm'n v. Driver, 585 F. App'x 366 (9th Cir. 2014) (citing

Cuited States v. W.T. Grant Co., 345 U.S. 629, 633 (1953)) (subsequent citation omitted). "Determining the likelihood of future violations may involve consideration of past unlawful conduct." *Id.* (citation omitted). Here, the CFTC has shown not only past violations, but also the transfer of control of the unlawful conduct from an LLC to a DAO apparently for the express purpose of avoiding regulation, *see* Compl. ¶ 3, as well as ongoing violations of the CEA. This is sufficient to establish likelihood of future violations absent permanent injunctive relief. Its request is GRANTED.

Second, the CFTC requests \$643,542 in civil monetary penalties under 7 U.S.C. § 13a-1(d)(1) and 17 C.F.R. § 143.8(b)(1), which authorize a penalty of \$214,514 per violation of the Act. As discussed, the merits of each cause of action regarding each alleged violation favor the CFTC. This aligns with other enforcement cases brought by the CFTC and

is in fact much lower than others, such as **Driver*, 877 F. Supp. 2d at 982-83, where the court entered a civil monetary penalty of \$31.8 million. Accordingly, the CFTC's requested relief of the statutorily prescribed amount per violation is appropriate for the offense and sufficient as a deterrent. It is GRANTED.

***9** Third, the CFTC requests the removal of Ooki DAO's website, Mot. 15:22-16:10, and it provided supplemental briefing in support, Supp. Br. Amici oppose this request. *See* Oppo. 6:13-20.

"A default judgment must not differ in kind from, or exceed in amount, what is demanded in the pleadings." Fed. R. Civ. Proc. 54(c). "The purpose of this rule is to ensure that a defendant is put on notice of the damages being sought against it so that he may make a calculated decision as to whether or not it is in his best interest to answer." Baskin-Robbins Franchising LLC v. Chun, No. 18-CV-05476-BLF, 2019 WL 3207777, at *2 (N.D. Cal. July 16, 2019) (citing Alameda Cnty. Elec. Indus. Serv. Corp. v. Banister Elec., Inc., No. C 11-04126 LB, 2012 WL 3042696, at *1 (N.D. Cal. July 25, 2012)). "By limiting recoverable damages to what is specified in the pleadings, Rule 54(c) 'ensures that a defendant considering default can look at the damages clause [and] satisfy himself that he is willing to suffer judgment in that amount.' " Alliant Credit Union v. EAGLE'S REST, No. C 09-1616 SBA, 2010 WL 3491140, at *2 (N.D. Cal. Sept. 2, 2010) (quoting Silge v. Merz, 510 F.3d 157, 159 (2d Cir. 2007)). The Ninth Circuit has affirmed the denial of fees and costs requested under a state statute where the complaint "lack[ed] the requisite specificity to put the defendants on notice" that fees and costs would be sought on default. In re Ferrell, 539 F.3d 1186, 1192-93 (9th Cir. 2008).

This case differs from others in the Northern District where my colleagues found that the requested relief differed in kind from the requested relief. For example, in Alliant Credit, 2010 WL 3491140, at *3, the court reasoned that the complaint gave the defendant notice that a judgment may be entered against him where the sale of a vessel failed to satisfy the outstanding mortgage, but it did not give the defendant notice that the plaintiff might forgo the sale of the vessel and hold the plaintiff personally liable for the full balance of the mortgage. The requested relief was different in kind from that in the complaint and so was denied. Id. And in Baskin-Robbins, 2019 WL 3207777, at *7, the court denied the plaintiff's request for over \$43,307.09 in damages for breach of contract where the complaint only identified that the defendant would be responsible for "monetary damages in an amount that has yet to be determined," because the request exceeded the amount provided in the complaint or in the later Notice to Cure.

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As the CFTC points out in the supplemental brief, its complaint explains that the website facilitates Ooki DAO's violations of the CEA, and the complaint clearly requests a permanent injunction precluding Ooki DAO from continuing to violate the CEA. See Compl. at 22(B)-(C). Because the complaint makes clear that the website is critical for operating the Protocol and making it available to the public, consequently it is clear that shutting down the website is critical to shutting down the Protocol and precluding access by the public. The request is therefore unlike those in Alliant Credit and Baskin-Robbins because the relief requested on default does not differ from that requested in the complaint —indeed, it may be the only way of ensuring the permanent injunction has any effect. Accordingly, the complaint has the requisite particularity to put Ooki DAO on notice that the

requested relief including shutting down the website. See In re Ferrell, 539 F.3d at 1192-93; Baskin-Robbins. 2019 WL 3207777, at *2. This request is GRANTED.

CONCLUSION

*10 For those reasons, the motion is GRANTED.

IT IS SO ORDERED.

All Citations

Not Reported in Fed. Supp., 2023 WL 5321527

Footnotes

- 1 A DAO is a "decentralized autonomous organization" which is "a way to organize people, a social-coordination technology that relies on blockchain-based smart contracts and incentives" to facilitate collaboration and collective action. Paradigm Operations LP Brief ("Para. Amicus Br.") [Dkt. No. 31] 2:16-18. Put differently, DAOs allow "unrelated parties" to use software code on a blockchain without needing a "centralized coordinating authority," and permit users "to take actions to edit open-source software." DeFi Education Fund Brief ("DEF Amicus Br.") [Dkt. No. 22] 3:24-4:1, 7:7-8.
- 2 I assume as true that smart contracts are, as alleged by the CFTC and contextualized by the amici, pieces of computer or software code, not necessarily contracts as understood in the legal sense. See Compl. ¶ 25; Order at 2 n.1.
- 3 For related context, see U.S. Commodity Futures Trading Comm'n v. Monex Credit Co., 931 F.3d 966, 969 (9th Cir. 2019) ("Through [the defendant company], investors can purchase commodities on 'margin.' Also known as 'leverage,' the concept is simple: A customer buys [the commodity] by paying only a portion of the full price. The remaining amount is financed through [the defendant].").
- 4 The "bZx Protocol" was later renamed the "Ooki Protocol." Compl. ¶ 46.
- 5 The same is true even if, as LeXpunK suggests, I adopt a rule that best comports with the CEA's regulatory scheme, because it seems that LeXpunK argues that the federal definition best comports with the law, and I do not imagine that the LeXpunK believes a third new definition is what should apply here. I also note that for support of this proposition, LeXpunK cites PM Grp., 953 F.2d at 546, which discussed the federal common law associated with ERISA and the resulting authority and obligation of federal courts to adopt federal rules that best complied with ERISA's regulatory scheme. That reasoning is not clearly applicable here, where there is no apparent federal common law associated with the CEA.
- 6 7 U.S.C. § 6(a) provides:

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(a) Restriction on futures trading

Unless exempted by the Commission ... it shall be unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting or accepting any order for, or otherwise dealing in, any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery (other than a contract which is made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions) unless—

- (1) such transaction is conducted on or subject to the rules of a board of trade which has been designated or registered by the Commission as a contract market or derivatives transaction execution facility for such commodity;
- (2) such contract is executed or consummated by or through a contract market; and
- (3) such contract is evidenced by a record in writing which shows the date, the parties to such contract and their addresses, the property covered and its price, and the terms of delivery ...
- 7 Under 7 U.S.C. § 2(c)(2)(D), a retail commodity transaction is defined as: any agreement, contract, or transaction in any commodity that is—
 - (I) entered into with, or offered to (even if not entered into with), a person that is not an eligible contract participant or eligible commercial entity; and
 - (II) entered into, or offered (even if not entered into), on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis.

The exceptions include:

- (I) an agreement, contract, or transaction described in [certain sections], including any agreement, contract, or transaction specifically excluded from [certain sections];
- (II) any security;
- (III) a contract of sale that-
- (aa) results in actual delivery within 28 days or such other longer period as the Commission may determine ...; or
- (bb) creates an enforceable obligation to deliver between a seller and a buyer that have the ability to deliver and accept delivery, respectively, in connection with the line of business of the seller and buyer; or
- (IV) an agreement, contract, or transaction that is listed on a national securities exchange registered under [the Securities Exchange Act]; or
- (V) an identified banking product, as defined in section 27(b) of this title.

ld.

This penalty is for violations occurring between November 2, 2015 and the present, as determined by the Inflation Adjustment Act of 1990.

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End of Document	© 2025 Thomson Reuters. No claim to original U.S. Government Works.

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	Document	Page 1 01 25
Fill in this information to identify the case:		
United States Bankruptcy Court for the:		
District of New Jersey		
Case number (If known):	Chapter 15	☐ Check if this is a amended filing

Official Form 401

Chapter 15 Petition for Recognition of a Foreign Proceeding 12

If more space is needed, attach a separate sheet to this form. On the top of any additional pages, write debtor's name and case number (if known). **Hector DAO** Debtor's name 2. Debtor's unique identifier For non-individual debtors: **☑** Other N/A _. Describe identifier _____ For individual debtors: □ Social Security number: xxx - xx- ___ _ ☐ Individual Taxpayer Identification number (ITIN): 9 xx − xx − ____ ___ ___ Other . Describe identifier 3. Name of foreign James Drury and Paul Pretlove, as the Appointed Receivers of Hector DAO representative(s) 4. Foreign proceeding in which Receivership in Eastern Caribbean Supreme Court of the British Virgin Islands appointment of the foreign representative(s) occurred 5. Nature of the foreign Check one: proceeding ⊻ Foreign main proceeding Foreign nonmain proceeding Foreign main proceeding, or in the alternative foreign nonmain proceeding 6. Evidence of the foreign A certified copy, translated into English, of the decision commencing the foreign proceeding and proceeding appointing the foreign representative is attached. A certificate, translated into English, from the foreign court, affirming the existence of the foreign proceeding and of the appointment of the foreign representative, is attached. Other evidence of the existence of the foreign proceeding and of the appointment of the foreign representative is described below, and relevant documentation, translated into English, is attached. 7. Is this the only foreign No. (Attach a statement identifying each country in which a foreign proceeding by, regarding, or against the proceeding with respect to the debtor known to the Ø Yes foreign representative(s)?

Official Form 401

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page 1

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Debtor Hector DAO Name	Ca	ise number (if known)
8. Others entitled to notice	Attach a list containing the names and addresses of:	
	(i) all persons or bodies authorized to administer fo	reign proceedings of the debtor,
	(ii) all parties to litigation pending in the United State petition, and	es in which the debtor is a party at the time of filing of this
	(iii) all entities against whom provisional relief is beir	ng sought under § 1519 of the Bankruptcy Code.
9. Addresses	Country where the debtor has the center of its main interests:	Debtor's registered office:
	British Virgin Islands	<u></u>
		Number Street
		P.O. Box
		City State/Province/Region ZIP/Postal Code
		Country
	Individual debtor's habitual residence:	Address of foreign representative(s):
		LM Business Centre, Fish Lock Road
	Number Street	Number Street
	P.O. Box	4571 P.O. Box
	P.O. Box	
	City State/Province/Region ZIP/Postal Code	Road Town, Tortola City State/Province/Region ZIP/Postal Code
		- w
	Country	British Virgin Islands Country
	,	,
10. Debtor's website (URL)	https://hector.network	
11. Type of debtor	Check one:	
	☑ Non-individual (<i>check one</i>):	
	Corporation. Attach a corporate ownershi described in Fed. R. Bankr. P. 7007.1.	p statement containing the information
	Partnership	
	✓ Other. Specify: <u>DAO (decentralized</u>	autonomous organization)
	☐ Individual	
	☐ Individual	

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page 2

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Debtor	Hector DAO	Ca	ase number (if known)
12. Why is district	venue proper in <i>this</i> ??	Check one: Debtor's principal place of business or principal Debtor does not have a place of business or as action or proceeding in a federal or state court i If neither box is checked, venue is consistent wi of the parties, having regard to the relief sought	sets in the United States, but the following is pending against the debtor in this district: ith the interests of justice and the convenience
	ure of foreign entative(s)	relief sought in this petition, and I am authorize I have examined the information in this petition	foreign proceeding, the debtor is eligible for the ed to file this petition.
		I declare under penalty of perjury that the foreg	going is true and correct, James Drury Printed name
		Signature of foreign representative Executed on 06/16/2024 MM / DD / YYYY Signature of foreign representative D6/16/2024	Printed name
14. Signati	ure of attorney	/s/ Daniel M. Stolz Signature of Attorney for foreign representative Daniel M. Stolz Printed name	Date 06/17/2024 MM / DD / YYYY
		Genova Burns LLC Firm name 110 Allen Rd., Suite 304 Number Street Basking Ridge City	NJ 07920 State ZIP Code
		(973) 230-2095 Contact phone 028461980 Bar number	dstolz@genovaburns.com Email address NJ State

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Chapter 15 Petition for Recognition of a Foreign Proceeding

page 3

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UNITED STATES BANKRUPTCY COURT	
DISTRICT OF NEW JERSEY	
Caption in Compliance with D.N.J. LBR 9004-1(b)	
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Appointed Receivers of Hector DAO	
In re:	Chapter 15
	Case No.
HECTOR DAO,	
Debtor.	

EVIDENCE OF THE FOREIGN PROCEEDING AND STATEMENTS AND LISTS REQUIRED BY SECTION 1515 OF THE BANKRUPTCY CODE AND RULE 1007(A)(4) OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE

James Drury and Paul Pretlove, in their capacity as the appointed receivers (the "<u>Petitioners</u>") of Hector DAO, make the following statements required by section 1515(c) of title

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11 of the United States Code (the "Bankruptcy Code") and Rule 1007(a)(4) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). 1

- A. Evidence of the Foreign Proceeding as Required by Section 1515(b) of the Bankruptcy Code.
- 1. On February 16, 2024, Hector Enterprise Inc., with the cooperation of Hector DAO's Liquidation Committee, filed an application with High Court of the Virgin Islands (Commercial Division), Eastern Caribbean Supreme Court (the "<u>BVI Court</u>") to appoint the Petitioners as joint and several receivers over the assets and undertakings of Hector DAO.
- 2. On February 19, 2024, the BVI Court entered the Interim Receivership Order appointing the Petitioners as joint and several interim receivers over the assets of Hector DAO, including the Treasury Assets, for the purpose of collecting and preserving such assets as part of a wind-down of Hector DAO.
- 3. On March 12, 2024, the BVI Court entered the Continuation Order, continuing the relief granted in the Interim Receivership Order and granting certain additional relief, including: (i) permitting the Petitioners to take legal advice on and pursue an application for chapter 15 recognition under the United States Bankruptcy Code; and (ii) permitting the Petitioners to formulate a detailed plan for the distribution of Hector DAO's Treasury Assets to HEC Tokenholders.
- 4. On April 10, 2024, the BVI Court entered the Final Receivership Order, appointing the Petitioners as joint and several receivers, on a full and final basis, over the Treasury Assets, with immediate effect, for the purpose of collecting in and preserving such assets, winding down the operations of Hector DAO and distributing the Treasury Assets, firstly to admitted creditors

_

¹ Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the *Declaration of James Drury in Support of (I) Verified Petition for Recognition of Foreign Proceeding and (II) Motion in Support of Verified Petition for Recognition of Foreign Proceeding and for Related Relief*, filed contemporaneously herewith.

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and then amongst the HEC Tokenholders who are eligible for a redemption in proportion with their token holding, as part of a collective liquidation process. *See* Final Receivership Order at 2, 4-5 (attached herein as Exhibit A). Pursuant to the Final Receivership Order the Receivers were granted additional powers for the purpose of planning and giving effect to a distribution of Treasury Assets amongst eligible HEC Tokenholders, rather than the preservatory role that the Receivers held in accordance with their interim appointment. *See id.* at 7.

- 5. As the court-appointed receivers in the BVI Receivership Proceeding, the Petitioners have control over the assets and management of Hector DAO pursuant to the Final Receivership Order. *See* Final Receivership Order at 3-5.
- 6. The BVI Court specifically authorized the Petitioners, as court officers and licensed insolvency practitioners, to exercise their powers both in the British Virgin Islands and abroad. *See* Final Receivership Order at 4-5.
- 7. The Final Receivership Order also authorized the Petitioners to, among other things, take and retain possession and/or control of the Treasury Wallet, take and retain possession of all documents, information, books and records relating to Hector DAO, investigate antecedent transactions effecting Hector DAO, exercise any rights exercisable by Hector DAO, enter into any transaction on behalf of Hector DAO, bring and defend actions in order to recognize the BVI Receivership Proceeding and the Petitioners' powers or to otherwise prevent interference with the receivership process, and do other acts that are in the Petitioners' discretion necessary for carrying out and giving effect to their appointment. *See* Final Receivership Order at 3-5.
- 8. The Petitioners assert that the Final Receivership Order satisfies the requirements of one or more of subsections 1515(b)(1) ("a certified copy of the decision commencing such foreign proceeding and appointing the foreign representative"), (b)(2) ("a certificate from the

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foreign court affirming the existence of such foreign proceeding and of the appointment of the foreign representative"), and (b)(3) ("any other evidence acceptable to the court of the existence of such foreign proceeding and of the appointment of the foreign representative").

- B. Statement Regarding One Foreign Proceeding Pursuant to Section 1515(c) of the Bankruptcy Code.
- 9. There is a foreign receivership proceeding pending in the British Virgin Islands concerning Hector DAO (the "BVI Receivership Proceeding"). The BVI Receivership Proceeding is described in greater detail in (a) the Declaration of James Drury in Support of (i) Verified Petition for Recognition of Foreign Proceeding and (ii) Motion in Support of Verified Petition for Recognition of Foreign Proceeding and for Related Relief (the "Drury Declaration"), and (b) the Declaration of Christopher Pease in Support of (i) Verified Petition for Recognition of Foreign Proceeding and (ii) Motion in Support of Verified Petition for Recognition of Foreign Proceeding and for Related Relief (the "Pease Declaration"), each filed contemporaneously herewith.
 - C. List of All Authorized Administrators of Hector DAO in the BVI Receivership Proceeding.
- 10. Pursuant to Bankruptcy Rule 1007(a)(4)(B), the Petitioners state that they are the only persons or bodies authorized to administer foreign proceedings of Hector DAO. The Petitioners' address is as follows:

James Drury and Paul Pretlove, as the Appointed Receivers of Hector DAO
PO Box 4571

LM Business Centre, Fish Lock Road
Road Town, Tortola
British Virgin Islands, VG1110
Email:
james.drury@interpath.com
paul.pretlove@interpath.com

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D. Litigation Pending in the United States.

11. As described in greater detail in the Drury Declaration, on February 7, 2024, Newton AC/DC Fund L.P., an HEC Tokenholder, filed a complaint (the "Newton Complaint" and the proceeding the "Newton Proceeding") in U.S. District Court for the District of New Jersey, Trenton Division, Judge Robert Kirsch presiding (the "NJ District Court"), against Hector DAO, Farooq Hassan (a former member of the Liquidation Committee), and John Doe (an unknown person who holds an account at the Binance Exchange), alleging, among other things, that Hector DAO failed to fulfil its obligations to HEC Tokenholders and misapplied and/or wasted the Treasury Assets. *See* Verified Complaint, Newton AC/DC Fund L.P. v. Hector DAO, Civil Action No. 24-722 (RK) (JBD) (D.N.J. filed Feb. 7, 2024) (Dkt. No. 1). The Newton Complaint alleges breach of contract, unregistered offer and sale of securities under sections 5 and 12(a)(1) of the Securities Act of 1933, and breach of fiduciary duty against all named defendants, and conversion against all defendants.

- 12. The Newton Proceeding remains pending in NJ District Court. Accordingly, pursuant to Bankruptcy Rule 1007(a)(4)(B) the Petitioners provide the below list containing the names and addresses of all known parties to the Newton Proceeding:
 - Newton AC/DC Fund L.P.

c/o: Eric B. Meyer, Esq. Pierson Ferdinand LLP One Liberty Place 1650 Market Street, Suite 3600 Philadelphia, Pennsylvania 19103

and

William H. Newman, Esq. Oberheiden, P.C. 30 Wall Street, Eighth Floor New York, New York 10005

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- Farooq Hassan
 24 Elm Drive
 East Windsor, New Jersey 08520
- E. Entities Against Whom Provisional Relief is Sought.
- 13. Pursuant to Bankruptcy Rule 1007(a)(4)(B), the Petitioners state they are not seeking provisional relief under section 1519 of the Bankruptcy Code against any entity at this time. The Petitioners, however, reserve their rights to seek any such provisional relief.

Respectfully Submitted:

Dated: June 17, 2024

/s/ Daniel M. Stolz

GENOVA BURNS LLC

Daniel M. Stolz, Esq. Donald W. Clarke, Esq. 110 Allen Rd., Suite 304 Basking Ridge, NJ 07920 (973) 230-2095 dstolz@genovaburns.com dclarke@genovaburns.com

Local Counsel for James Drury and Paul Pretlove, as the Appointed Receivers of Hector DAO

BROWN RUDNICK LLP

David J. Molton, Esq. Gerard T. Cicero, Esq. Seven Times Square New York, New York 10036 (212) 209-4800 dmolton@brownrudnick.com gcicero@brownrudnick.com

and

Stephen D. Palley, Esq. (*pro hac vice* pending) 601 13th St. NW Suite 600 Washington, D.C. 20005 (202) 536-1766 spalley@brownrudnick.com

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and

Michael W. Reining, Esq. (pro hac vice pending) One Financial Center Boston, MA 02111 (617) 856-8200 mreining@brownrudnick.com

Counsel for James Drury and Paul Pretlove, as the Appointed Receivers of Hector DAO

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Exhibit A

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Case Number : BVIHCOM2024/0072

IN THE EASTERN CARIBBEAN SUPREME COURT IN THE HIGH COURT OF JUSTICE VIRGIN ISLANDS COMMERCIAL DIVISION CLAIM NO. BVIHCOM 2024/0072

Submitted Date:10/04/2024 13:34

FILED HIGH COURT

TERRITORY OF THE VIRGIN ISLANDS

Filed Date: 10/04/2024 13:34

Fees Paid:72.59

BETWEEN:

HECTOR ENTERPRISE INC (acting through its director DLT SOLUTIONS LIMITED)

AND

Applicant

(1) HECTOR DAO
(2)
(3)
(4)
(5)

Respondents

ORDER

Before:

The Honourable Justice Webster (Ag)

Made:

9 April 2024

Entered:

[NO] April 2024

UPON the Applicant filing a Fixed Date Claim Form (the *Claim*) for the appointment of receivers, on a final basis, to collect, preserve and distribute assets held by or on behalf of Hector DAO (the *Treasury Assets*) including those held within digital wallet address 0xdCad10a8E82fe4e90Cb69B1757C2d612745CD1C9 (the *Treasury Wallet*) as part of a wind-down of Hector DAO and a distribution of the Treasury Assets to eligible Hector DAO tokenholders (*HEC Tokenholders*)

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AND UPON the Agreement dated 16 February 2024 between the Applicant and the Second, Third and

Fourth Respondents

AND UPON the Interim Receivership Order of Justice Webster dated 19 February 2024 and the

Continuation Order of Justice Webster dated 12 March 2024 pursuant to which Mr James Drury and Mr

Paul Pretlove both of Interpath (BVI) Limited, PO Box 4571, LM Business Centre, Fish Lock Road, Road

Town, Tortola, British Virgin Islands, VG1110 (the Receivers) were appointed on an interim basis for the

purpose of preserving the Treasury Assets

AND UPON the court considering the evidence listed at Schedule A to this order

AND UPON the parties agreeing to the terms of this order

AND UPON the Claim coming on for hearing on 9 April 2024, with the hearing taking place in private to

preserve the confidentiality of evidence and reports that are sealed in these proceedings

AND UPON HEARING Counsel for the Claimant

AND UPON the Applicant giving the Undertakings to the Court as set out in Schedule B to this order

IT IS ORDERED THAT:-

RECEIVERSHIP

1. The Receivers be appointed joint and several receivers, on a full and final basis, over the Treasury

Assets, with immediate effect, for the purpose of collecting in and preserving such assets, winding

down the operations of Hector DAO and distributing the Treasury Assets amongst the HEC

Tokenholders who are eligible for a redemption in proportion with their token holding, as part of

a collective liquidation process.

2

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- The Receivers shall have the power, in any jurisdiction, which shall only be exercisable with further sanction from this court, to bring or defend any action or other legal proceedings in the courts in this jurisdiction or any other country that do not fall within the type of legal proceedings caught by paragraph 3(m) below.
- The Receivers shall have the following powers, which shall be exercisable in any jurisdiction without further sanction from this court:
 - a. To take and retain possession and/or control of the Treasury Wallet;
 - subject to paragraphs 10 and 11 below, to take, retain possession of, collect, transfer, hold, preserve and/or distribute the Treasury Assets to all HEC Tokenholders eligible for a redemption in proportion with their token holding;
 - to require the Respondents to provide such information and documents relating to Hector DAO, the Treasury Wallet and/or the Treasury Assets as the Receivers may require;
 - d. to require any other persons or entities, wherever located, to transfer or otherwise provide to the Receivers any of the Treasury Assets and/or any documentation or information relating to Hector DAO, the Treasury Wallet and/or the Treasury Assets, within their possession or control;
 - to take and retain possession of all documents, information, books and records (whether
 electronic or otherwise) relating to the undertaking and affairs of Hector DAO and its
 assets including the Treasury Wallet and the Treasury Assets;
 - f. to investigate any such, and all, "antecedent transactions" effecting Hector DAO, not limited to, the exploit and hack of the distribution smart contract on 15 January 2024;
 - g. to execute such documents, in the name of Hector DAO or otherwise, as may be required to enable them to carry out their duties under this order;

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- to exercise any rights that are exercisable by Hector DAO or those acting on its behalf, including employees and/or contractors engaged by the Applicant;
- to enter into any transaction, including any blockchain transaction, on behalf of Hector DAO;
- to create, use, alter or terminate any smart contract, algorithm or code on behalf of Hector DAO;
- to appoint and engage employees, managers, agents and advisers, on behalf of Hector DAO or otherwise, upon such terms as to remuneration and otherwise and for such periods as they may determine, and to dismiss them;
- to instruct legal representatives or other professionals to act for the Receivers and/or for Hector DAO in any jurisdiction to assist them in the performance of their duties and for that purpose to execute in the name and on behalf of Hector DAO all necessary documents, including powers of attorney;
- m. to take legal advice on and to bring or defend any action or other legal proceedings in the courts in this jurisdiction or any other country in order to recognise the receivership and the powers granted in accordance with this order, including by way of Chapter 15 recognition in the United States, or to otherwise prevent interference with the receivership process;
- to use any agents, tools, software or otherwise for the purpose of taking custody of, transferring and/or distributing the Treasury Assets;
- to use Treasury Assets for the payment of the Receivers' reasonable fees, costs and expenses, including the fees, costs and expenses of any employees, managers, agents, advisors, legal representatives or other professionals, with such fees, costs and expenses to be paid in priority to the distribution of the remaining Treasury Assets amongst the HEC Tokenholders;
- p. to adjudicate claims by creditors of Hector DAO and/or of the Applicant and to use Treasury Assets to make payment of any claims admitted by the Receivers in full and, if

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necessary, in priority to the distribution of the remaining Treasury Assets amongst eligible HEC Tokenholders, provided that any such creditors shall have the right to apply to Court to challenge the Receivers' adjudication or otherwise seek directions from the Court in relation to the adjudication;

- q. to give notice of the Receivers' appointment to such parties as the Receivers deem necessary;
- to seek recognition of the Receivers' appointment in such jurisdiction(s) as the Receivers
 deem necessary, including by way of Chapter 15 proceedings the United States;
- s. to obtain such approvals or authorisations, whether judicial or otherwise and whether in the Receivers' own name or in the name of Hector DAO as may be necessary or expedient to enable the Receivers to exercise their powers within any jurisdiction;
- t. to share any information with the Applicant and/or Respondents that the Receivers consider it necessary or appropriate to share, whether obtained pursuant to this order or otherwise; and
- u. except as otherwise provided for in this order, to do all such acts or things as the Receivers may in their discretion consider necessary for carrying out and giving effect to their appointment.
- 4. The Respondents shall, upon the Receivers making any request for information, documents, books or records in accordance with the Receivers' powers set out at paragraph 2 above, take all steps reasonable to comply.
- 5. The Respondents shall provide all reasonable assistance (and shall procure that their agents, nominees, trustees or attorneys shall provide all reasonable assistance) to the Receivers in their exercise of their powers.
- 6. The reasonable costs of the receivership shall be paid out of the Treasury Assets in priority to all other claims as if they were costs of a liquidator where a company had been placed into liquidation, provided that the Applicant or any other interested person shall have liberty to apply to the court

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on notice to the Receivers for a determination of the reasonableness of such remuneration, costs and expenses.

- 7. The Receivers shall have the power and be permitted to apply sums from the Treasury Assets to pay the Receivers' reasonable fees, costs and expenses of the receivership, in accordance with paragraphs 3(o) and 6, and may do so as and when such fees, costs and expenses are incurred without first seeking an order of the court pursuant to s.134(3) of the Insolvency Act provided that 100% of out of pocket expenses and costs but only 80% of professional fees are paid until such a time as the court fixes the Receivers' remuneration (with the remaining 20% to be held in reserve and, where appropriate, separated from other Treasury Assets until remuneration has been fixed).
- 8. Security for the appointment of the Receivers is hereby dispensed with (such requirement being dispensed with pursuant to CPR 51.4(2)).
- 9. The Receivers must file a report within 3 months of the date of this order, and thereafter every 3 months, updating the court on the status of the receivership, which shall include (but need not be limited to):
 - a. The actions taken in accordance with their appointment;
 - b. The status of the Treasury Assets, if not distributed at the time of the report;
 - c. The steps still to be taken and estimated timeframe until any distribution of the Treasury Assets can take place;
 - d. Any other actions required to wind-down the operations of Hector DAO and an estimated timeframe for the same; and
 - e. The fees, costs and expenses incurred to date and an estimate of the fees, costs and expenses that will be incurred until the purpose of the Receivers' appointment has been achieved.

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- 10. The Receivers shall formulate, prepare and submit to the Court a plan for the distribution of the Treasury Assets to eligible HEC Tokenholders in accordance with paragraph 11 below, which shall be subject to the Court's approval before any final distribution is made.
- 11. The plan for distribution required by paragraph 10 above shall, inter alia:
 - a. consider the rights and obligations of all HEC Tokenholders and identify which HEC
 Tokenholders are eligible to receive a proportion of the Treasury Assets upon redemption
 of relevant tokens;
 - b. provide for pari passu and pro rata treatment of all eligible Tokenholders;
 - c. explain by which method(s) eligible HEC Tokenholders will satisfy the Receivers (and the Court) of their identity as part of a KYC process in accordance with British Virgin Islands Anti Money Laundering Regulations, which shall be required as part of the distribution process before payments to eligible HEC Tokenholders will be permitted by the Court;
 - explain by which method(s) eligible HEC Tokenholders will satisfy the Receivers of their eligibility to receive a redemption payment as part of the distribution, which shall include an explanation of how the prior snapshot registration will be adopted; and
 - e. explain the method by which a distribution to eligible HEC Tokenholders will take place.
- 12. The Receivers shall have the power, and shall be permitted, to proceed with the plan on the basis of the decisions already outlined in the Receivers' Second Interim Report to the BVI Court, although they shall not be constrained in making a distribution solely in accordance with those decisions.

PARTIES OTHER THAN THE APPLICANT, THE RESPONDENTS AND THE RECEIVERS

- 13. Persons outside the Virgin Islands:
 - (a) Except as provided in paragraph (b) below, the terms of this order do not affect or concern anyone outside the jurisdiction of this court.

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- (b) The terms of this order will affect the following persons in a country or state outside the jurisdiction of this court:
 - (i) any person who:
 - (A) is subject to the jurisdiction of this court;
 - (B) has been given written notice of this order at his residence or place of business within the jurisdiction of this court; and
 - (C) is able to prevent acts or omissions outside the jurisdiction of this court which constitute or assist in a breach of the terms of this order; and
 - (ii) any other person, only to the extent that this order is declared enforceable by or is enforced by a court in that country or state.

ASSETS LOCATED OUTSIDE THE BRITISH VIRGIN ISLANDS

- 14. Nothing in this order shall, in respect of assets outside the British Virgin Islands, prevent any third party from complying with-
 - (a) What it reasonably believes to be its obligations, contractual or otherwise, under the laws and obligations of the country or state in which those assets are situated or under the proper law of any contract between itself and the Respondents; and
 - (b) Any orders of the Courts of that country or state, provided that reasonable notice of any application for such an order is given to the Applicants' solicitors.

LIBERTY TO APPLY

15. The Applicant, the Respondents, the Receivers and any other person affected by this order shall have liberty to apply for directions concerning the conduct of the receivership or any other issues arising from this order.

SEALING THE EVIDENCE AND REPORTS

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16. The Registrar of the High Court shall, until further order of the Court, seal the evidence and the Receivers reports filed in these proceedings to preserve the confidentiality of and prevent the disclosure of information contained within them and there is no requirement to serve copies of the evidence or the Receivers' reports on any of the Respondents.

COSTS

17. The costs of this application be costs in the receivership.

BY ORDER OF THE COURT

P- REGISTRAR

COMMUNICATIONS WITH THIS COURT

All communications to the Court about this Order should be sent to:-

The Court office is located at the Registry of the High Court, the Court House, Road Town, Tortola, British Virgin Islands; Telephone number: +1 284 468 5001; Facsimile number: +1 284 468 4951; REF: 062928.0001/CJP. The office is open between 9am and 4:30pm, Monday to Friday, except public holidays.

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SCHEDULE A

EVIDENCE IN SUPPORT OF FIXED DATE CLAIM FORM

1.	First Affidavit of	dated 16 February 2024
2.	Second Affidavit of	dated 19 February 2024
3.	Third Affidavit of	dated 11 March 2024
4.	Fourth Affidavit of	dated 5 April 2024

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SCHEDULE B

UNDERTAKINGS GIVEN TO THE COURT BY THE APPLICANTS

- 1. The Applicant will as soon as reasonably practicable serve this Order upon the Respondents.
- The Applicant will not, without the permission of the court, seek to enforce this order in any
 country outside the BVI (albeit this will not disturb the Receivers' right to take steps to preserve
 the Treasury Assets in any other jurisdiction).

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IN THE EASTERN CARIBBEAN SUPREME COURT
IN THE HIGH COURT OF JUSTICE
VIRGIN ISLANDS
COMMERCIAL DIVISION

CLAIM NO. BVIHCOM 2024/0072

HECTOR ENTERPRISE INC (acting through its director DLT SOLUTIONS LIMITED)

<u>Applicant</u>

(1) HECTOR DAO	
(2)	
(3)	
(4)	
(5)	

AND

Respondents

ORDER

Harney Westwood & Riegels, LP
Legal Practitioners for the Applicant
Craigmuir Chambers, PO Box 71
Road Town, Tortola
British Virgin Islands
T (284) 494-2233
Ref: 062928.0001/CJP

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UNITED STATES BANKRUPTCY COURT	
DISTRICT OF NEW JERSEY	
Caption in Compliance with D.N.J. LBR 9004-1(b)	
BROWN RUDNICK LLP	GENOVA BURNS LLC
David J. Molton, Esq.	Daniel M. Stolz, Esq.
Gerard T. Cicero, Esq.	Donald W. Clarke, Esq.
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gcicero@brownrudnick.com	dclarke@genovaburns.com
Seven Times Square	110 Allen Rd., Suite 304
New York, NY 10036	Basking Ridge, NJ 07920
Tel: (212) 209-4800	Tel: (973) 230-2095
Fax: (212) 209-4801	
and	Local Counsel for James Drury and Paul Pretlove, as the
	Appointed Receivers of Hector DAO
Stephen D. Palley, Esq. (pro hac vice pending)	
spalley@brownrudnick.com	
601 Thirteenth Street NW Suite 600	
Washington, D.C. 20005	
Tel: (202) 536-1766	
Fax: (617) 289-0766	
and	
Michael W. Reining, Esq. (pro hac vice pending)	
mreining@brownrudnick.com	
One Financial Center	
Boston, MA 02111	
Tel: (617) 856-8200	
Fax: (617) 856-8201	
Counsel for James Drury and Paul Pretlove, as the	
Appointed Receivers of Hector DAO	
In re:	Chapter 15
	Case No.
HECTOR DAO,	
Debtor.	

VERIFICATION OF CHAPTER 15 PETITION

I, James Drury, verify as follows:

I am a court-appointed joint and several receiver (a "<u>Receiver</u>") of Hector DAO,
 duly appointed by the High Court of the Virgin Islands (Commercial Division), Eastern
 Caribbean Supreme Court.

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2. In my capacity as a Receiver, I filed a voluntary Chapter 15 Petition for Recognition of a Foreign Proceeding, including the following attachments thereto (together, the "Chapter 15 Petition"):

- Evidence of the Foreign Proceeding and Statements and Lists Required by Section 1515 of the Bankruptcy Code and Rule 1007(a)(4) of the Federal Rules of Bankruptcy Procedure
- 3. The factual statements set forth in the Chapter 15 Petition are true and correct.

I verify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on: June 16, 2024

James Drury, as Joint and Several Receiver of Hector DAO

	DCCJ 2977/2024
	[2024] HKDC 1628
IN THE DISTRICT COURT OF THE	
HONG KONG SPECIAL ADMINISTRATIVE REGION	
CIVIL ACTION NO 2977 OF 2024	4
BETWEEN	
CHAN WING YAN	1 st Plaintiff
LEE SUNG HIM HERBERT	2 nd Plaintiff
and	
JP-EX CRYPTO ASSET PLATFORM PTY LTD	1 st Defendant
WEB3.0 TECHNICAL SUPPORT LIMITED (FORMERLY KNOWN AS JPEX TECHNICAL SUPPORT CO. PTY LIMITED)	2 nd Defendant
HOLDER OF WALLET ADDRESS TNCxvfB7aW4JjgyLph91Mj8FBWHnD77DM8	3 rd Defendant
HOLDER OF WALLET ADDRESS TM6tdiP77qsyfTWegZ9sULzwmiev41ySNT	4 th Defendant
HOLDER OF WALLET ADDRESS TM6ezzj72Hyi92g4fDyRXPqF8Y93KMe87L	5 th Defendant
CHIU KING YIN FELIX (趙敬賢)	6 th Defendant
PERSONS UNKNOWN WHO CARRIED OUT AND/OR ASSISTED AND/OR PARTICIPATED	

- 2 -

A		A
В	IN THE SCHEME WHICH CAUSED THE 1ST	В
C	AND 2^{ND} PLAINTIFFS TO TRANSFER ASSETS TO THE 1^{ST} TO 6^{TH} DEFENDANTS IN THE	C
D	MANNER AS PLEADED IN THE STATEMENT OF CLAIM	D
E		E
F		F
~	Before: Her Honour Judge G. Chow in Chambers (Open to Public)	
G	Date of Hearing: 25 September 2024	(
Н	Date of Judgment: 29 October 2024	H
I		I
J	JUDGMENT	J
K		k
L	A. Introduction	I
M	1. By Inter Partes Summons dated 30 July 2024 ("the	N
N	Summons"), the 1st Plaintiff ("P1") and 2nd Plaintiff ("P2") (collectively,	N
o	"Ps") apply for default judgment against the 2 nd Defendant ("D2") pursuant	C
P	to O 19, r 7 of the Rules of the District Court, Cap 336H ("RDC").	P
Q	2. According to Ps, they were registered users of a	Ç
	cryptocurrency exchange and investment platform operated by the 1st	
R	Defendant ("D1") and D2 under the name "JPEX" ("the Platform"). They	R
S	claim to be victims in that they were led to deposit crypto-assets into what they believed were their crypto-asset wallets on the Platform but ultimately	S
T	could not retrieve any of their crypto-assets.	Т
U		Ū
V		V

- 3 -

A		A
В	3. Since 13 September 2023, the Securities and Futures	В
C	Commission ("SFC") identified JPEX as operating an unlicensed virtual	C
D	asset trading platform ("VATP").	D
E	4. As reported in the local media, as of 18 April 2024, the Police	E
F	received reports from 2,636 victims against JPEX, involving about HK\$1.6 billion. The Police has commenced criminal investigation and arrested	F
G	over 70 individuals.	G
Н	5. However, as stressed by Mr Tam, counsel (together with Mr	Н
I	Joshua Chu, solicitor advocate) who appears for Ps, no case of fraud is	I
J	relied upon in the present action (in contrast with what may be happening on the criminal investigation end). Rather, Ps' primary case against D2 is	J
K	based on the breach of an express trust. Alternatively, it is claimed that the	K
L	relationship between Ps and D2 was that of a creditor and debtor, analogous to a bank and customer. Accordingly, the alternative claim is one for	L
M	recovery of a debt.	M
N	B. Service of process and non-appearance of D2	N
0		0
P	6. I am satisfied from the affirmation of service filed on behalf of Ps that the Amended Writ specifically endorsed with the Amended	P
Q	Statement of Claim ("ASOC") issued on 5 June 2024 was served on D2 by	Q
R	leaving the same at, and sending by post to, D2's registered office. I accept that this amounts to proper service on D2 under s 827 of the Companies	R
S	Ordinance, Cap 622.	S
T		Т
U		U
\mathbf{v}		\mathbf{V}

- 4 -

A		A
В	7. Furthermore, given that a notice of intention to enter judgment	В
C	and the Summons were served on D2, by leaving them at, and sending by	C
D	post to, D2's registered office, I was of the view that it was expedient to proceed with the hearing of the Summons under O 32, r 5 of RDC	D
E	notwithstanding the absence of D2 at the hearing before me.	E
F	C. No notice of intention to defend and no defence filed by D2	F
G		G
Н	8. As declaratory relief is sought by Ps, not being within O 13, rr 1-4 of RDC, Ps must proceed, and have proceeded, as if D2 has given	Н
I	notice of intention to defend under O 13, r 6(1) of RDC, notwithstanding	I
J	that D2 has never filed any acknowledgement of service of the Amended Writ.	J
K	1111.	K
L	9. As no defence has ever been filed by D2, I am satisfied that Ps are entitled to make this application pursuant to O 19, r 7 of RDC.	L
M	15 are entitled to make this application parsuant to 0 17,17 of 100.	M
N	D. The Applicable Principles	N
0	10. The applicable principles for default judgment under O 19, r 7	o
P	of RDC are well-settled. The power to grant judgment under O 19, r 7 is	P
Q	discretionary. The court is required to scrutinize whether the matters pleaded in the Statement of Claim entitle the plaintiff to the judgment	Q
R	sought. The court's decision is made on the basis of pleaded facts, rather	R
	than on evidence. See <i>Hong Kong Civil Procedure 2024</i> , Vol 1, §§19/7/11	
S	and 19/7/14.	S
T		T
U		U
V		V 7

- 5 -

A	J. Control of the con	
В	11. Furthermore, the basis upon which default judgment can be	
C	obtained in circumstances where no defence is filed is that the court will	
D	assume that the Statement of Claim has been impliedly admitted by the defendant. This is why, in an application for default judgment, the court	
E	will only consider the Statement of Claim without admitting any evidence:	
F	see <i>ibid</i> at §19/2/1 and <i>Feng Bo v Dela Cruz Anabelle-Gamoso</i> [2024] HKCFI 1819, §3 <i>per</i> DHCJ Kent Yee.	
G		
Н	12. As for declaratory relief, the rule of the court that a declaration will not be granted when giving judgment by consent or in default without	
I	a trial is a rule of practice and not of law, and will give way to the	
J	paramount duty of the court to do the fullest justice to the plaintiff to which he is entitled. The court will consider whether the declaratory relief is	
K	properly made out on the pleadings and whether it is appropriate in the	
L	overall exercise of discretion for such relief to be granted without trial. The declaratory reliefs to be granted should not be in terms wider than what the	
M	plaintiffs are entitled to and what is necessary to do justice to them. See	
N	Hong Kong Civil Procedure 2024, Vol 1, §§19/7/14 and 19/7/20.	
o	13. Importantly, merely because of the nature of a default	
P	judgment application is uncontested, the court does not act as a "rubber- stamp". It is necessary in each and every application for default judgment	
Q	to consider whether the declaratory relief is properly made out on the	
R	pleadings and whether it is appropriate in the overall exercise of discretion for such relief to be granted without a trial. In the exercise of the court's	
S	discretion, the court will consider all relevant factors, including whether	
Т	the plaintiff has established a strong and obvious case for proprietary relief on the face of its pleadings, and where the claim is proprietary, whether	
U	on the face of its pleadings, and where the claim is proprietary, whether	
V		

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A							
В	there will be any prejudice to the plaintiff's property and rights. The						
C	importance of a claim to proprietary relief arises because of the distinction						
D	from a merely personal claim which would only put a plaintiff in a position of an unsecured judgment creditor. On the other hand, a declaration of						
E	proprietary interest will secure that interest. See <i>Cheung Sai Lon v Cheung Sai Ha</i> [2020] HKCFI 2551 <i>per</i> Coleman J at §§32-33.						
F							
G	14. As for injunctive relief, the court has jurisdiction to grant						
Н	injunctions in default judgment applications: see <i>Hong Kong Civil Procedure 2024</i> , Vol 1, §19/7/17 and <i>Biostime International Investment</i>						
I	Ltd v France Heson Paper (Hong Kong) Co Ltd [2015] 2 HKLRD 658,						
J	§§12-13.						
K	E. Ps' pleaded case						
L	15. The following facts are pleaded in the ASOC:						
M							
N	(1) D2 is a company incorporated in Hong Kong;						
o	(2) D1 and D2 (and/or with other unknown entities) carried						
P	on business as a virtual asset service provider under the						
Q	name "JPEX" and operated the Platform which was accessible by users through their website (https://jp-						
R	ex.io/) and mobile application named "JPEX Wallet";						
S	(3) The 6 th Defendant ("D6") was the general manager of						
Т	"Coingaroo", an over-the-counter virtual asset spot						
U	brokerage or money changer owned and operated by						
X 7							

A	- 7 -	
A		A
В	Kangarooss Gallery Limited and/or Kangarooss	В
C	Limited. He was also one of the influencers and	C
D	promoters actively promoting JPEX through social media;	D
E		E
F	(4) JPEX Coin ("JPC") was a platform token created by JPEX. Before cessation of trading operations of JPEX,	F
G	only less than 20% of total JPC was released by JPEX	G
Н	and circulated and tradeable on the Platform and a limited number of small online cryptocurrency	Н
I	exchanges;	I
J	(5) Since about mid to late 2021, JPEX began extensively	J
K	promoting their platform and services in Hong Kong	K
L	through advertisements and engaging or partnering with local key opinion leaders and social media	L
M	influencers ("the Promoters"), including Mr Joseph	M
N	Lam ("JL");	N
0	(6) P1 attended some of JL's seminars, followed his social	0
P	media account on Instagram and was a member of JL's private Telegram and Whatsapp messaging groups	P
Q	which advocated for the credibility, stability and	Q
R	profitability of JPEX, the Platform and JPC;	R
s	(7) JPEX has also, through its website and the Promoters,	S
Т	represented to the public that investments placed in	T
U	JPEX would be safe and profit making;	U

V

 \mathbf{V}

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A				A
В				В
C	(8)	-	n attending the seminars and reading the posts and sage of JL, P1 was led to believe that JPEX was a	C
D			used, genuine and secured cryptocurrency exchange	D
E		and i	investment platform and as a result:	E
F		(a)	On 13 July 2023, P1 registered an account on the	F
G			Platform ("the 1st Account"). The 1st Account	G
Н			was purportedly assigned with a newly created crypto-asset wallet bearing public address	Н
I			TNCxvfB7aW4JjgyLph91Mj8FBWHnD77DM8	I
J			("the 1st Wallet");	J
K		(b)	On 3 August 2023, P1 registered an account on	K
L			the Platform ("the 2 nd Account"). The 2 nd Account was purportedly assigned with a newly	L
M			created crypto-asset wallet bearing public	M
N			address TM6tdiP77qsyfTWegZ9sULzwmiev41 ySNT ("the 2 nd Wallet"); and	N
o				O
P		(c)	On 11 August 2023, P1 registered, in the name of P2, an account on the Platform ("the 3 rd	P
Q			Account"). The 3 rd Account was purportedly	Q
R			assigned with a newly created crypto-asset wallet bearing public address TM6ezzj72Hyi92	R
S			g4fDyRXPqF8Y93KMe87L ("the 3 rd Wallet");	S
T				Т
U				U
v				V

- 9 -

A			A
В	(9)	At the time of the creation of each of the 1st Account,	В
С		the 2 nd Account and the 3 rd Account (collectively, "the	C
D		Accounts"), Ps had agreed to a set of "Users Terms of Service" of D1 and D2 which is found in an	D
E		announcement dated 29 January 2019 on JPEX's	E
F		website titled "User Agreement";	F
G	(10)	Whilst a person who had registered on JPEX and had	G
Н		access to an account on the Platform is referred to as "User", the person in actual ownership and control of a	Н
I		crypto-asset wallet is referred to as "Wallet Holder".	I
J		Notwithstanding Ps had access to the Accounts, neither of them were given the private key to each of the	J
K		Wallets which were at all material times retained by	K
L		D1, D2 and/or D6 and/or the unknown real wallet holder(s). On a blockchain, a private key to a crypto-	L
M		asset wallet is exclusively used to authorize	M
N		transactions, controls and prove ownership of the wallet and the assets therein. Crypto-assets in a wallet cannot	N
0		be removed without the use of the private key. In case	0
P		the private key is lost, the corresponding wallet would	P
Q		become inaccessible and the crypto-assets in the wallets irretrievable;	Q
R	(1.1)	0 16 1 1 2022 P14	R
S	(11)	On 16 July 2023, P1 transferred a total of 6219.556164 USDT from her other crypto-asset wallet held with	S
Т		Binance Holdings Ltd into the 1st Wallet. The same	T
U			U
V			V

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A			A
В		was then recorded in the balance of the 1st Account on	В
C		the Platform;	C
D	(12)	Further, on the recommendation of JL and with the use	D
E		of some referral codes he provided to benefit from	E
F		preferential exchange rates, on about 19 July 2023, P1 attended Coingaroo's office. D6 recommended P1 to	F
G		participate in a programme called "JPP Launchpad" which required the deposit of USDT into wallets and to	G
Н		use the same to subscribe JPP, another platform token	Н
I		created by JPEX, for rewards after a specified period of	I
J		being locked up. On D6's instructions, P1 transferred a sum of HK\$300,000 from her Standard Chartered	J
K		Bank account ("SCB Account") to D6's account with	K
L		Airstar Bank Limited ("D6's Airstar Account"). In return, 39,311.17 USDT was deposited into the 1st	L
M		Wallet and recorded in the balance of the 1st Account	N
N		on the Platform;	N
0	(13)	On about 22 July 2023, on instructions of D6 to acquire	o
P		more USDT, P1 transferred another HK\$50,000 from the SCB Account to D6's Airstar Account. In return,	P
Q		6,468.49 USDT was deposited into the 1st Wallet and	Q
R		recorded in the balance of the 1st Account on the Platform;	R
S			s
Т	(14)	On about 4 August 2023, as per the instructions of D6,	Т
U		HK\$1,000,000 in cash (as D6 has represented that only	U
V			v

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A		A
В	cash deposits would entitle P1 to bonus rewards), and	I
C	HK\$500,000 from the SCB Account, were transferred	(
D	to D6's account with Livi Bank Limited. A total of 195,499.092079 USDT was deposited into the 2 nd	Г
E	Wallet and recorded in the balance of the 2 nd Account	I
F	on the Platform;	F
G (15)		(
н	promotion advertised through the Promoters, between 13 and 31 August 2023, P1 gave instructions on the	I
I	Platform to transfer 200,015 USDT from the 1 st and 2 nd	I
J	Accounts to the 3 rd Account. The same was purportedly recorded in the balance of the 3 rd Account	J
K	on the Platform;	ŀ
L (16)	On 13 September 2023, SFC published a warning	I
М	statement. It identified JPEX as an unlicensed VATP	N
N	operating in Hong Kong and warned the public that some of the products offered by JPEX were not allowed	N
o	under the SFC's regime;	(
P (17)	On 14 September 2023, JPEX published an	P
Q	announcement that it had increased the fees chargeable	(
R	against Users for withdrawing USDT. Any Users having urgent withdrawal needs could apply by	F
s	completing an online Google form for priority	S
Т	withdrawal sequencing;	1
U		τ
V		1

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A				
3	(18)	As of	f about 15 September 2023,	the Platform displayed
C		the f	following balances in the Ac	ecounts, purporting to
		show	the amount of cryptocurren	cies held in each of the
D		Wall		
E		(a)	The 1 st Account:	
F		(a)	The T Account.	
				T
G			Cryptocurrency	Purported value in USD
Н			399,611.19 JPC	15,815.64
			62,500 JPP	1,250
			0.00052452 bitcoin ("BTC")	13.83
I				
I			39,301.19062932 USDT	39,301.19062932
J K		(b)	39,301.19062932 USDT Total value in USD/USDT The 2 nd Account:	39,301.19062932 56,380.67
I J K		(b)	Total value in USD/USDT	
J K L		(b)	Total value in USD/USDT	
J K L		(b)	Total value in USD/USDT The 2 nd Account:	Purported value in USD
J		(b)	Total value in USD/USDT The 2 nd Account: Cryptocurrency	56,380.67
J K L M		(b) (c)	Total value in USD/USDT The 2 nd Account: Cryptocurrency	Purported value in USD
J K L M			Total value in USD/USDT The 2 nd Account: Cryptocurrency 39.74 USDT	Purported value in USD
J K L M			Total value in USD/USDT The 2 nd Account: Cryptocurrency 39.74 USDT	Purported value in USD 39.74
J K L M N			Total value in USD/USDT The 2 nd Account: Cryptocurrency 39.74 USDT The 3 rd Account:	Purported value in USD
J K L M N O			Total value in USD/USDT The 2 nd Account: Cryptocurrency 39.74 USDT The 3 rd Account: Cryptocurrency	Purported value in USD 39.74 Purported value in USD 5,047.39
J K L M N O P			Total value in USD/USDT The 2 nd Account: Cryptocurrency 39.74 USDT The 3 rd Account: Cryptocurrency 130,231.76 JPC	Purported value in USD 39.74 Purported value in USD
J K L M N O P			Total value in USD/USDT The 2 nd Account: Cryptocurrency 39.74 USDT The 3 rd Account: Cryptocurrency 130,231.76 JPC 250,000 JPP	Purported value in USD 39.74 Purported value in USD 5,047.39 5,000 10,926.95
J K L M N			Total value in USD/USDT The 2 nd Account: Cryptocurrency 39.74 USDT The 3 rd Account: Cryptocurrency 130,231.76 JPC 250,000 JPP 0.41296110BTC	Purported value in USD 39.74 Purported value in USD 5,047.39 5,000

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A		A
B (19)	Whilst P1 and P2 had submitted to D1 and D2	F
С	applications for urgent withdrawals on 15 and 27 September 2023 respectively, neither were successful	(
D	in making withdrawals;	Ι
E (20)	On 14 September 2023, by use of a legitimate online	F
F (20)	blockchain explorers, contrary to the transactions and	F
G	balance of the Accounts displayed on the Platform, it	(
Н	was revealed that wrongfully and without Ps' knowledge, consent or authorization:	I
I		I
J	(a) D1, D2, the 3 rd Defendant, the 4 th Defendant and/or the 7 th Defendant ("D7") transferred away	J
K	nearly all of the 51,999.216164 +	ŀ
L	195,499.092079 = 247,498.308243 USDT deposited into the 1 st Wallet and 2 nd Wallet	I
M	within 5 minutes after each of the deposits were	N
N	made. They were first transferred to an unknown hot wallet and further transferred onwards to	N
0	other wallets of unknown holders (instead of to	(
P	some cold wallets as JPEX had claimed in its announcements on its website);	F
Q		(
R	(b) There was never any transfer from the 1 st Wallet and 2 nd Wallet to the 3 rd Wallet;	F
s		S
Т	(c) There was never any BTC, JPC or JPP existed in the Wallets; and	1
U		τ
V		χ.

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A		A
В		В
\mathbf{c}	(d) The 1 st Wallet and the 3 rd Wallet had zero	C
D	balances and the 2 nd Wallet had a balance of 0.013219 USDT;	D
E		E
F (21)	On 20 September 2023, SFC issued another statement reiterating that JPEX was operating the Platform as an	F
G	unregulated VATP and no entity was licensed or had	G
Н	applied to be licensed under the SFC to operate as a VATP;	Н
I		I
J (22)	On the same day, JPEX purported to launch a "DAO Stakeholders Dividend Plan" giving Users the right to	J
K	convert their crypto-assets on the Platform to "DAO	K
L	Stakeholder dividends" at 1:1 ratio. JPEX claimed that it would begin repurchase of all the "dividends" by	L
M	stages after a lapse of 1 year at various discounted	M
N	prices of the original conversion value and would distribute 49% of the DAO Stakeholder dividends for	N
0	the said subscription and conversion;	0
P (23	On 23 September 2023, JPC was delisted from all other	P
Q	cryptocurrency exchanges and JPEX suspended all	Q
R	trading which up to the time of the writ remains suspended and no User could withdraw any crypto-	R
s	assets from their wallets;	S
T		Т
U		U
V		v

	1	Ε	
-	- 1		-

A			
В		(24)	On about 4 October 2023, JPEX claimed to have
C			received majority votes from Users in favour of the "DAO Stakeholders Dividend Plan" and without the
D			knowledge, consent or authorization of Ps, all their
E			BTC and USDT in the Accounts as displayed on the Platform (which was false and untrue by reason of (20)
F			above) were converted into JPC;
G		(25)	Up to the time of the Writ, the Accounts as displayed
Н		(23)	on the Platform showed the following balances:
I			(a) The 1st Account: 10,353.80 JPC and
J			5,163,650.608288 JPP;
K			(b) The 2 nd Account: 1,324.68 JPC; and
L			(b) The 2 Account. 1,324.06 JFC, and
M			(c) The 3 rd Account: 6,765,399.04 JPC and 250,000 JPP.
N			JFF.
О		(26)	As a result of JPEX's suspension and the lack of circulation of JPC in other cryptocurrency exchanges,
P			all JPC and JPP had become untradeable and practically
Q			worthless.
R	16.	In the	e ASOC, Ps have pleaded the following causes of action
S	against D2:		
T		(1)	Breach of trust; and
U			
\mathbf{V}			

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A				A
В				В
C		(2)	Alternatively, reconstitution and repayment of debt.	C
D	17.	In re	spect of the cause of action based on trust, at the hearing,	D
E	Mr Tam c	arified	that Ps' primary case was that there was an express trust	E
	over the U	JSDT o	leposits that were originally deposited in the 1 st and 2 nd	
F	Wallets. I	t is onl	y if the court does not accept there was an express trust,	F
G	alternative	ly, it is	claimed that there was a <i>Quistclose</i> trust ¹ .	G
Н	18.	As f	or relief, in the event that the court accepts that there was	Н
I	a breach o	f trust,	Mr Tam has also clarified that Ps only seek the following	I
			in the ASOC:	
J	rener as pr	cudod	in the risse.	J
K		(1)	A declaration that D2 was and is holding	K
L			51,999.216164 USDT received in the 1st Wallet and	L
L			195,499.092079 USDT received in the 2 nd Wallet	L
M			(together "the USDT Deposits") on trust for P1;	M
N		(2)		N
		(2)	An injunction to restrain D2, whether by its servants or	
0			agents or otherwise howsoever, from parting with or	О
P			dealing with the USDT Deposits otherwise than with	P
			the consent of P1;	
Q				Q
R	Ltd [1970] AC	567. In t	from the House of Lords decision in Barclays Bank Ltd v Quistclose Investments the recent Court of Final Appeal decision in China Life Trustees Limited v China	R
S	Quistclose tru property) to Y	st arises: by way of	hemicals Group Overseas [2024] HKCFA 15, Ribeiro PJ explained how a "Such a trust comes into existence where X pays money (or transfers other loan or otherwise, with the parties objectively intending the money to be applied and the state of the state o	S
T	properly applie achieved, the f	ed by the unds are s	nd no other). That clothes the transferred funds with a trust subject to their being recipient for the designated purpose. If for any reason that purpose fails to be simply held on trust for the payer. Such restriction on the use of the funds is the eyer must have intended, with the recipient's agreement or acquiescence, that the	Т
U			nly for that specific purpose and should not be at the recipient's free disposal".	U
V				T ?

A			- 17/ -	A
В				В
		(3)	An order that D2 do account to P1 for the USDT	
C		(0)	Deposits, including all necessary accounts and	C
D			inquiries to enable P1 to trace and recover the same	D
E			including their fruits, substitutes and/or proceeds;	E
F		(4)	Delivery up of the USDT Deposits held on trust to P1;	F
G			and	G
Н		(5)	To the extent the USDT Deposits, and the fruits,	Н
I		(-)	substitutes and the proceeds thereof are untraceable, D2	I
J			do pay P1 equitable compensation to be assessed.	J
K	19.	In th	ne event the court does not accept Ps' primary case on	K
L	-		accepts Ps' alternative case on debt, Mr Tam confirmed owing pleaded relief are sought:	L
M				M
N		(1)	D2 do pay, transfer or deliver up:	N
o			(a) to P1 0.00052452 BTC and 39,340.9306293	o
P			USDT;	P
Q			(b) to P2 0.41296110 BTC and 186,672.68163085	Q
R			USDT; or	R
S		(2)	Alternatively, common law damages to be assessed.	s
Т		` `		Т
U				U
V				V

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A		A
В	F. Analysis and Disposition	В
C		C
D	20. It is now accepted by the courts of many common law jurisdictions, including Hong Kong, that cryptocurrency is "property" and	D
E	is capable of forming the subject matter of a trust.	E
F	21. Re Gatecoin Ltd (in Liq) [2023] 2 HKLRD 1079 was a case	F
\mathbf{G}	where a company which operated a cryptocurrency exchange platform was	\mathbf{G}
Н	wound up and the liquidators applied for directions on <i>inter alia</i> whether certain cryptocurrencies and fiat currencies were held on trust for the	Н
I	company's customers. In that case, Linda Chan J comprehensively	I
J	reviewed and outlined the academic debate and jurisprudence including those overseas. The learned judge took the view that it was appropriate to	J
K	apply and follow the reasoning and conclusions of the UK Jurisdiction	K
L	Task Force in <i>Legal Statement on Cryptoassets and Smart Contracts</i> (November 2019) and Gendall J in <i>Ruscoe v Cryptopia</i> [2020] NZHC 728,	L
M	and accordingly held that cryptocurrency is property which is capable of	M
N	forming the subject matter of a trust. See §§47-59.	N
0	22. In Feng Bo, following Re Gatecoin Ltd (In Liq) and other	0
P	more recent authorities, DHCJ Kent Yee held that Tether, a type of cryptocurrency common known as USDT, is property capable of forming	P
Q	the subject matter of a trust. In that case, the learned judge granted default	Q
R	judgment and relief which included a declaration that 172,151.86 USDT transferred by the plaintiff to the defendant's account maintained with	R
S	Binance were held on constructive trust by the defendant for the plaintiff.	S
Т	See §§9, 10 and 17(1).	Т
U		U
V		v

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A				A
В	23.	Acco	ordingly, I am satisfied that USDT is property capable of	В
C	forming the	e subje	ct matter of a trust.	C
D	24.	The 1	real question is whether on the pleaded facts, the USDT	D
E	Deposits ar trustees) fo		ere held on express trust by D2 as trustee (or one of the	E
F G H	_	guiding	egards the circumstances in which an express trust will be grinciples were summarized by Briggs J (as he then was) others International (Europe) (In Administration) [2010]	F G H
I	EWHC 291	14 (Ch)). At §225, principles (i) to (x) were stated as follows:	I
J		(i)	The recognition of a proprietary interest of B in	J
K L			property where A has the legal or superior title necessarily assumes the existence of a trust as between A and B;	K L
M			A and D,	M
N		(ii)	There can be no such proprietary interest if the necessary trust would fail for uncertainty;	N
0		····		0
P		(iii)	A trust of part of a fungible mass without the appropriation of any specific part of it for the	P
Q			beneficiary does not fail for uncertainty of subject	Q
R			matter, provided that the mass itself is sufficiently identified and provided also that the beneficiary's	R
S			proportionate share of it is not itself uncertain;	S
T				T
U				U
V				V

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A		
В	(iv)	A trust does not fail for want of certainty merely
C		because its subject matter is at present uncertain, if the
D		terms of the trust are sufficient to identify its subject matter in the future;
E		
F	(v)	Subject to the issue of certainty, the question whether B has a proprietary interest in the property acquired by
G		A for B's account depends upon their mutual intention,
Н		to be ascertained by an objective assessment of the terms of the agreement or relationship between A and
I		B with reference to that property;
J	(vi)	The words used by the parties such as "trust, "custody",
K		"belonging", "ownership", "title", may be persuasive,
L		but they are not conclusive in favour of the recognition of B's proprietary interest in the property, if the terms
M		of the agreement or relationship, viewed objectively, compels a different conclusion;
N		compels a different conclusion,
0	(vii)	The identification of a relationship in which A is B's
P		agent or broker is not conclusive of a conclusion that A is, in relation to that property, B's trustee, although it
Q		may be a pointer towards that conclusion;
R	(viii)	A relationship which absolves A from one or more of
s	(*111)	the basic duties of trusteeship towards B is not thereby
T		rendered incapable of being a trustee beneficiary
U		
V		

A				- 21 -	A
В			relati	onship, but may be a pointer towards a conclusion	В
C				t is not;	C
D		(ix)	Spec	ial care is needed in a business or commercial	D
E		,	-	ext. Thus:	E
F			(a)	The law should not confine the recognition and	F
G				operation of a trust to circumstances which	G
Н				resemble a traditional family trust, where the fulfilment of the parties' commercial objectives	Н
I				calls for the recognition of a proprietary interest	I
J				in B;	J
K			(b)	The law should not unthinkingly impose a trust	K
L				where purely personal rights between A and B sufficiently achieve their commercial objective;	L
M					M
N		(x)		e is, at least at the margin, an element of policy. example, what appears to be A's property should	N
0			not 1	ightly be made unavailable for distribution to its	0
P				cured creditors in its insolvency, by the recognition proprietary interest in favour of B. Conversely, the	P
Q				ts of intermediaries which acquire property for	Q
R				should be appropriately protected from the mediary's insolvency.	R
s			micon	inequally 5 inservency.	s
Т	26.			coin Ltd (In Liq), Linda Chan J also held that to there must be the "three certainties". The "three	Т
U	cicale all	captess	uust,	mere must be the times certainties. The three	U
V					\mathbf{v}

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certainti	ies" are: (a	a) certainty of subject matter; (b) certainty of object; and
(c) certa	ainty of ir	ntention. See §§60-65. Furthermore, the learned judge
held tha	t question	is to determine not just the express arrangements as to
how the	property	is to be held but whether it is held on trust. See §60.
27.	In th	e present case, I am satisfied of the "three certainties" to
create a	n express	trust based on Ps' pleaded case.
28.	First	ly, there is sufficient certainty of subject matter:
	(1)	As I have found above, USDT, a cryptocurrency, is
		property which is able to form the subject of a trust;
	(2)	D1 and D2 held themselves out to be creating and
		operating a cryptocurrency exchange platform for
		Users to transact with each other for crypto-assets;
	(3)	As a cryptocurrency exchange, the Platform recorded
		and documented all the balance and transactions of
		crypto-assets in each account;
	(4)	In any event, given a blockchain is a decentralized
		ledger, by conducting a scan using online blockchain
		explorers, the location and movement of crypto-assets
		in the Wallets is publicly available information ² ;
20 00	7.70	
on blockcha	ain technolog	$a \ Liq$) at §12, which helpfully explained: "Cryptocurrency is a digital asset based y, which records transaction data in a list of records (a block) with a time stamp, a the payt by cryptography. The blockshain contains all transactions processed
with each to	ransaction cry	to the next by cryptography. The blockchain contains all transactions processed, ptographically linked to the previous one. The data stored can only be changed to arrea. This ensures that blockchain is not controlled by any single authority.
when all th	e participants	agree. This ensures that blockchain is not controlled by any single authority,

	22	
-	23	-

A	23	A
В		В
C	(5) The USDT Deposits were clearly segregated and	(
D	contained in the 1 st Wallet and 2 nd Wallet before they were withdrawn and transferred out of the Wallets;	D
E		E
F	(6) In any event, even if the USDT Deposits were transferred out and stored in JPEX's cold wallets as	F
G	claimed, a trust of part of a fungible mass without	(
Н	appropriation of any specific part does not fail for uncertainty of subject matter provided the beneficiary's	H
I	proportionate share is not uncertain (see Re Gatecoin	I
J	(In Liq), §§61-62 and Re Lehman Brothers Intl (Europe), principle (iii)). Where the amounts of	J
K	crypto-assets was recorded, on the basis that there can	ŀ
L	be a trust over a proportionate share of all crypto-assets, the subject matter of the trust vis-à-vis each User is	I
M	sufficiently certain.	N
N	29. Secondly, I am also satisfied there was certainty of object as	N
0	the beneficiaries of the trust is certain and the extent of Ps' claim can be	C
P	readily seen from the balance of the Accounts recorded on the Platform. See <i>Re Gatecoin (In Liq)</i> , §§63-64.	P
Q		C
R		F
S		s
T	and the data stored in the blockchain is immutable." See also at §18, " blockchain is a publicly available ledger containing a record of all transactions made in respect of that cryptocurrency. For	Т
U	example, in respect of Bitcoin, details of all transactions can be viewed at Wallet.Exlorer.com. A user can trace a cryptocurrency from its creation all the way through to each transaction it has gone through."	ι
V		v

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A					A
В	30.	Third	dly, I	am further satisfied that there was certainty of	В
C				objective assessment of the terms of the parties'	C
D	agreemer	it or reia	uonsni	.p.	D
E		(1)		X through its conduct in creating the exchange	E
F				out allocating to Users the private keys manifested tent to hold crypto-assets deposited by its Users on	F
G			trust	· ,	G
Н		(2)	D1,	D2 and/or D7 and/or other unknown	Н
I				viduals/entities have retained the private keys to the	I
J			exclı	usion of Ps;	J
K		(3)	JPEX	X had made the following representations through	K
L			-	ic announcement published on its website and the ls used (such as "client funds", "customer funds",	L
M			"use	r's property", "all users' assets", "customers'	M
N				erly construed, acknowledged the beneficial	N
o			owne	ership of crypto-assets deposited in wallets	0
P			belo	nged to the Users:	P
Q			(a)	In an announcement dated 24 July 2020:	Q
R				"[JPEX] use the hot and cold wallet isolation	R
S				mechanism, store 95% of the currency value in the cold wallet, we will only reserve 5% of the currency for withdrawal and recharge	s
T				Collaboration on audits, multi-signature wallets, and two-step verification. Ensure that sensitive	Т
U					U
V					v

		- 25 -	
A			A
В		personal information of users will not be disclosed."	В
С			C
D	(b)	In an announcement dated 18 August 2020:	D
E		" Most of JPEX's client funds are stored in multi-signature cold wallets. To ensure the	E
F		security of assets, we will store customer funds in a multi-signature cold wallet first JPEX's cold wallet must be signed twice by three professional	F
G		auditors in the operation team We believe that the user's property most important, so the most	G
н		time and resources are spent on the structure of the entire platform to ensure that the assets of all our accounts are safe and accurate."	Н
I			I
J	(c)	In an announcement dated 26 October 2020:	J
K		"JPEX has always been committed to providing the most secure protection for all customers'	K
L		assets, and the platform will regularly update the security system Recently, in order to prevent hacking activity, we has updated the storage and	L
M		all wallet deposit addresses will also be changed."	M
N	(d)	In an announcement dated 16 November 2020:	N
0		"The multi-signature cold wallet technology is set	0
P		up on the security system, and all users' assets are very safe."	P
Q	(e)	In an announcement dated 7 April 2023:	Q
R			R
s		" To protect the security of our users' assets and accounts, JPEX has establish multiple protection mechanisms Through multi-step	S
Т		verification, your account's security and assets will be better protected."	Т
U			U
V			V

_	26	_
_	20	_

A				A
В		(4)	The absence of the word "trust" in the announcements	В
C			or in the Users Terms of Service is not conclusive;	C
D		(5)	JPEX held itself out to be a cryptocurrency exchange to	D
E			provide a platform where the users can transact with	E
F			each other for crypto-assets as opposed to JPEX being in the business of selling cryptocurrency for profit;	F
G				G
Н		(6)	It was represented that Users' cryptocurrencies (95%) are stored in "cold wallets" which suggest that they	Н
I			were not for free disposable by JPEX. The remaining	I
J			(5%) were for the specific purpose of withdrawal by Users; and	J
K				K
L		(7)	By depositing 51,999.216164 USDT and 195,499.092079 USDT into the 1st Wallet and 2nd	L
M			Wallet respectively, P1 intended to entrust, and	M
N			entrusted, the same to D2 for the special purpose of depositing, trading and investing in cryptocurrencies	N
0			for profit.	o
P	31.	I ther	efore take the view that Ps have pleaded a viable case of	P
Q			operators of the Platform, D2 (together with D1) held the	Q
R	USDT Depo	sits o	n express trust for Ps.	R
S	32.	As he	eld in Ruscoe v Cryptopia (where the court likewise was	S
T		• •	ocurrencies were held on express trust for the account	Т
U	holders), ess	sential	ly, the principle role of the exchange, as bare trustee, was	U
V				v

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A	
В	to hold the assets as trustee for the accountholders, to follow their
C	instructions, and let individual accountholders then to increase or reduce
D	their beneficial interest in the trusts in accordance with the system that the exchange had created for that purpose. See §196.
E	
F	33. See also <i>Lewin on Trusts</i> , Vol 1, §§1-037, 1-040, 1-041, 34-026 and 34-050, where the learned editors are of the view that generally a
G	trustee has: (a) a duty to transfer the property to or at the direction of the
Н	beneficiary; (b) a duty to take proper care of trust property; and (c) a duty to preserve and manage trust property for the benefit of the beneficiaries.
I	
J	34. I am therefore satisfied that D2, as one of the trustees, acted in breach of its duties as trustee as pleaded by:
K	
L	(1) wrongfully and without authorization transferring away the USDT Deposits to other unknown wallets; and
M	
N	(2) failing to and/or refusing to pay over to P1 the whole or any part of the USDT Deposits despite Ps' request.
O	
P	35. Accordingly, I am further satisfied that P1 is entitled to the relief as pleaded on her primary case.
Q	
R	36. In particular, I am satisfied that the declaration sought is properly made out on the pleadings and that I ought to exercise my
S	discretion to grant the declaration without trial. It seems to me that P1 has
T	a strong and obvious case for seeking proprietary relief. Otherwise, she
U	
X 7	

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A			A				
В	remains	in a position of an unsecured judgment creditor. There is a genuine	В				
C	need to	grant the declarations sought to do fullest justice to P1.	C				
D	37.	As for the injunction sought against D2, I am also satisfied	D				
E	that it is	s necessary and ancillary to assist in the recovery of the USDT	E				
F	Deposits, which I have held on the Ps' pleaded case were held on trust by D2 (together with D1) for P1.						
G			G				
Н	38. any disr	Given my acceptance of Ps' primary case, without intending respect to the submissions of Mr Tam on his alternative claims	Н				
I	Ţ.	n Quistclose trust and debt, which admittedly are quite novel, I do	I				
J		not consider it necessary to go on to decide whether those alternative claims are viable and entitle Ps to the alternative relief sought.					
K			K				
L	G. Orde	ers and Costs	L				
M	39.	Accordingly, I would grant default judgment against D2 and	N				
N	order the	e relief sought by Ps on their primary case.	N				
0	40.	Costs should follow the event. I therefore order that D2 pay	C				
P	to Ps the	e costs of and occasioned by the Summons as summarily assessed	P				
Q	by file o	n paper.	Ç				
R	41.	Having considered the Statement of Costs submitted at the adopting a broad-brush approach, I have summarily assessed Ps'	R				
s		HK\$120,000.00.	s				
T			Т				
U		(G. Chow)	τ				
v		District Judge	v				

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A		A
В		В
C	Ma Tagman Taga instructed by Hayran LLD and Ma Jashya Chy, solicitan	C
D	Mr Tasman Tam, instructed by Hauzen LLP, and Mr Joshua Chu, solicitor advocate of Hauzen LLP, for the 1 st and 2 nd Plaintiffs	D
E	The 2 nd Defendant was not represented and did not appear	E
F		F
G		G
Н		Н
I		I
J		J
K		K
L		L
M		M
N		N
o		o
P		P
Q		Q
R		R
S		s
T		T
U		U
V		V

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IN THE GRAND COURT OF THE CAYMAN ISLANDS FINANCIAL SERVICES DIVISION

FSD CAUSE NO: 54 OF 2023 (IKJ)

IN THE MATTER OF THE COMPANIES ACT AND

IN THE MATTER OF ATOM HOLDINGS (IN PROVISIONAL LIQUIDATION)

IN COURT

Appearance

Mr. Adam Crane, Ms. Nicosia Lawson and Ms Nia Statham of Baker and

Partners for the Petitioner

Ms Gemma Lardner and Mr Max Galt of Ogier for the Company

Jalil Asif KC of Kobre & Kim for the Joint Provisional Liquidators

Before: The Hon. Justice Kawaley

Heard: 7 July 2023

Date of Judgment: 7 July 2023

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EX TEMPORE JUDGMENT

Introduction and summary

1. I am satisfied that the Company's present application should be refused. The application for an adjournment in this case is made not just in the "59th minute of the eleventh hour", but in the last minute of time added on for stoppages; and it is made in the weakest possible way.

Background

- I am satisfied that the former Directors, whom I accept have standing despite their being removed from office to instruct counsel on behalf of the Company knew of the existence of these proceedings, despite the embargoes placed on the Order appointing the Joint Provisional Liquidators, from at least the middle of May this year.
- 3. On 20 June 2023, they seemingly resolved to instruct counsel to appear and oppose the Petition, but for reasons that are unexplained they took from 20 June until this week to instruct Cayman Islands counsel. The basis of the adjournment is set out in the Affidavit of a Hong Kong Ogier lawyer who, in effect, says that Ogier only became aware of the proceedings on 5 July (two days ago); and they need time, more time, to respond to the legal and factual issues raised in the Petition.
- 4. One might have thought that the former directors, having been aware of the existence of these proceedings since the middle of May would, if they were serious about opposing the Petition, have identified some basis for doing so before 5 July 2023, two days before the hearing of the Petition.

Grounds for adjournment application

Ms Lardner, who was asked in effect to lead the 'Charge of the Light Brigade', was forced to rely on this ground: the possibility that the Company may want to dispute the standing of the Petitioners. That ground is a potentially valid ground; however as far as the present case is concerned it is a somewhat tenuous one. Because I gave extensive reasons for finding at the interlocutory stage that

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¹ Re MV Cayman Ltd, FSD 8 of 2022, Judgment dated 28 September 2022 (DDJ) (unreported), per Justice David Doyle at paragraph 9.

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the Petitioners had sufficient standing to appoint provisional liquidators². And in appointing provisional liquidators I found that there was a *prima facie* case for winding-up³.

6. And while the decision that a contingent creditor has standing to petition under Cayman Islands law may be an unusual one, it is not unprecedented. So, there is no basis for anxiety that there is an obvious, cogent standing issue upon which the Company is likely to prevail⁴.

Governing legal principles

7. The key legal principles governing adjournments have been addressed in various cases. A local case that Ms Lardner relied upon was the decision of Justice Doyle on 28th September 2022 in the *MV Cayman Limited* matter and Justice Doyle, at paragraph 18, said this:

"18. In Evergreen⁵ at paragraph 55 Ramsay-Hale J stated: 'It is well settled that if a creditor with standing to make an application wants to have a company wound up, and if the court is satisfied that the company cannot pay its debts, a winding up order will follow unless there are some special reasons why it should not.' At paragraph 58 Ramsay-Hale J refers to authorities to the effect that in practice the court will only adjourn if there is credible evidence that there is a reasonable prospect of the petition debt be repaid within a reasonable time. Ramsay-Hale J at paragraph 61 adopting the words of Kawaley J in ASL Asean Tower (FSD unreported judgment 8 March 2019) stated that the court should be 'leery' in respect of last minute applications. It is right that the court should be cautious and wary in respect of last minute adjournment applications. I should, for present purposes, set Kawaley J's 'leery' comment in context. The full sentence at paragraph 39 of his judgment was as follows:

'In my judgment winding up courts should generally be leery of last minute adjournment applications made by insolvent companies and/or related parties and which are framed as requests to investigate for the first time matters which ought to have been investigated long ago.'..."

Application of principles to facts of the present case

8. In *MV Cayman* the position was that Justice Doyle found that there was a good reason to adjourn because there would be a relatively short adjournment, from the date of the hearing (28 September)

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² Judgment dated 18 May 2023 (released for publication on 15 June 2023), at paragraphs 10, 37-44.

³ *Ibid*, at paragraphs 45-46.

⁴ In the course of the subsequent substantive hearing of the Petition I observed, by way of afterthought, that the Authority would probably have been able to apply to be substituted as petitioner to meet any valid standing objections.

⁵ Re Evergreen International Holdings Limited, FSD 349 of 2022 (MRHJ), Judgment dated 11 January 2022 (unreported).

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until 25 October; and that period would have afforded the company an opportunity to pursue refinancing efforts with a view to paying off its creditors. Those factual circumstances could not be further from the present case.

- 9. Here it is believed that the former management of the Company have been involved in fraudulent conduct, have obstructed, or not cooperated with, the Provisional Liquidators and have left large numbers of creditors with individually small claims, but with claims cumulatively running into millions, unpaid and with no immediate prospect of any recovery. Moreover, in this case there is a public interest in an investigation, one of the winding-up grounds being that there is a need for an investigation and the Cayman Islands Monetary Authority has sent representatives to observe these proceedings.
- 10. The question of the approach to adjournments is also summarised crisply in French, 'Applications to Wind Up Companies', Fourth Edition, in a paragraph to which Mr Crane referred in opposing the application for an adjournment (paragraph 5.120). It is stated:

"A mere assertion by counsel for the company that, given time, it was hoped to obtain evidence to establish the petitioner did not have standing was not enough to obtain an adjournment in EG & H Nominees Proprietary Limited v General Insurance Company Limited..."

Conclusion

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11. And so, in all the circumstances of this case I am bound to refuse the application for an adjournment and now just need to deal very summarily with the application to wind up this Company.

more

THE HONOURABLE MR JUSTICE IAN RC KAWALEY JUDGE OF THE GRAND COURT

Faculty

Gregory V. Demo is an attorney with Pachulski Stang Ziehl & Jones in New York and regularly represents hedge funds and other significant holders of securities in connection with complex chapter 11 reorganizations. In addition, he is part of the firm's team handling insolvency-related sales and acquisitions. Mr. Demo is adept at creating litigation strategies for investments in state, federal and bankruptcy court, and overseeing all aspects of the implementation of such strategies. He is admitted to practice in New York and Illinois. Mr. Demo received his B.A. *magna cum laude* in 2003 from Marquette University and his J.D. in 2008 from the College of William & Mary School of Law, where he was elected to the Order of the Coif, served on the *William & Mary Law Review* and graduated second in his class

James Drury is a managing director with Interpath Ltd. in Road Town, Tortola, BVI, and has a broad range of experience, managing a number of high-profile multijurisdictional engagements including complex insolvency, restructuring and advisory-focused engagements the U.K., Cayman Islands and BVI. He has experience advising clients relating to cryptocurrencies, NFTs and blockchain technology, and he has assisted in the recovery of digital assets, often in circumstances where there has been fraud or hacking activity, or where assets are held by exchanges. Mr. Drury received his law degree from BPP Law School.

Stacy A. Lutkus is a partner in the Business Restructuring group of McDermott Will & Emery LLP in New York, where she focuses her practice on all aspects of complex domestic and cross-border reorganization matters. She advises companies and foreign representatives preparing chapter 11 and chapter 15 cases for filing, as well as debtors, creditors, purchasers (including stalking-horse bidders) and lenders in connection with out-of-court restructuring transactions, distressed-asset sales, DIP financing and exit financing. She also advises official committees of unsecured creditors, as well as individual secured and unsecured creditors, equityholders and post-confirmation trusts in bankruptcy and litigation matters. Ms. Lutkus maintains an active pro bono practice, with a focus on representing the interests of children. Prior to her legal career, she spent several years working as a special agent for the U.S. Department of the Treasury Internal Revenue Service's Criminal Investigation Division, where she gained experience conducting witness interviews, participating in enforcement operations, preparing special agent reports and testifying in court proceedings. Ms. Lutkus has been listed in Lawdragon as a 2020 Leading U.S. Bankruptcy and Restructuring Lawyer, and she was selected for the International Insolvency Institute's NextGen Leadership Program, She is a member of ABI, the Federal Bar Council's Bankruptcy Litigation Committee, INSOL and the International Women's Insolvency & Restructuring Confederation (IWIRC). Ms. Lutkus received her B.S. magna cum laude in 1997 from Drexel University and her J.D. in 2002 from the University of Pennsylvania Law School.

Nia Statham is an associate at Baker & Partners (Cayman) Ltd. in Camana Bay, Grand Cayman, Cayman Islands, where she focuses on Web3 disputes, asset-tracing and recovery, fraud and dispute resolution. She was admitted as an Attorney-at-Law in the Cayman Islands in May 2023. She also was admitted to practice as a solicitor in the British Virgin Islands (March 2021) and in England and Wales (November 2017). Prior to joining Baker & Partners in May 2023, Ms. Statham trained and

qualified at a U.S. law firm before moving to an employment boutique and later a full-service national law firm in New Zealand. She then practiced at a top 10 firm in the British Virgin Islands and has gained broad experience in both civil and commercial dispute resolution, fraud, insolvency, restructuring, regulatory and compliance investigations, and employment and competition. Ms. Statham graduated from the University of Manchester, United Kingdom in 2011 and continued her education at the University of Law in Bristol, where she achieved a Graduate Diploma in Law and a Post Graduate Diploma in Legal Practice.