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The Rise of Cryptocurrency and a New Field of Litigation

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Created by an unnamed programmer in 2009, Bitcoin was initially ignored by the mainstream business world and was best known as a currency used by hackers and criminals for anonymous transactions. But in the past few years, Bitcoin and other cryptocurrencies have exploded, reaching a total market capitalization of over $147 Billion.[1] They are perceived by many as a disruptive technology, poised to transform banking and payment industries forever. While this remains in doubt, for as long as cryptocurrency is here, lawyers in many areas, including litigation, must adapt and understand this new technology.

Cryptocurrencies are digital tokens whose authenticity can be proved because they document their own ancestry. An on-line ledger called a "blockchain" shows each time a token was exchanged so that it can be traced back to its creation through an unbroken series of valid transfers. Across the world, an open network of "miners" compete to create additional blocks to add to the chain (successful miners are rewarded with tokens), ensuring that a token cannot be sold twice. This process is intentionally burdensome, designed to make corruption of the blockchain practically impossible. In fact, the essential value of cryptocurrency is that it will not be counterfeited, which is remarkable considering it is entirely digital and exchanged on a decentralized peer-to-peer network.

While traditional payments require some form of trust between parties or an intermediary, such as a bank, to mediate the exchange, cryptocurrency can be transferred instantly without an intermediary or any real-world relationship between the parties. Because of this, blockchain technology may lead to a new paradigm in how we pay for things and transfer value.

Despite its numerous potential applications, cryptocurrency is sure to create problems. Bitcoin's price has increased over 2,000% in the past two years, while other emerging digital currencies, such as Ethereum, have seen even greater inflation during that span.[2] This volatile, expanding market is not controlled by any central authority or bank.

Businesses have taken advantage of this undefined or non-existent regulatory framework by launching Initial Coin Offerings (ICOs) or "token sales." ICOs are like digital stock certificates and companies are increasingly using them to fund enterprises without the rigors of traditional capitalization. In a matter of hours, start-ups have raised millions without offering anything resembling a viable product by conventional metrics.

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[1] https://coinmarketcap.com

[2] https://www.coindesk.com/price

This Wild West atmosphere, where anyone can launch an ICO or create a new token, is rife with opportunity for fraud, theft, and blatant Ponzi schemes. By nature, cryptocurrencies are bearer instruments. Whoever possesses the token is its owner and transactions are irrevocable. Tokens can be lost or stolen and token exchanges can be compromised. As such, many investors have seen their digital assets disappear with little or no recourse. An early example occurred in 2014 when the world's then largest bitcoin exchange, Mt. Gox, filed for bankruptcy amid allegations that customer Bitcoins (equal to approximately 6% of all coins in circulation) had gone missing.[3] At least one other company has been accused of offering a cryptocurrency that never even existed.[4]

Recent class-action lawsuits have taken aim at cryptocurrency exchanges such as Coinbase and Kraken, alleging system crashes or lack of access to funds. Users of the Cryptsy exchange have sued Coinbase, Inc. after Crypty's CEO, Paul Vernon, allegedly funneled billions in stolen customer Bitcoins through his Coinbase accounts.[5] The plaintiff alleges Coinbase failed to investigate Vernon's suspiciously large withdraws in violation of its duties under U.S. anti-money laundering rules.

These cases present interesting questions and challenges for courts and litigators. Cryptocurrency networks are global, decentralized, and anonymous; they are specifically designed to prevent third-party interference, including, ostensibly, by the courts. For example, without the "private key" known only to the token owner (without which the token is worthless), courts and litigants may have difficulty accessing the currency in dispute. Moreover, its sheer complexity will certainly cause developments in many aspects of litigation, including discovery, evidentiary rules, and expert testimony, as cryptocurrency cases are brought to trial.

[3] https://dealbook.nytimes.com/2014/02/25/trading-site-failure-stirs-ire-and-hope-for-bitcoin/?_php=true&_type=blogs&_r=0

[4] https://cointelegraph.com/news/one-coin-much-scam-onecoin-exposed-as-global-mlm-ponzi-scheme.

[5] *See* Complaint, *Leidel*, et al. v. *Coinbase*, *Inc*., U.S. District Court, Fla. S.D., case no. 9:16-cv-81992 (December 13, 2016).