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TETHER TANGLE AND BINANCE BREAKS FREE

PIROOZZADEH v Persons Unknown Category A and others [2023] EWHC 1024 (Ch), [2023] 3 W.L.U.K. 723 is the first reported case where a crypto-exchange successfully challenged an interim proprietary injunction. The claimant alleged he was the victim of a fraud and obtained the injunction, but Binance (the eighth defendant in the case) had it discharged. In 2021, the claimant, a Canadian resident, was induced to transfer almost CAD$2 million into two accounts held by the third defendant (purportedly an English company) to enable him to partake in foreign exchange trading on an account he was convinced to open with them. The claimant was subsequently persuaded to increase his trading capital with the third defendant. Consequently, he transferred 870,818 Tether (a type of crypto asset known as a stablecoin whose value is pegged on a one-to-one basis to the US dollar) to four separate crypto asset wallets utilised by the third defendant. In December 2021, the claimant realised he was the victim of a fraud when he could not withdraw funds from his trading account. Reports produced by investigation agents showed that the Tether could be traced from the third defendant's wallets into five others, two of which belonged to Binance. In previous proceedings, the claimant successfully applied to the court for an order without notice to restrain the defendants from dealing with the Tether. The application also included an order requiring the defendant crypto exchanges to preserve the Tether and its proceeds upon its receipt, as constructive trustees.

Piroozzadeh concerned Binance's application to discharge the interim proprietary injunction previously made against it. Binance argued that the application should not have been made without notice and that the claimant's legal representatives failed in their duty of fair presentation. The defendant further made the following four points in support of its application (*Piroozzadeh*, at [9]): the claimant failed to outline the defences likely to be available to Binance regarding its alleged liability as a constructive trustee; the claimant did not explain why there was a sufficient risk of a breach of trust by Binance to warrant an injunction; an explanation of why damages would be an inadequate remedy was not provided; and, finally, the claimant did not give details on how the eighth defendant would be able to comply with the order in practice.

Trower J. initially addressed Binance's complaint that the order should not have been made without notice. He reiterated the established principle that an order should not be made against a party without allowing them to be heard (*Re First Express Ltd.* [1991] B.C.C. 782). While exceptions to this principle exist, such as when notice would cause an injustice to the applicant, urgency alone does not negate the need for notice, as digitalisation generally makes communication easier (at [11]). The judge was unpersuaded by the claimant's argument that the order was properly obtained on an urgent without-notice basis because notifying Binance could have resulted in the inadvertent tipping off of the other defendants. Trower J. emphasised that the failure to give notice to the eighth defendant was compounded in seriousness because the claimant failed in his duty to make a fair presentation of the case at the without-notice hearing as established in *Comdel Commodities Ltd. v Siporex Trade S.A.* [1986] 2 Lloyd's Rep. 428.

The judge subsequently addressed the four points made by Binance in support of its application to discharge the injunction. First, he held that the claimant failed to present potential defences likely to be available to Binance regarding its alleged liability as a constructive trustee during the without-notice hearing. Binance credited its user's account with the value of the Tether, and the actual crypto assets were swept into a central unsegregated pool address (its hot wallet), where they were treated as part of Binance's general assets. Accordingly, the judge asserted that the claimant should have raised the possibility of the defendant being able to rely on a bona fide purchaser defence, and lambasted the claimant's legal representatives for making a "deliberate decision . . . not to disclose a possible defence" (at [38]). Second, as no wrongdoing was alleged against the crypto-exchange, the injunction was not warranted. Trower J. was unconvinced that there was a material risk of the eighth defendant tipping off others and asserted that the need for secrecy was unjustified (at [15]). He did, however, suggest that Binance's lack of regulatory oversight alone did not justify discharging the injunction that was initially granted without notice, when considered in isolation. Third, the claimant failed to explain why damages would be an inadequate remedy. Finally, Trower J. was sympathetic to the eighth defendant's assertion that the claimant failed to expound how the crypto-exchange could practically comply with the order in a situation where the pooling structure it had would render identification of the claimant's Tether difficult, if not impossible. Accordingly, the injunction was discharged.

Trower J.'s decision was no doubt correct; the claimant's counsel omitted to present possible defences that the defendant may be likely to raise (namely the bona fide purchaser for value without notice defence) during the initial hearing (at [38]) and because there was a failure to explain why damages would not be an adequate remedy – a prerequisite for the granting of an injunction. However, in relation to the latter point, it is conceivable that the claimant may have regarded damages to be an inadequate remedy because of Binance's opaque corporate structure, a lack of headquarters (which may crucially make it difficult to enforce a judgment), and on account of Binance's troubled history with the law and regulators. For example, it has been reported that Binance has cancelled its UK registration with the UK's Financial Conduct Authority over money laundering and compliance concerns, it has withdrawn its registration with the Cyprus regulator, citing a focus on fewer European districts as the EU's new Markets in Crypto Assets (MiCA) regulation was enacted, and its founder, Changpeng Zhao, and the US arm of Binance are facing a lawsuit from the US's Securities and Exchange Commission (S. Handagama and J. Crawley, "UK Financial Watchdog Cancels Binance Permissions on Firm's Request", available at https://www.coindesk.com/policy/2023/06/19/uk-financial-watchdog-cancels-binance-permissions-on-firms-request/). Binance's strained relationship with regulation is unsurprising given the libertarian ideals pervading the crypto realm. It may prove to be helpful for judges to be kept abreast of occurrences and ideologies permeating the crypto realm (as it is in its nascent phase of development) as it may assist to provide a more nuanced solution for claimants and understand the practical workings and challenges within the arena.

Piroozzadeh raises interesting questions concerning proprietary rights and remedies available to claimants who have been the victims of crypto-fraud. According to Binance, when an individual deposits crypto assets at its address, the user's account is credited with the deposit amount; the user can then draw against any credit balance (*Piroozzadeh*, at [8]). The crypto assets are transferred into a central unsegregated pool address referred to as a "hot wallet", where they are treated as part of Binance's general assets; they are not specifically segregated to be held for the sole benefit of the user from whose account they have been transferred (*Piroozzadeh*, at [8]). On the basis of this structure, Trower J. erroneously accepted (obiter) the defendant's argument that "the user does not retain any property in the Tether deposited with the exchange" (*Piroozzadeh*, at [8]). Such an assertion is problematic because the account holders ought arguably to have property rights in relation to the crypto assets held by Binance that are credited to the users' accounts, which would be reflected on Binance's internal ledger (*Ruscoe v Cryptopia Ltd. (in Liquidation)* [2020] NZHC 728).

It was further accepted that because all the "claimant's" Tether in question was allocated into one of two wallets and, given that there have been very many transactions through each of the hot wallets which were operating as a central pool, it was a "close to impossible and possibly impossible exercise" (*Piroozzadeh*, at [8]) to trace the assets several months later. This assertion is unconvincing. A hallmark of crypto assets is traceability – they can be tracked as they move across different addresses. A "mixed fund" of crypto assets ought to give rise to significantly fewer problems than a "mixed fund" of cash, which may result in the claimant's money becoming unidentifiable (*James Roscoe (Bolton) Ltd. v Winder* [1915] 1 Ch. 62).

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Property rights in crypto assets cannot cease to exist simply because they have been transferred elsewhere. The implicit suggestion that transferring crypto assets to an exchange's hot wallet extinguishes claimants' property rights due to the difficulties of tracing the assets is troubling. Since most crypto exchanges operate similarly to Binance, on this analysis, claimants would find it nearly impossible to access remedies, as exchanges pool assets in their own wallets and credit user accounts. This would be categorically an undesirable outcome. This can be avoided, however, if crypto exchanges are treated as trustees but not as analogous to banks. Unlike banks, they lack extensive regulatory oversight, and are not neutral institutions – rather, their listing decisions impact the trajectory of crypto assets.

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