MINTZ GROUP

Coming to Terms with Crypto

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Introduction

What the ultimate role of cryptocurrency should be is one of the most important issues facing the global financial community today. The uncertainty and flux around this question generates considerable noise and makes it challenging for attorneys who advise clients on asset recovery to develop a consistent approach to cryptocurrency. However, once that noise is filtered out, a clearer picture of how to respond to crypto quickly emerges.

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ICC FraudNet is an international network of independent lawyers who are the leading civil asset recovery specialists in each country. FraudNet's membership extends to every continent and the world's major economies, as well as leading offshore wealth havens that have complex bank secrecy laws and institutions where the proceeds of fraud often are hidden. FraudNet is recognized by Chambers Global as the world's leading asset recovery legal network. Mintz Group is proud to be a strategic partner of ICC FraudNet.

Crypto is Here to Stay

Much of the distraction around crypto stems from the lingering debate over whether it should be considered a legitimate asset class, given crypto's considerable market gyrations, the risk of investing in a fraudulent project and regulatory uncertainties. But while this debate has raged since crypto's inception, it is being increasingly resolved in crypto's favor. If crypto's market value has fluctuated considerably, the integration of crypto into the mechanics of the financial system has maintained a relatively steady upward momentum for the past several years. Just in recent weeks, for example, a Bitcoin futures ETF has made its debut on U.S. exchanges and U.S. banks have begun offering a cryptocurrency custody service for large investment managers. Among emerging markets, several countries are considering following El Salvador's lead and adopting Bitcoin as legal tender in the near future.

Similarly, while government officials may sound the alarm over crypto's risks and regulatory issues, most of those pronouncements in the U.S. and elsewhere implicitly acknowledge crypto's continued existence. Even in the best of cases, the process of regulation catching up to innovation is messy. It is all the more so when that process involves trying to regulate something that was designed from the start to be unregulated. How that fundamental, structural conflict will be resolved is far from clear. Nonetheless, it is increasingly safe to say that crypto's role in the global financial system is a question of how and when, not if.

Piercing Crypto’s Aura of Impenetrability

Once we accept that crypto is here to stay, we must then confront crypto’s aura of impenetrability. But here, too, a much more manageable reality emerges once the noise is ignored. All currency is based on trust, and crypto is no exception. Instead of the backing of a government, crypto’s trust is based on the transparency of its blockchain, a public ledger of transactions stored in a continuous chain of time-stamped blocks, distributed across thousands of computers, providing a record that is essentially permanent, immutable and highly resistant to tampering.

Crypto’s much-discussed privacy stems from the fact that while the transactions are listed on the blockchain for all to see, the parties to each transaction are identified only by a long randomly generated 24-plus-character pseudonym, which is not directly tied to a user’s identity. However, such privacy is compromised whenever the user attempts to convert cash to crypto on an exchange, which is still necessary for most users when they want to invest in a cryptocurrency or conduct a transaction. Conversely, the same vulnerability exists when converting crypto to cash, when users want to move profits to the traditional bank account.

These “on-ramps” and “off-ramps” to the crypto blockchain are both the weakest links in the chain and the leverage points for any investigation of cryptocurrency assets.

Entering and exiting the cryptocurrency ecosystem generally requires using a crypto exchange, such as Coinbase, Kraken or Binance, which act as on-ramps and off-ramps to the pseudonymous blockchain. These exchanges, which began as part of crypto’s opaque libertarian origins, have evolved to become firmly planted in the world of mainstream institutions—allowing lawyers,

investigators, regulators and law enforcement to bring to bear the traditional tools of subpoenas and court orders, and get the information necessary to link fiat and crypto exchange accounts and follow the money. Indeed, in the case of U.S. vs. Gratkowski [2020] the Fifth Circuit ruled that law enforcement does not even need a warrant to demand customer records from a crypto exchange, using the same Fourth Amendment exclusion that the courts previously applied to bank records.

It is important to note, however, that while crypto exchanges are not immune from legal action, they are not yet subject to the same regulatory scrutiny as banks and brokerages. Some offshore exchanges are less than cooperative in complying with law enforcement and civil court requests; others are lax in applying KYC and other crime-prevention measures. In general, however, cryptocurrency exchanges have been tightening their KYC rules and lowering the amount of crypto that can be sent without providing some identifying information.

In addition to the information that can be gleaned from crypto exchanges, a new generation of digital investigative tools is dramatically increasing the capacity to trace and recover crypto by scraping the massive amounts of data on blockchains to identify suspicious transaction patterns or addresses and allow investigators to track stolen or fraudulent crypto to exchanges, where the recipient could then be identified through civil court requests. Given the nature of the blockchain, these transactions can even be monitored and traced years later, when stolen crypto that had been dormant starts to move again. The seizure of crypto linked to theft or fraud is now sufficiently commonplace that the U.S. Justice Department recently awarded a contract for the handling of the digital assets seized by the U.S. Marshals Service.

The Crypto Arms Race

These advances in "domesticating" crypto pave the way for it to be integrated into the global financial system. At the same time, however, other technological innovations help keep crypto rooted to its undomesticated, off-the-grid origins. For example, the emerging sector of "decentralized finance" or "DeFi" protocols leverage "smart contracts" to bypass crypto exchanges entirely, allowing for more opaquely pseudonymous transactions. Despite their legitimate uses, bad actors are also using DeFi to avoid centralized exchanges and increase the difficulty of tracing stolen crypto. They are even engaging in strategies akin to money laundering, in which "dirty" crypto acquired through fraud or theft is used as collateral on a DeFi platform to obtain a loan made in "clean" crypto that can be moved back through centralized exchanges.

The playing field for digital asset recovery is thus highly dynamic, similar to the arms race between hackers and cybersecurity experts. And just as crypto has its libertarian legacy, the Internet's evolution from obscure niches in government and academia to global ubiquity was intertwined with a hacking culture with heavy anarchist undertones. That hacking culture did not prevent the internet's trajectory, but it did require an ever-evolving corpus of regulations, resources and best practices to guide actions and mitigate risk.

Crypto is in the early stages of a similarly bumpy evolution. As with cybersecurity, the prudent course for those helping clients recover assets in the crypto realm is not to wait for all of crypto's uncertainties to be resolved—because they may never be—but rather to adapt existing tools where possible and innovate where needed, as this new domain becomes just one more element in the global asset recovery toolkit. The tried and true methods of asset tracing and recovery, mixing both open source and traditional investigative steps with judicially-sanctioned discovery, apply to the crypto realm. Chief amongst these tools is the opportunity afforded by leveraging disclosures at the on-ramps and off-ramps of the blockchain.

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Christopher Weil is managing partner of the Mintz Group's Washington, D.C. office specializing in complex litigation and public-policy disputes. He co-heads the firm's international asset tracing unit and leads the firm's antitrust practice. His practice focuses exclusively on complex disputes — ranging from corporate litigation to international arbitration claims to trade disputes and corporate reputation management. He has conducted investigations in a wide variety of industries, from manufacturing to logistics to the financial services sector, and has worked as the lead investigator in some of the largest global asset investigations in recent years.

Chris and his team have particular expertise in areas they have found crucial to asset tracing and recovery, including: Banking, Offshore Structures, Shipping, Real Estate, Private Aircraft and Internet Forensics. Chris has pioneered creative investigative asset tracing techniques in the energy and extractive industries tracking the shipment of commodities, and seeking injunctive relief in multiple jurisdictions to help enforce multi-billion dollar court judgments.

Chris joined the Mintz Group as an investigator in 1999 and has held senior investigator roles in both the New York and Washington, D.C. offices of the firm. Since 2016, Chris has been recognized as a leading practitioner in *Who's Who Legal* Asset Recovery Experts. He also serves on the Editorial Advisory Board of the *Journal of Enforcement of Arbitration Awards* published by JurisNet.

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Sean Anderson is a director based in Mexico City, who heads our Mexico City office and works closely with the Mintz Group's Washington D.C. office. . He manages investigations on behalf of clients involved in major cryptocurrency-related class action lawsuits and has helped clients trace millions of dollars in stolen cryptocurrency. Sean works in our Latin American practice and has experience conducting complex litigation, integrity due diligence and asset tracing investigations. Sean has conducted numerous investigations throughout Latin America, with a particular emphasis on the infrastructure, energy and financial services sectors. Recently, he undertook comprehensive pre-deal investigations into companies in Honduras, Guatemala and Mexico, which uncovered ties to organized crime, large-scale tax fraud and money-laundering. Sean has also led internal investigations into contract fraud and bribery at a large mining company and undisclosed conflicts of interest leading to multimillion-dollar distressed loans at a multinational financial institution. Sean is fluent in English, Spanish and proficient in French.

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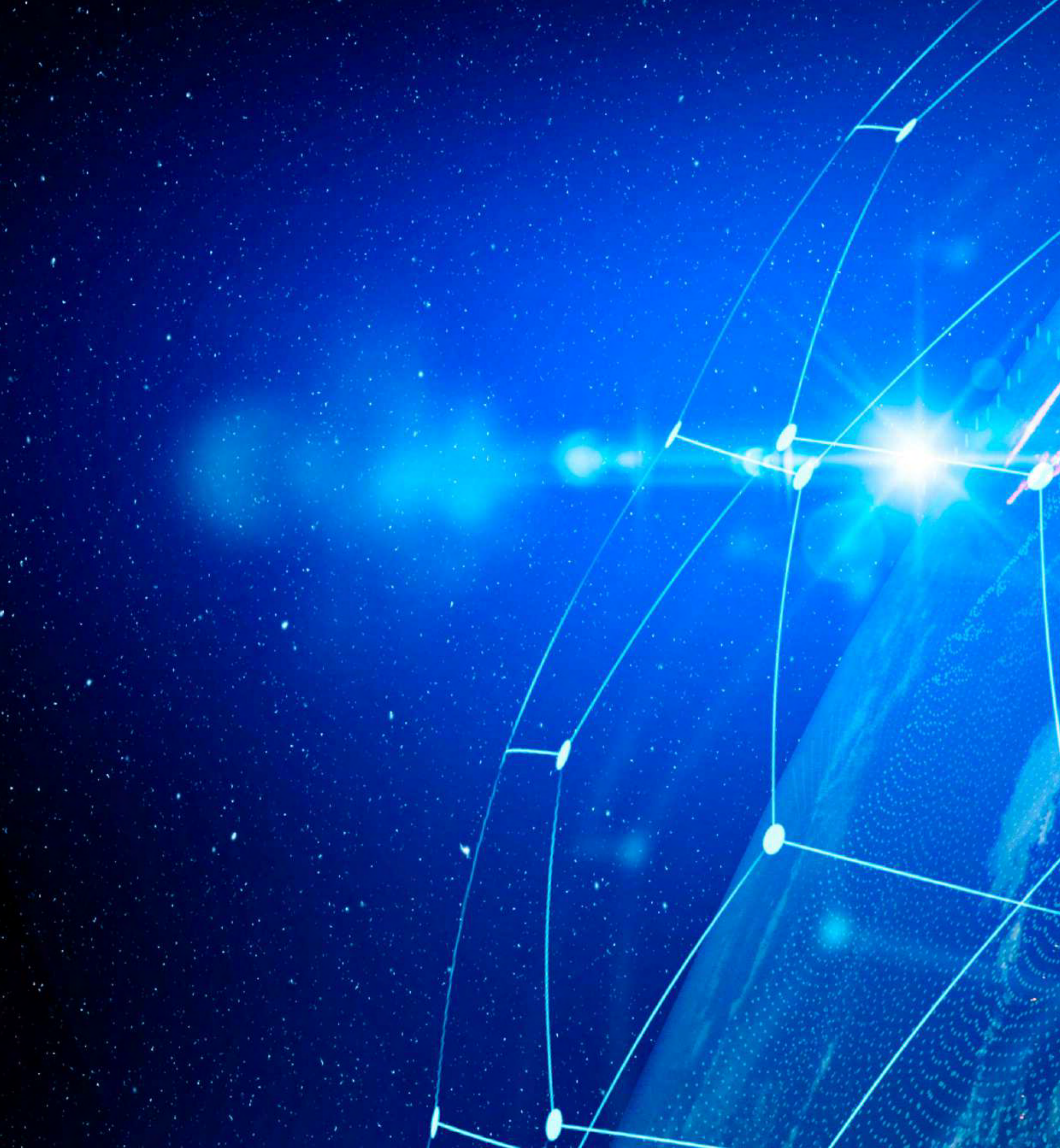
Craig Heschuk is Executive Vice President Covering North America & the Arabian Gulf at GreyList Trace Limited. Craig is a legal and management professional with three decades of experience in commercial project development. He was admitted to the Canadian Bar Association in 1990. His career spans dozens of countries starting in the early 1990's when he was advising a major Canadian energy company on international projects. His subsequent experience includes 17 years living abroad in Abu Dhabi, Singapore, Doha and Quito. His career has centered on corporate/commercial work, mainly in the development of major infrastructure projects in the energy, real estate and manufacturing sectors. He has extensive contacts with major law firms in North America and Canada, particularly in New York and Washington. Craig is fluent in English, Spanish with reasonable facility in French and Greek.



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