

Article

Dispute Resolution & Insolvency



How to Freeze Crypto Assets in South Australia

Despite what some might think, the law applies to the Internet as it does to all relations among people, governments, and others.¹

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This article aims to demonstrate how to freeze crypto assets in South Australia. The term crypto assets in this article refers to cryptocurrencies and non-fungible tokens (NFTs).

For businesses and individuals, the relevance of the information shared in this article will continue to increase in line with the adoption of these new technologies. This is because crypto assets are popular vehicles for theft and fraud. Recently, we have seen several of the world's largest cryptocurrency exchanges go bankrupt, participate in (alleged) fraud, and engage in risky fractional reserve practices.² An estimated US\$3.5 billion worth of cryptocurrency was stolen in 2022 alone.³ Newly created cryptocurrencies and NFT collections are often nothing more than thinly veiled 'rug pulls' often endorsed by celebrities (seemingly without consequence).⁴

Crypto assets have also been purposefully designed to exist outside of traditional infrastructure, such as the legal and banking system, which has led some users to believe their actions are beyond the reach of the law.⁵ This is incorrect. Although these new technologies raise novel questions, they can be positioned within the existing framework of the common law, particularly that part which relates to interlocutory relief.⁶

There is a lack of reasoned domestic decisions concerning the subject matter of this article. As such, foreign domestic decisions from common law countries will be considered regarding how Australian application may occur.

Freezing orders

A freezing order restrains a defendant from dealing with assets in which the applicant claims no right. It has been accepted by the High Court of Australia that a freezing order can be granted 'if the circumstances are such that there is a danger of [the defendant's] absconding, or a danger of the assets being removed out of the jurisdiction or disposed of within the jurisdiction, or otherwise deal with so that there is a danger that the plaintiff, if he gets judgment, will not be able to get it satisfied'.⁷

¹ *Cicada 137 LLC v Medjedovic 2021* ONSC 8581, [11].

² Bankman-Fried, FTX Execs Received Billions in Hidden Loans' *Aljazeera* (Online, 23 December 2022) <<https://www.aljazeera.com/economy/2022/12/23/bankman-fried-ftx-execs-received-billions-in-hidden-loans>>; Lucas Nolan, 'Report: Sam Bankman-Fried Used FTX Customer Accounts to Fund Investment Firm' *Breitbart* (Online, 14 November 2022) <<https://www.breitbart.com/tech/2022/11/14/report-sam-bankmanfried-used-ftx-customer-accounts-to-fund-investment-firm/>>.

³ Theo Tsihitas, 'Worldwide Cryptocurrency Heists Tracker', *Comparitech* (Web Page, 22 December 2022) <<https://www.comparitech.com/crypto/biggest-cryptocurrency-heists/>>.

⁴ For detailed investigations into this phenomena see generally Stephen Findeisen (Coffeezilla), 'Investigating Logan Paul's Biggest Scam', YouTube (Video, 17 December 2022) <https://youtu.be/386p68_IDHA>; Stephen Findeisen (Coffeezilla), 'Jake Paul Promotes MASSIVE Scam... again', YouTube (Video, 9 June 2022) <<https://youtu.be/Uvw-7Eeseak>>; Stephen Findeisen (Coffeezilla), 'Kim Kardashian Is Promoting a Crypto Scam and It's Disgusting', YouTube (Video, 18 June 2021) <<https://youtu.be/R63blfLKD20>>.

⁵ See Satoshi Nakamoto, 'Bitcoin: Open Source Implementation of P2P Currency', P2P Foundation, (Forum Post, 11 February 2009) <<http://p2pfoundation.ning.com/forum/topics/bitcoin-open-source>>; Satoshi Nakamoto, 'Bitcoin: A Peer-to-Peer Electronic Cash System' (Article) <<http://satoshiinakamoto.me/bitcoin.pdf>>; Timothy May, 'The Crypto Anarchist Manifesto, The Anarchist Library (Blog Post, 1988) <<https://theanarchistlibrary.org/library/timothy-c-may-crypto-anarchist-manifesto>>; UK Jurisdiction Taskforce, *Legal Statement on Cryptoassets and Smart Contracts* (Report, November 2019) [41].

⁶ David Fox and Sarah Green (eds), *Cryptocurrencies in Public and Private Law* (Oxford University Press, 2019) 176.

⁷ *Jackson v Stirling Industries Ltd* (1987) 162 CLR 612, 623.

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The rules of each of the state courts⁸ and the Federal Court of Australia⁹ provide for the availability of this type of order in a 'generally harmonised form'.¹⁰ To successfully obtain a freezing order, the plaintiff must demonstrate a good arguable case, and a risk the defendant will dissipate its assets, or the judgment will be unsatisfied.¹¹

Nature of crypto assets can weigh in favour of granting freezing order

Recent common law decisions have shown that the nature of crypto assets can be a factor which weighs in favour of granting a freezing order.

*CLM v CLN*¹² is an interim decision of the High Court of the Republic of Singapore. Proceedings were instituted by the plaintiff to trace and recover 109.83 Bitcoin and 1,497.54 Ethereum (totalling some US\$7,089,894.68 at the relevant time) that were allegedly misappropriated from him by unidentified persons. By way of summons, the claimant sought a proprietary injunction, a worldwide freezing injunction, and ancillary disclosure orders against cryptocurrency exchanges to assist in the tracing of the stolen cryptocurrency and the identification of the person responsible for the misappropriation.

The Singaporean test for the grant of a freezing order is analogous to the Australian test for a freezing order.¹³

Interestingly, the Court considered that the nature of the misappropriated cryptocurrencies was a factor which weighed in favour of granting the freezing order (relevant to the second limb of the test). After discussing the underlying technology in impressive detail, the Court granted the orders sought by the claimant, stating that:¹⁴

the risk of dissipation in the present case is heightened by the nature of cryptocurrency... (which is) susceptible to being transferred by the click of a button, through digital wallets that may be completely anonymous and untraceable to the

8 *Court Procedure Rules 2006* (ACT) rr 740-45; *Uniform Civil Procedure Rules 2005* (NSW) rr 25.10-25.17; *Supreme Court Rules* (NT) r 37A; *Uniform Civil Procedure Rules 1999* (Qld) rr 260-260G; *Uniform Civil Rules 2020* (SA) r 112.14; *Supreme Court Rules 2000* (Tas) rr 937A-937H; *Supreme Court (General Civil Procedure) Rules 2015* (Vic) O 37A; *Rules of the Supreme Court 1971* (WA) O 52A.

9 *Federal Court Rules 2011* (Cth) rr 7.31-38.

10 Adrian Zuckerman et al, *Zuckerman on Australian Civil Procedure* (Lexis Nexis Butterworths, 2018) 395.

11 *Ibid* 396.

12 *CLM v CLN* [2022] SGHC 46.

13 *Bouvier v Accent Delight International Ltd* [2015] 5 SLR 558, [143]-[164]; *CLM v CLN* [2022] SGHC 46, [51].

14 *Ibid* [54].

owner, and can be easily dissipated and hidden in cyberspace.

The Ontario Superior Court of Justice made a similar statement in *Cicada 137 LLC v Medjedovic*, noting in its brief reasons that the 'digital tokens are readily moved by the defendant and are hard to trace... the defendant went to great lengths to conceal his planning, transactions, and identity in carrying out the apparent theft, using numerous different anonymous usernames and addresses'.¹⁵

These decisions do not mean that freezing orders will be granted over all crypto assets in all circumstances. The reasoning of each court related to the particular crypto assets involved in those proceedings and it will not necessarily be applicable to all crypto assets. Businesses and individuals considering similar action must establish that the misappropriated crypto asset is capable of being easily transferred to pseudonymous or anonymous wallet addresses. This should be done by way of expert testimony where possible.¹⁶

The author can foresee a future where there are certain crypto assets to which this reasoning will not apply either due to design or increased government regulation. However, for now, it could generally be said that many of the most popular cryptocurrencies and NFTs can be bought and sold pseudonymously. There are even some cryptocurrencies¹⁷ and crypto exchanges¹⁸ which have been intentionally designed to provide total anonymity and untraceability to their users. This has led to difficulties for investigators.¹⁹

Australian courts recognise this aspect of cryptocurrency²⁰

In *Australian Securities and Investments Commission v A One Multi Services Pty Ltd*, the Federal Court of Australia said that 'by its nature, cryptocurrency is easily transferred and moved about. Moreover, it can be moved only by persons possessed of particular codes'.²¹

15 *Cicada 137 LLC v Medjedovic* 2021 ONSC 8581, [7] ('Cicada').

16 Noting that freezing orders are often sought on an urgent basis which can prohibit the extent of evidence able to be obtained.

17 See for example 'What is Monero (XMR)', *Monero* (Web Page) <<https://www.getmonero.org/getstarted/what-is-monero/>>.

18 See for example, 'Bisq' (Web Page) <<https://bisq.network/>>.

19 For a helpful guide to what information to look for in an investigation regarding cryptocurrencies see Dominic Rolfe, 'Off The Chain: Why Cryptocurrency Smarts are Crucial in Modern Investigations' (2022) 36 *Australian Restructuring Insolvency & Turnaround Association Journal* 17.

20 Note that this article has not considered how crypto assets are treated in criminal and family law proceedings.

21 *Australian Securities and Investments Commission v A One Multi Services Pty Ltd* [2021] FCA 1297, [19].

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Worldwide freezing orders & freezing orders in relation to third parties

It is often the case that freezing orders in relation to crypto assets must be made “worldwide” (meaning that they have an international effect) and in relation to third parties (who are typically either crypto exchanges, or persons in receipt of misappropriated assets). This type of order is necessitated by the fact that litigation involving crypto assets can be cross-jurisdictional in nature.

The freezing order sought in the Singaporean case of *CLM v CLN* (discussed above) was of this nature. In the United Kingdom, the plaintiff in *Fetch.ai v Persons Unknown*²² also sought worldwide freezing orders. These were sought against the first defendants, who were unknown persons (more on this in Part V), and also against Binance, a cryptocurrency exchange registered in the Cayman Islands. As with *CLM v CLN*, the Court granted the orders sought by the plaintiff.

Australian courts can grant freezing orders which either have worldwide application, or are made against third parties (or both).

For third-party freezing orders, the High Court of Australia has stated that it may be appropriate to make such an order in two types of circumstances:²³

- i. the third party holds, is using, or has exercised or is exercising a power of disposition over, or is otherwise in possession of, assets, including claims and expectancies, of the judgment debtor or potential judgment debtor; or
- ii. some process, ultimately enforceable by the courts, is or may be available to the judgment creditor as a consequence of a judgment against that actual or potential judgment debtor, pursuant to which, whether by appointment of a liquidator, trustee in bankruptcy, receiver or otherwise, the third party may be obliged to disgorge property or otherwise contribute to the funds or property of the judgment debtor to help satisfy the judgment against the judgment debtor.

In relation to worldwide freezing orders, Justice Biscoe has explained that there are generally three questions that must be answered:²⁴

- i. Does the court have personal jurisdiction over the defendant? Personal jurisdiction over the defendant is enlivened if the defendant is served in Australia, submits to the jurisdiction of the court, or is properly served outside Australia.
- ii. If so, does the court have jurisdiction to make a freezing order? The court has jurisdiction to make a freezing order against anyone over whom the court has personal jurisdiction.
- iii. If so, are there difficulties of conflict of laws, comity or enforceability, or other discretionary considerations, which affect the decision whether to make the order, or the form that any order should take? Some of the considerations arising in this context include (a) whether the assets were in the jurisdiction at the time the proceedings were commenced (though this is not a precondition for the making of a freezing order over foreign assets), or indeed have ever been within the jurisdiction; and (b) whether judgment has already been given (in which case, an order relating to foreign assets is more likely).

Practical considerations

Practical considerations arise when it comes to the freezing of crypto assets. The exercise can be straightforward if the defendant holds all its crypto assets on public exchanges which adhere to so-called Know Your Client (KYC) protocols. In these circumstances, the exchange can be served

with the orders in the same way a bank can. And even if the exchange does not freeze the defendants accounts entirely in the same way a bank would (in the author's experience, crypto exchanges based in Australia do), then at least there is a mechanism by which transactions made by the defendant can be tracked (and therefore compliance with the freezing order may be verified).

But what if a defendant holds crypto in a cold wallet? That cold wallet is likely to be pseudonymous, identified only by a public key. In these circumstances, a tracing exercise of publicly available blockchain transactions may be able to identify all wallets owned by the defendant (or at least all wallets to which the defendant has transferred cryptocurrency). A search order will likely be necessary to recover possession of any cold wallet. A further issue arises if the defendant has taken steps to hide their

²² *Fetch.ai Ltd v Persons Unknown* [2021] EWHC 2254 (Comm).

²³ *Cardile v LED Builders* (1999) 198 CLR 380, 405-6.

²⁴ Peter Biscoe, *Freezing and Search Orders: Mareva and Anton Piller Orders* (LexisNexis Butterworths, 2nd ed, 2014), 146-7.

cryptocurrency transactions through the use of Monero,²⁵ Bisq,²⁶ Tor, or something similar.²⁷

Ancillary disclosure orders may be of assistance. In *Australian Securities and Investments Commission v Hopkins*,²⁸ the plaintiff sought extensive disclosure orders in relation to cryptocurrencies on the following terms:

- a. all relevant credentials and passwords for access to any cryptocurrency held by the First, Second or Third Defendants, including but not limited to, the public and private access keys and / or seed string for any hot or cold wallet held or controlled by the First, Second or Third Defendants;
- b. any and all authentication devices required to facilitate access, operation or control of any cryptocurrency held or controlled by the First, Second or Third Defendants;
- c. all relevant credentials and passwords for access to the authentication devices or systems, including email, SMS or mobile apps, that facilitate access, operation or control of cryptocurrency held or controlled by the First, Second or Third Defendants; and
- d. any hard wallet device containing cryptocurrency held or controlled by the First, Second or Third Defendants together with that device's access code. Australian courts appear to be satisfied that such orders can be made.

Anecdotally, in the Supreme Court of South Australia, the author recently obtained ancillary disclosure orders on comparable terms to those granted in *Australian Securities and Investments Commission v Hopkins*.

An important consideration when advising clients on the extent to which ancillary disclosure orders will be effective is the privilege against self-incrimination, which may arise in matters involving a fraud.²⁹

²⁵ 'What is Monero (XMR)', *Monero* (Web Page) <<https://www.getmonero.org/get-started/what-is-monero/>>.

²⁶ 'Bisq' (Web Page) <<https://bisq.network/>>.

²⁷ See for example, 'How it Works' Z.cash (Web Page) <<https://z.cash/technology/>>.

²⁸ (Federal Court of Australia, Beach J, 31 May 2022).

²⁹ *Reid v Howard* (1995) 184 CLR 1, 4-5; *Sorby v The Commonwealth* (1983) 152 CLR 281 at 309; *Adelaide Brighton Cement v Burgess* [2018] SASC 134, [12]-[25].

Conclusion

Cryptocurrencies are an increasingly popular vehicle for fraud and other cyber crimes. It is important for business owners to understand the implications of their assets being converted into cryptocurrency and distributed (perhaps) globally in an attempt to obfuscate recovery attempts. Although these technologies are new, our existing legal framework is well equipped to deal with this new technology, and there are remedies available to those who have had assets misappropriated.



MORE INFO

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