

Misselling Cryptoassets

Helen Pugh, Outer Temple Chambers

On 6 April 2022 cryptocurrency exchange Binance announced a “safe and happy” lending program whereby customers would stake Terra USD coins for a yield of 20%. The following month Terra USD and then its sister token, Luna, collapsed in one of the biggest crypto crashes of all time, losing nearly \$40 billion. Unsurprisingly that has triggered an avalanche of lawsuits against Binance for alleged “mis-selling” of Terra USD. As crypto and digital assets proliferate and gain in mainstream popularity, it is likely that incidences of mis-selling will only rise. This article outlines the types of mis-selling claims which we expect to see in the coming months and years.

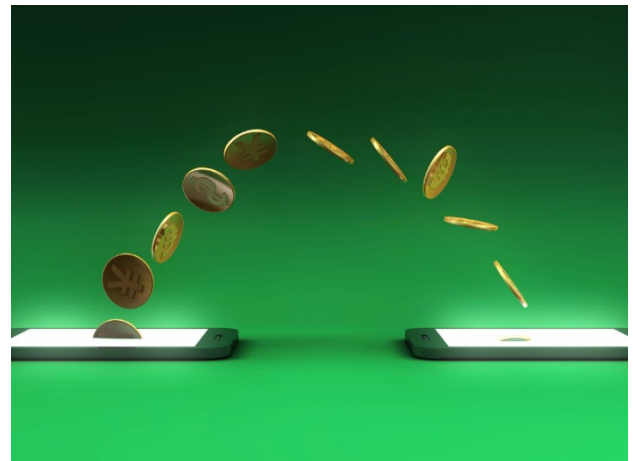
Three categories of claims

1. Misstatement/ misrepresentation claims
2. Professional negligence; and
3. Regulatory claims.

Misstatement and Misrepresentation Claims

Crypto-crashes on the scale of the recent Terra USD and Luna collapse will undoubtedly fuel an upswing in classic misstatement or misrepresentation claims, those claims brought in tort or contract (or both) against a representee for false statements.

To date fraud has featured heavily in the crypto-related claims issued in the High Court. Whilst deceit is usually viewed as a more difficult cause of



action than negligence, many of the cases so far seem to feature patent incidences of fraud, such as the theft of NFTs in *Osbourne v Persons Unknown* [2022] EWHC 1021 (Comm) and the failure to return control of bitcoin in *Ellis v Digit Europe Ltd* (unreported). In the latter case the claimant alleged that he had been duped by fraudsters purporting to run portfolio management services in cryptocurrency. With UK Police reporting that victims lost more than £146m in Q1-3 of 2021, there is no doubt that these claims will continue to feature in the High Court future.

However, in the fast-moving and often poorly understood crypto-sphere, it is also likely that negligent misstatements will be common place. The Binance example above is a good example of this type of claim which may be tortious or, if it results in a contract with the representee, contractual with a parallel claim in tort. The usual legal requirements of such claims will need to be made out. A key hurdle in non-contractual cases will be establishing a duty of care was owed by the representee. This is likely to be relatively easy in two-party advisory cases. Conversely it is likely to be more difficult to establish in cases of public statements, such as the celebrity endorsements – including a deluge during the 2022 Super Bowl or “Crypto Bowl” - which have come in for criticism from regulators. Whether Paris

Hilton can be sued for “mis-selling” cryptocurrencies by naming her dogs ‘Crypto Hilton’ and ‘Ether Reum’ will nonetheless hopefully be tested by some enterprising US citizen.

Professional Negligence Claims

It is inevitable that the English courts will see an increase in professional negligence claims with a crypto dimension. Claims are likely to include actions against auditors failing to apply adequate care and skill in relation to the treatment and assessment of their client’s crypto transactions or accountants failing to advise correctly on tax treatment of digital assets, claims against financial advisors recommending investment in ‘safe’ unstable coins, or claims against legal advisors for negligent advice on tax or other matters in relation to digital assets.

Some professions have already taken some steps to provide guidance on the application of their existing standards to cryptoassets. In June 2019 the IFRS set out its view on the applicability of IAS 2 ‘Inventories’ and IAS 38 ‘Intangible Assets’ to holdings of crypto assets. HMRC has published a cryptoassets manual setting out HMRC’s view of the appropriate tax treatment of cryptoassets which almost certainly any tax lawyer should have regard to.

Whilst existing professional standards can be adapted and applied to cryptoassets and businesses to a large extent, there will probably continue to be uncertainty amongst professionals as to the practical implementation of those standards for some time to come. It is likely that much of that uncertainty will only be alleviated by professional bodies adopting specific standards or caselaw (e.g. on taxation) or a combination of the two.

Regulatory Claims

In January 2022 Kim Kardashian was amongst a trio of celebrities sued in a US class action for alleged involvement in a “pump and dump” scheme whereby misleading marketing is said to have been used to inflate the price of EthereumMax which was then sold to naïve investors at a profit. It has been described by the head of the FCA, Charles Randell, as possibly a “financial promotion with the single biggest audience reach in history.”

Many factual scenarios giving rise to the classic misstatement claims and/or professional negligence claims will also have regulatory overlays. By virtue of section 26 of the Financial Services and Markets Act 2000 (“FSMA”) an agreement made by an unauthorised person carrying on a regulated activity (and so in breach of the general prohibition in section 19) may be unenforceable against the other contracting party. By virtue of section 27 this may also be the case if the contract was entered into with an authorised person but as a result of a third party’s unauthorised regulated activities (e.g. a financial intermediary). Private persons (that is, for most practical purposes, a definition covering individuals rather than corporate entities) may also have a right to damages where an authorised person has contravened the FCA’s rules pursuant to section 138D of FSMA.

However, there is no quick answer to whether a cryptoasset is regulated or whether an activity carried out in relation to that cryptoasset is a regulated activity or other questions relating to the FCA’s regulatory perimeter. The FCA’s own view on the extent to which different tokens are likely to fall within its current regulatory perimeter is set out in its non-handbook cryptoassets guidance. That regulatory perimeter is also likely to increase if the Finance Bill is enacted (see article on the Finance Bill by OTC’s Joshua Hitchens).

Conclusion

As crypto and digital assets proliferate, so too will claims. The privacy feature peculiar to many blockchain transactions and cryptoassets is fiercely defended by those with legitimate interests in privacy, but it undoubtedly will provide fertile ground for fraudulent actors giving rise to deceit claims. The complexity and novelty of crypto assets, and the complexity of the FCA regulatory perimeter, will also likely fuel an increase in negligent misstatement, professional negligence and FSMA claims. With in-house teams specialising in crypto-related claims specifically, and with crossover expertise in professional negligence and financial services and regulation, OTC look forward to remaining leaders in this developing field.