

ZI WANG V GRAHAM DARBY [2021] EWHC 3054 (COMM)

I. SUMMARY

Stephen Houseman QC partially granted the Defendant's reverse summary judgment application ruling that contracts under which the parties had agreed a reciprocal cryptocurrency swapping structure did not give rise to the existence of a trust. The Judge also set aside the Claimant's proprietary injunction application but upheld its application for the continuation of a worldwide freezing order against the Defendant. An application to vary the terms of the freezing order was stood over for a subsequent hearing.

Notably, this was the first contested hearing in this jurisdiction dealing with the question of whether a trust existed over cryptocurrency.

II. BACKGROUND

The Claimant, Mr Wang, is an Australian national who has been a cryptocurrency trader for several years. The Defendant, Mr Darby, is a UK national who is also a cryptocurrency trader and operates an extensive web of digital accounts/ wallets.

The Claimant and the Defendant traded cryptocurrency with one another; specifically, Bitcoin and Tezos.

Persons may make money trading cryptocurrencies or by "mining" them, which is known, in Tezos's case, as "baking". Baking generates rewards for the "baker" in the form of additional tokens credited by the global issuer.

A holder of Tezos may delegate their rights to another Tezos holder for "baking". This is known as "staking" (or "farming" in other crypto contexts) and is done by private arrangements between Tezos holders.

The dispute between the parties concerns two related contracts for the exchange of Bitcoin and Tezos and the baking of Tezos by the Defendant on the Claimant's behalf with profits to be shared: [23-45]

1. **Contract 1:** The first contract was entered into on 28 December 2018 (*Contract 1*). Under Contract 1 the Claimant transferred 200,000 Tezos to the Defendant in exchange for 13 Bitcoins. The parties were to restore (or swap back) the currency to one another after a minimum two-year period.
2. **Contract 2:** The second contract was entered into on 24-25 January 2019 (*Contract 2*, together with Contract 1, the *Contracts*). Under Contract 2, the Claimant transferred a further 200,000 Tezos to the Defendant in exchange for 17 Bitcoins. As with Contract 1, the parties were to restore the currency to one another after a minimum two-year period.

The Contracts were concluded on an online communications platform called Telegram which the parties used to communicate.

During this two-year period the relationship between the parties soured. In March 2019, when the value of Tezos started to rise, the Defendant informed the Claimant that he was going to cease "baking" and proceeded to trade the 400,000 Tezos for his own gain.

The Claimant viewed this as a repudiation of the Contracts and demanded compensation. The Defendant blocked the Claimant from messaging him on Telegram.

On 15 February 2021, the Claimant contacted the Defendant on another device and asked for the return of the 400,000 Tezos. The Defendant blocked the Claimant again and did not return any Tezos to him.

III. THE APPLICATIONS BEFORE THE COURT

The hearing was for three discrete applications [3]:

1. An application by the Defendant to strike out or enter reverse summary judgment of proprietary claims relating to the 400,000 Tezos (the *SJ Application*);
2. An application by the Claimant to continue a worldwide freezing order (*WFO*) and proprietary injunction (together, the *Injunction Order*) granted by HHJ Pelling QC at a without notice hearing on 2 August 2021 (the *WFO Continuation Application* and *PI Continuation Application*); and
3. A second application by the Claimant seeking to vary the terms of the WFO as regards the Defendant's expenditure allowance which was necessarily contingent on the success of its first application (the *WFO Variation Application*).

IV. THE FINDINGS OF THE COURT

(i) *SJ Application*

The SJ Application concerned proprietary claims by the Claimant relating to (a) the assertion by the Claimant of a trust over the 400,000 Tezos transferred under the Contracts to the Defendant; and (b) the Claimant's allegations that the Defendant was in breach of trust/ his fiduciary duties by failing to return to him the 400,000 Tezos.

(a) *Trust claims*

The Claimant pleaded that there was an express, Quistclose-resulting or constructive trust in respect of the 400,000 Tezos he transferred to the Defendant.

Although the parties agreed that Tezos constitutes property which can, in principle, be the subject of a trust, the Defendant considered the claim as to the existence of a trust had no real prospect of success.

The Court considered that whether or not a trust exists over the 400,000 Tezos was to be determined by examining the transaction structure. It held that no trust had arisen over the 400,000 Tezos for, *inter alia*, the following reasons:

1. The fundamental problem with the existence or imposition of any kind of trust over the 400,000 Tezos was the “*essential economic reciprocity of the transactions*”. In order for the Claimant to become entitled to the return of the 400,000 Tezos, he was required to return “*corresponding value in [...] Bitcoins*” to the Defendant. The “*essential economic reciprocity*” of this arrangement precludes the existence of any trust. [78]

2. The Claimant could identify no case in which a beneficiary under a trust was “*obliged to transfer [...] economic value to the trustee in order to obtain the trust property.*” Rather, a beneficiary “*has an interest in and right to receive the trust property, not an option to (re-)acquire it for value.*” This “*transactional element*” is “*inimical to the concept of a trust*”. [79]
3. The pleaded characterisation of the Claimant’s restoration obligation as one of sale or purchase back was “*fatal to any trust analysis*” given each sale/purchase transfers full title from transferor/seller to transferee/purchaser. This structure is “*anathema to the existence of a trust*”. [81]
4. The Claimant accepts that the transfer of Bitcoins to him from the Defendant was a full transfer of ownership. A trust over the 400,000 Tezos would therefore impose asymmetry in this reciprocal capital-swapping arrangement. [82]
5. A trust over the 400,000 Tezos was not necessary to give effect to the parties’ legitimate expectations or commercial interests, in the sense that they are sufficiently served by the existence of personal rights and obligations. [85]
6. The fact that the parties used possessive or proprietary language at times to describe the 400,000 Tezos does not determine the legal characterisation of the transactions. [86]
7. With respect to the assertion of a Quistclose-resulting trust, the Court noted that no case has been identified in which such a trust has been considered to have arisen over property transferred as part of reciprocal exchange of assets and on terms whereby its re-transfer was expressly conditional upon a reciprocal re-transfer of value from beneficiary to trustee. [91]
8. With respect to the assertion of a constructive trust, the Court noted that while a constructive trust can arise when a specifically enforceable contract of sale is concluded (e.g. for land), such that beneficial ownership passes to the buyer and the seller is constituted a trustee on behalf of the buyer pending completion, it was “*impossible to say that the Defendant’s conditional obligation to return 400,000 Tezos after the minimum contractual period would be enforceable by decree of specific performance given the entirely fungible and non-identifiable nature of such digital currency.*” [92]

The Court concluded that the claim that the 400,000 Tezos were subject to either an express, Quistclose-resulting or constructive trust had no real prospect of success and that there was no other compelling reason for it to proceed to trial. The proprietary claim based on the existence of a trust was therefore dismissed.

The Judge did, however, observe obiter that the unilateral transfer of digital assets from one account holder to another for the purposes of baking or stake bonding could theoretically result in the creation or imposition of a trust on different facts. However, this would “*depend on all the circumstances*” including whether “*a loan or sale was the more appropriate characterisation to give effect to the parties’ commercial objectives*”. [89]

(b) Fiduciary duties

The Claimant claimed equitable compensation and an account of profits for breach of trust/ fiduciary duties.

The claim for equitable compensation was for three heads of loss: (i) loss of the value of the 400,000 Tezos; (ii) loss of baking rewards; and (iii) loss of opportunity to earn third party baking profits through stake bonding. The claim for an account of profits concerned the failure to account for any baking rewards or stake bonding profits or any profits the Defendant made from trading the 400,000 Tezos.

The scope of the Claimant's pleaded case was unclear from the Particulars of Claim and the Judge considered that the alleged breach of trust/ fiduciary duties may refer to (i) a claim for *breach of trust* which is necessarily contingent on the prior establishment of a trust (whether express, Quistclose or constructive) over the 400,000 Tezos; or (ii) a claim for *breach of fiduciary duties* which arose simply from the "*nature and terms of the contracts*".

The Judge read the pleaded claim as referring only to (ii) and held that "*such [a] claim if properly pleaded could have a real or reasonable prospect of success.*" [97]

However, the Judge also held that if he was wrong about his interpretation of the Claimant's pleaded case and it in fact referred to (i), such a claim would have "*no real or reasonable prospect at trial*" as it would, given his conclusion as to the non-existence of any trust, amount to "*the imposition of trustee duties in the absence of a trust*". [96]

(ii) WFO Continuation Application

The Court determined the WFO Continuation Application by reference to the principles, set out in *Lakatamia Shipping Company Limited v Morimoto* [2019] EWCA Civ 2203 at [34].

The determinative issue as to whether to grant an Order for the continuation of the WFO was whether there exists a real risk of unjustified dissipation of assets by the Defendant that might render enforcement of any future judgment against him more difficult.

The Court determined that the continuation of the WFO should be granted for, *inter alia*, the following reasons:

1. The position had become more difficult for the Defendant since the WFO was first granted as a result of (i) his incomplete asset disclosure pursuant to the Injunction Order, (ii) his own evidence served since that date; and (iii) the expert evidence demonstrating that the Defendant holds substantial quantities of Bitcoins worth far in excess of his disclosed net worth. [102] and [103]
2. Following the Claimant's demand for compensation from the Defendant after he admitted that he had ceased to "bake" Tezos, the Defendant proceeded to trade the 400,000 Tezos for his own. The trading profit he made was at the expense of the Claimant in so far as he was under an obligation to seek to generate baking rewards or stake bonding profits for the Claimant's benefit from the 400,000 Tezos. [104] and [106]
3. The Defendant must have appreciated that by ceasing to bake and trading the 400,000 Tezos, "*he was not honouring the spirit or purpose of the swapping*

transactions.” The Judge held that “whether or not this was dishonest [...] it was manifestly arguably dishonourable or commercially colourable behaviour.” [104]

In light of these factors, the Court found that “*there is, at least, a real risk of unjustified dissipation by [the Defendant] if not restrained by continuation of the WFO [...] The grant and continuation of such relief is and remains just and convenient in all the circumstances.*” [108]

V. DISPOSAL OF THE APPLICATIONS

In light of the above, the Court disposed of the applications as follows [109]:

1. The SJ Application was granted save for the pleaded claim for equitable compensation and account of profits based upon alleged (dishonest) breach of fiduciary duty independent of the existence of any trust.

The Claimant’s proprietary claims were struck out, save in so far as a viable claim can be maintained for a constructive trust in respect of any direct or indirect gains made the Defendant (by baking, stake-holding or trading the 400,000 Tezos) and not accounted for by him to the Claimant.

2. In light of (1) above, the proprietary injunction contained in the Injunction Order was set aside. The PI Continuation Application will be heard subsequently and will provide an opportunity for the Claimant to persuade the Court that a proprietary injunction is appropriate in some form by reference to any viable residual claim for constructive trusteeship as outlined in (1) above.
3. The WFO Continuation Application was granted on the basis of the personal claims made against the Defendant such that the WFO will continue until further Order of the Court.
4. The WFO Variation Application will be heard subsequently in light of (3) above.