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The court considers cryptocurrency to be “property” under Hong Kong law for the first time

Richard Hudson and Judy Wu

The judgment given by the Honourable Justice Linda Chan on 31 March 2023 in *Re Gatecoin Limited* [2023] HKCFI 914 gave detailed consideration for the first time in Hong Kong to the question of whether cryptocurrency is “property”. The decision is noteworthy as it is likely to have an impact in a number of legal areas.

Background

Gatecoin Limited (Gatecoin) was a Hong Kong company which operated a cryptocurrency exchange platform. Gatecoin was wound up by the court, and joint and several liquidators were appointed in 2019. The liquidators applied under section 200(3) of the Companies (Winding up and Miscellaneous Provisions) Ordinance (Cap. 32) (CWUMPO) for directions in relation to various issues, including the characterisation of cryptocurrencies held by Gatecoin, and whether the cryptocurrencies were held on trust by Gatecoin for its customers and thus were not assets available to satisfy unsecured creditors’ claims.

Issue 1: Whether the cryptocurrencies were held on trust by Gatecoin for the benefit of its customers

The liquidators identified the following 3 sets of terms and conditions which were in force during various periods of Gatecoin’s operation:

1. 2016 T&C: from January 2015 to November 2016;
2. Trust T&C: from November 2016 and March 2018; and
3. 2018 T&C: from March 2018 to March 2019.

The court held that the question of whether the cryptocurrencies were held on trust by Gatecoin for the customers should primarily be determined by construing the terms of the 2018 T&C. The earlier versions had no application, after customers who had originally used Gatecoin’s platform pursuant to the 2016 T&C and Trust T&C, accepted and agreed to the 2018 T&C, which they were deemed to have done when they accessed and used the platform after March 2018. There were no provisions in the 2018 T&C which had the effect of creating a trust. On this basis, the court ruled that no trust was formed from a contract law perspective.

The court also reached the same conclusion from a trust law perspective: whilst the court was satisfied that there was sufficient certainty of subject matter and certainty of object to allow for the creation of a trust, the court held that there was no intention to create any trust for the customers under the 2018 T&C, as it was clear from the 2018 T&C that cryptocurrencies were not held on trust by Gatecoin.

The court accepted that customers who had never accessed the platform after the 2018 T&C came into force may have their cryptocurrencies held on trust. The liquidators have been tasked with determining whether any customers fall into this category.

Issue 2: Whether cryptocurrency is “property”

Section 197 of the CWUMPO imposes an obligation on a liquidator to take into custody all “property” of the company. However, the meaning of “property” was not defined in the CWUMPO, and section 3 of the Interpretation and General Clauses Ordinance (Cap. 1) is unhelpful as the meaning of property is very wide in scope.

In considering whether cryptocurrency is property, the court took note of past cases in Hong Kong whereby interlocutory proprietary injunctions over cryptocurrencies were granted without any party suggesting that cryptocurrencies were not “property”. The court also looked at cases from other jurisdictions, such as England and Wales, Singapore and Australia that considered the nature of cryptocurrency, and agreed with the following reasoning in the New Zealand decision of *Ruscoe v Cryptopia* [2020] NZHC 728 which held that cryptocurrency is property:

1. Cryptocurrency is definable as the public key allocated to a cryptocurrency wallet, is readily identifiable, sufficiently distinct and capable of being allocated uniquely to individual accountholders;
2. Cryptocurrency is identifiable by third parties in that only the holder of a private key is able to access and transfer the cryptocurrency from one wallet to another;
3. Cryptocurrency is capable of assumption by third parties in that it can be and is the subject of active trading markets; and
4. Cryptocurrency has some degree of permanence or stability as the entire life history of a cryptocurrency is available in the blockchain.

Conclusion

The decision is a welcome one, as it brings Hong Kong’s jurisprudence in line with other major common law jurisdictions on this point. It also gives clarity on how to treat cryptocurrency during insolvency situations and in the rising number of fraud cases involving cryptocurrency: for example, cryptocurrency can be the subject of an injunction. The question of whether an exchange holds cryptocurrency on trust, however, is a matter of contractual interpretation on a case by case basis.

Series on Hong Kong /Mainland Cross-Boundary Marriages – Third party interests in family proceedings

Sherlynn Chan and Rachael Leung

Deacons’ Family Practice is at the forefront of handling issues related to cross-boundary marriages. In light of the new Mainland Judgments in Matrimonial and Family Cases (Reciprocal Recognition and Enforcement) Ordinance (Cap.639), we have prepared a series of articles on Mainland/ Hong Kong cross-boundary matrimonial matters and have invited Mainland lawyers to share their views.

In this 5th article, we will discuss how the Hong Kong and the Mainland Courts will handle disputes of ownership of property in divorce proceedings between the couple and a third party.

“My husband and I are going through divorce and he is now claiming an interest in a property which I am holding on trust for my parents. My parents funded the purchase of the property and I did not make any financial contribution. My husband is arguing that my parents purchased the property as a gift for me.”

In Hong Kong, when disputes over the ownership of properties arise in divorce proceedings, parties can apply to the court to have it first adjudicated as a “preliminary issue”, before proceeding with their underlying claim for financial relief. The relevant third party - usually the parent, sibling or relative of a spouse - may intervene or be joined as a party to the proceedings.

In *LLC v LMWA*¹, the Court of Appeal identified 2 types of cases. In cases where a third party is the legal owner or one of the legal owners of a disputed property, he/she should be joined as a party to the proceedings because the court may make an order requiring him/her to transfer the property or subject the property to an encumbrance.

For cases where a spouse claims that the third party has a beneficial interest in a property legally held under the spouse's name, that third party should be notified of the claim and is at liberty to decide whether to join in the proceedings or not. If the third party decides not to join, he/she will be bound by the judgment.

When determining whether the beneficial ownership of a disputed property should deviate from the legal ownership, the court will consider factors such as:-

- The purpose of the purchase;
- The reason the property was purchased in the name(s) of the legal owner(s);
- The financing arrangements of the purchase, for example, who paid for the down payment, estate agency fee and legal costs, in whose name was the mortgage obtained, and who serviced and/or redeemed the mortgage; and
- Pre- and post-purchase conduct.

Having said that, whilst the court may give directions for a trial of preliminary issues should the need arise, it does not mean that the parties must go ahead with the trial because it “*can be disastrously expensive, substantially increase the financial burden on the parties and unduly prolong the resolution of the ultimate issue which is the fair distribution of matrimonial assets.*”² Instead, all interested parties, including the third party, should proactively explore whether they can resolve their dispute by way of alternative dispute resolution methods, such as mediation.

For similar disputes in the Mainland, **Ms WANG Hao, family and private client specialist and senior partner of Rayyin & Partners P.R.C. Lawyers**, has the following to share:-

“In Mainland China, when there is a dispute on property ownership in divorce proceedings, it is necessary to consider various factors, such as the registration status of the property, the nature of the investment, and the timing of the purchase (i.e. whether it was purchased before or after the marriage). Under the premise that the legal system of matrimonial property in Mainland China is a communal system of matrimonial property, property acquired by one of the spouses after marriage is in principle the communal property of the spouses. However, property acquired by one of the spouses through inheritance or gift, and which is determined in a will or gift contract to belong to only one of the spouses, is the personal property of one of the spouses. When handling such disputes, The People's Courts in the Mainland usually conduct mediation with the parties first, and if mediation fails or the parties have no intention to mediate, the court will then adjudicate on the matter.”

In practice, when a divorce involves properties “purchased” by parents for their children, it is first necessary to determine the nature of the investment made by the parents. The Mainland courts will first determine whether the funds contributed by the parents were in the nature of a loan or a gift. If the funding is considered to be a loan, it shall be handled in accordance with the relevant provisions of the civil law on loans. If the funding is considered to be a gift and the property is registered in the name of either one or both spouses, but one party claims that the property was purchased by his or her parents, then it is critical to look at the timing of the purchase. According to the Interpretation (I) of the Supreme People's Court on the Application of the “Marriage and Family” Book of the Civil Code of the People's Republic of China:

1. *If a spouse's parents purchased a property for him/her before marriage, the investment shall be treated as a personal gift to their children, except in situations where the parents have made it clear to both parties that the property was purchased as a gift for them.*
2. *If a spouse's parents purchased a property for him/her after marriage, then it shall be determined in accordance with their own agreement; however, if there is no agreement amongst them or the agreement is unclear, then the property shall be regarded as a marital asset jointly owned by the spouses, unless the parents are able to produce sufficient evidence to show that the purchase was made solely for the benefit of their child.*

However in many cases, parents and their children seldom enter into any formal gift contract, given their close relationship and the unique Chinese traditional family culture. Accordingly, whether the parents have made a gift to their children is often a point of contention during a divorce. Usually in cases where one party's parents provide full funding and register the property in the name of their child, the Mainland court will consider that as a gift from the parents to their child. Given the complicated nature of such disputes, parties should specify the nature of their parents’

¹ [2019] HKCA 347, paragraph 25

² [2019] HKCA 347, paragraph 38

investment and property ownership by way of an agreement at the time of purchase or shortly after to minimize the occurrence of such disputes in the future.”

Our Family Law team at Deacons is experienced in handling matrimonial and family matters involving cross-boundary elements. Please reach out to us if you would like to know more.

The court’s approach to assessing evidence for defences in email fraud cases

Genevieve Lam

Email scams are very common nowadays. During the first quarter of 2023, the Hong Kong police intercepted nearly HK\$160 million stolen from overseas victims of technology-based crime and deception cases deposited into local bank accounts. Tracing and recovering becomes challenging in multiple layered scam cases.

In a recent large-scale fraud case, *Toyota Boshoku Europe NV v Kingsville (HK) Enterprises Limited & Others* [2023] HKCFI 1393, the High Court scrutinized evidence to determine whether the proprietary and *Mareva* injunctions should be continued.

Facts

The Plaintiff was a victim of a large-scale fraud, in which approximately HK\$500 million was paid to various companies as a result of unknown individual(s) impersonating the CEO and President of the Plaintiff’s parent company, and causing the Plaintiff’s general manager of finance to believe that the funds were required for a secret and urgent acquisition.

The Plaintiff had already obtained interlocutory proprietary and *Mareva* injunctions against 48 defendants, which comprised of 1st, 2nd and 3rd layer recipients in another action.

Subsequently, the Plaintiff in this action traced the proprietary funds against the next layer recipients of its funds and sought to continue the proprietary and a “top up” *Mareva* injunction against the 8th defendant (Defendant) which received traceable proprietary funds of around US\$274,000 in August 2019. The Defendant opposed the continuation of the injunction.

The court examined each of the defences put forward by the Defendant:-

- (A) it is a bona fide recipient of the funds through a transaction conducted in its wholesale wine business; and/or
- (B) it has so changed its position by making part payment for wine purchased from its supplier that it would be inequitable in all the circumstances to require it to make restitution.

Bona fide purchaser without notice

As to the proper approach to assess whether the purchaser is a bona fide purchaser without notice, the court held that the transactions cannot be looked at in isolation, but rather in the more structured context of the running of a legitimate business generally, whether the particular line of business in question is legitimate (in the present case, trading in wine) and the specific transactions involved.

The court examined four matters relied on by the Defendant in support of its legitimate operation of a wholesale trading business:-

1. the bank accounts for the Defendant’s business and relevant bank statements,
2. the container yard lease;
3. employees’ MPF records; and
4. 2 years of accounts in 2018 and 2019.

However, based on the evidence, it appeared that the Defendant was carrying on a wholesale trading business in frozen meat. The court held that it did not follow that it would automatically legitimise its trading in wine.

Further, the court raised a number of red flags as to the legitimacy of wholesale trading of wine, such as:-

1. There was no explanation as to why the Defendant suddenly branched out into the wine trade, when the Defendant's sole director did not provide any evidence of knowledge and experience in that field;
2. The Defendant did not maintain a log or chronological record of incoming orders for wine for accounting purposes;
3. The Defendant did not appear to maintain records of its customers, be they repeat or one-off customers;
4. The invoices in question specified the name of the purchaser, but without any address or contact number;
5. While the invoices contained important information (such as the name of the beneficiary and details of the bank account into which payment should be made), the court observed that the terms of payment were nowhere specified.

In conclusion, the court held that the Defendant was not carrying on a bona fide business of wholesale trading in wine.

Change of position in good faith

The Defendant's alternative defence was that it had altered its position in good faith since receipt of the funds in that the funds had been applied in partial payment for the wines the Defendant ordered in July 2019.

However, the court held that the Defendant only made a payment in the ordinary course of business, which did not come within the defence of a change of position, as it failed to show that as a result of receiving the funds, it engaged in some extraordinary expenditure, bearing in mind that the Defendant's liability for the July order had already arisen before it received the funds in August 2019.

The court ultimately ordered that the injunction be continued.

Comment

This judgment reaffirms the court's approach to scrutinising evidence in multiple layered fraud cases and willingness to grant and continue proprietary and *Mareva* injunctions to assist victims of cyber fraud to trace assets.

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