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TECHNOLOGY/CRIME

Congratulations, you've been served – over the blockchain

The judgments pave the way for New Zealand courts to make orders in relation to service and freezing of funds on the blockchain

Diana Clement

Courts in Britain and US have made legal history by allowing documents to be served on defendants over the blockchain ledger by a non-fungible token (NFT) in a bid to stop unidentified crypto asset thieves in their tracks.

It's the first time the courts have allowed service in this way – specifically, in these instances, because the identities and jurisdictions of the defendants were unknown and this was the only way service could be effected.

In both cases, NFTs were air-dropped on the crypto wallets holding the stolen currency. By accessing the wallets, the criminals were deemed to have been served and the contents of the wallets frozen.

The judgments pave the way for New Zealand courts to make orders in relation to service and freezing of funds on the blockchain.

Blockchain is a distributed database – a giant digital ledger – that stores copies of blocks of information electronically in a digital format across every computer on the network. Crypto transactions are recorded in that way, meaning that copies of the blocks are distributed right across the network. Importantly for the law, **those records**

are immutable.

So, blockchain offers the secure transfer of ownership, value, title and money and does it instantly. Many believe it has the potential to revolutionise global payments systems by cutting out third parties such as banks.

Service over the blockchain in New Zealand is only a matter of time, says James Cochrane, a partner at Stace Hammond. The New Zealand courts have already allowed substituted service via email and social media and the move in the UK and US courts have shown that service via the blockchain may be more effective than personal service, he says.

Even within the existing rules, it's possible here in New Zealand, says MinterEllisonRuddWatts partner Sean Gollin. However, Rule 6.8 of the High Court Rules 2016 might need updating to make it more effective.

The cases

In both the UK and US cases, crypto hunters on behalf of the victims were able to track the stolen funds as the

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assets passed from wallet to wallet on the blockchain, and even through crypto laundering processes that mix the funds in a tumbler.

In the case of *D'Aloia v Person Unknown & Ors* [2022] EWHC 1723 (Ch) (24/6/22) in the England and Wales High Court, tech entrepreneur Fabrizio D'Aloia, the founder of an online gambling company, had about 2.1 million Tether tokens and 230,000 USD Coins stolen. He was conned into moving money to a professional-looking website he thought was connected with TD Ameritrade, an online stock trading platform. It wasn't, and the thieves started moving the money from wallet to wallet, hoping it could not be traced.

D'Aloia employed crypto detectives to trace his stolen funds across the blockchain to wallets on Binance and other digital exchanges.

The UK court then permitted D'Aloia to serve unknown persons with the proceedings by way of air-drops of NFTs onto the wallets holding the misappropriated funds. The assets in those wallets could then be frozen even though the identity of the owners was not known.

Cochrane says the freezing was able to happen because Binance controlled the keys to the wallet and who could move the money in and out.

Air-dropping the NFTs on the wallets was particularly novel, embedding the service in the blockchain. Because of the verifiable record on the blockchain, the owners of the wallets holding the stolen cryptocurrency **could not argue that they had not been served**.

Gollin says once the NFT is air-dropped to the wallet containing the stolen funds, and that wallet has been accessed, then the service is deemed to have been brought to the attention of the person or persons controlling it.

Janine Grainger, co-founder and chief executive of New Zealand's Easy Crypto exchange, says service by NFT is fascinating and makes a lot of sense.

"[The courts] don't know the identity of the owner of that wallet, but they can see that the wallet has funds sitting in it," says Grainger. "It's like you're serving directly to the stolen funds themselves."

The overseas examples highlight the benefits of the blockchain being tamper-proof, Cochrane says. "You know that someone has been served. It's not a matter of them saying, 'Oh, it got lost in the post', which is the reason you serve someone by personal service by handing the



documents to them.

"And my view is that in the future, we will see the centralised entities having more regulation on them, because I think there will be an incentive for decentralised protocols to build in a way that is compliant with regulation."

As a result of the order, D'Aloia has been able to secure some of the stolen funds that were stored on the Coinbase platform, Cochrane says. The blockchain may be anonymous "but the downside for someone who wants to be nefarious is that the blockchain itself is open and transparent. You don't necessarily know who [owns] the wallet. But you can see where the funds go. That's the beauty of the blockchain."

The other case, *LCXAG v John Doe Nos 1-25* (2/6/22) involved theft of almost \$US8 million of virtual assets on the Ethereum blockchain. The New York Supreme Court authorised the plaintiff to serve a copy of its order on a John Doe or Does controlling the wallets holding the stolen funds.

The exchange LCX was able to identify the addresses of the hacker's wallets and the NFT token delivered. The NFT contained a hyperlink of an order to show cause. It had a mechanism in it to track when it was clicked on.

Justice Andrea Masley said **in the judgment**: "Such

The overseas court decisions highlight the transparency of the blockchain and how difficult it is to get away with the crimes



James Cochrane

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service shall constitute good and sufficient service for the purposes of jurisdiction under New York law on the person or persons controlling the address.”

“The two decisions that came out in June out of the English High Court and the earlier one out of the Supreme Court in New York will be useful in expanding the tools by which the courts can allow service of court documents within the context of court proceedings to include service on the blockchain,” Gollin says. “It’s an effective means technologically by which to get the relevant information to the relevant recipient.”

Alternative service

Methods of service have already expanded in New Zealand thanks to the march of technology. Service via email and Facebook have already been accepted by the New Zealand courts, Cochrane says. But substituted service is allowed only if personal service cannot be effected.

“My firm does a lot of debt recovery proceedings and sometimes the defendants are quite hard to find. If you’ve made reasonable attempts to effect personal service and you can’t serve them, then they can apply for an order for substituted service.

“There are examples of service by way of social media. So that’s not uncommon these days.”

In *Development West Coast v Gillman* [2019] NZHC 2460, a debtor announced his engagement on Facebook and a judge allowed a creditor to effect personal service of the documents via a post to a Facebook profile.

Likewise, in *Southpac 2015 Ltd (in liq) v Dziamska*, personal service was dispensed with and orders made that the bankruptcy notice be drawn to Dorota Dziamska’s attention by private message on Facebook Messenger. Blockchain can be even better than service by social media, says Cochrane.

The UK and US examples of service on the blockchain will inevitably lead to disgruntled investors or scam victims adopting a similar course here, Cochrane says.

In the wake of the decisions, Gollin notes that the UK lawyers said the case posed “potential for digital service over the blockchain with all the benefits of immutability and

verification, to become the norm in favour of conventional forms of service”.

He thinks that’s probably pushing things a little too far.

“There was commentary in one article I saw online in relation to the New York case [where] they said for the time being courts will likely view service on the blockchain as the last resort.

“The court has to accept that it has jurisdiction itself to be able to deal with the matter. It assumes jurisdiction by service,” Gollin says. It’s much the same as service by email, where the person could be anywhere in the world.

Understanding the concept

The New Zealand courts, he says, have been open generally to technological developments.

“Once they understand the concept of blockchain and what is meant by the air-dropping of this thing called an NFT and this thing called a wallet, then I think the New Zealand courts would be open to allowing for orders to be made to that effect.”

Rule 6.8 could be a problem because the key to recovering stolen crypto is speed. The requirement for attempts at personal service first could slow down justice at a time when speed matters.

“But there are certain circumstances where it is just impossible to try and make that [personal service] attempt in the first place,” Gollin says.

He adds: “I think the problem in New Zealand [is] not so much the willingness of the court to be able to deploy these sort of

tools that have been recognised in the UK and in the US, but how to fit that within the constraints of the wording of the rules that they have to operate [within].”

In the UK, the rules of civil procedure allow for alternative service if it can be established there is a good reason for such an order being made. “And in [the *D’Aloria*] case, the judge was more than satisfied it was good reason,” says Gollin.

Here in New Zealand, there have been freezing and interim relief orders made without notice in circumstances of urgency against overseas defendants.

Gollin’s firm represented Viagogo in a case taken by the Commerce Commission which was resolved in the

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Sean Gollin



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Court of Appeal.

“The court has jurisdiction to do that on overseas parties. The Court of Appeal [decision about Viagogo] makes many helpful comments about the ability to use a substituted service.”

Lex situs

Gollin says the UK case helped clarify the lex situs of the theft of cryptocurrency held on the blockchain. “It was interesting, the English decision *D’Aloia* referred to other English cases which established that the lex situs of crypto assets is the place where the owner was based. [In New Zealand] the subject matter jurisdiction would arise from the fact that the theft occurred in New Zealand.”

Transparency and stolen funds

The overseas court decisions highlight the transparency of the blockchain and how difficult it is to get away with the crimes, Grainger says.

“There is a digital trail of where the money is moving. And that allows the lawyers to serve the notices on those addresses.

“The [courts] can put effectively a black mark on that wallet address, and then any company that receives funds from that address can get an alert to say, ‘these are stolen funds’ or ‘there is a legal order against the money that you’d

need to take into consideration.”

On the subject of recovering stolen funds, larger centralised crypto exchanges such as Binance or Coinbase are becoming a lot more cautious in terms of ‘know your client’ (KYC), says Cochrane.

Not all stolen crypto is stored on centralised exchanges.

But the funds do in most cases need to pass through them, he says. In at least one of the overseas cases, the thieves did try to launder some of the money through Tornado Cash, a crypto-mixing service, to obscure the source of the funds, but it wasn’t entirely successful.

MinterEllisonRuddWatts partner Jeremy Muir adds that in some ways crypto is more traceable than money passing through the traditional financial system because the movements are recorded on the blockchain.

Crypto blockchain analytics companies such as **Chainalysis** are getting better and better at what they do and can work with authorities, says Muir.

“Any wallet that has had dealings with the dark web can be tagged by these bodies and anything that passes through those wallets through an exchange may be refused service. It’s effectively almost marked with red paint.”

Another interesting case to watch, Grainger says, is the US Treasury’s sanctions of Tornado Cash.

The notorious virtual currency mixer has been used to launder more than US\$7 billion worth of virtual currency since its creation in 2019, the **US Treasury said in a press release**. That included the washing of a portion of a single US\$455m heist by a North Korean state-sponsored hacking group. ■

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