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Ancient torts and modern assets

Recent court rulings show the venerable common-law tort of conversion providing an effective vehicle for relief in a number of cryptocurrency and NFT disputes.

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What relevance does a tort doctrine from the late Middle Ages hold for modern electronic forms of property like digital assets? Quite a bit, it turns out. Recent court rulings show the venerable common-law tort of conversion providing an effective vehicle for relief in a number of cryptocurrency and NFT disputes.

What is conversion?

The tort of conversion has been famously described as "the forgotten tort," obscure in its origins and requirements. See William L. Prosser, "The Nature of Conversion", 42 Cornell L. Rev. 168 (1957). Conversion is described as "an intentional exercise of dominion or control over a chattel which so seriously interferes with the right of another to control it that the actor may justly be required to pay the other the full value of the chattel." Restatement (Second) of Torts §222A (Am. L. Inst. 1965). A conversion claim thus seeks to recover the "value" of such property, rather than the property itself; the latter claim is the purview of the tort of replevin. See generally 66 Am. Jur. 2d *Replevin* § 5 (2023).

The right to recover in conversion is subject to a number of requirements, however. First, a plaintiff may only sue for conversion if plaintiff "at the time [of the conversion] was entitled to immediate possession of the chattel." Restatement (Second) of Torts §225. Moreover, liability for conversion only accrues once a demand for the return of the property is made and refused. "One in possession of a chattel as a bailee or otherwise who, on demand, refuses without proper qualification to surrender it to another entitled to its immediate possession, is subject to liability for its conversion."

There are also restrictions on what kinds of property may be the subject of a claim for conversion. "An action for conversion ordinarily lies only for personal property," i.e., not real property, and it is commonly said that for personal property to be converted it must be "tangible." 18 Am. Jur. 2d *Conversion* §7 (2023). But this tangibility requirement is subject to some nuance.

For example, "[w]here there is conversion of a document in which intangible rights are merged, the damages include the value of such rights." Restatement (Second) of Torts §242(1). Examples of such documents include "promissory notes, bonds, bills of exchange, share certificates, and warehouse receipts, whether negotiable or non-negotiable," as well as "insurance policies" and "savings bank books." In fact, "[o]ne who effectively prevents the exercise of intangible rights of the kind customarily merged in a document is subject to a liability similar to that for conversion, even though the document is not itself converted."

These tangibility requirements arose out of conversion's "descent from the common law action of trover."

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> [Conversion] originated as a remedy against the finder of lost goods who refused to return them. Because of this origin, and the persistence until comparatively recent years of the fiction of losing and finding, the action was narrowly limited in its scope, and it would not lie for the appropriation of any property which could not be lost and found.

But despite this history, "the modern action of conversion has undergone a slow process of extension, which has carried it beyond these ancient limits of the action of trover."

This expansion of the tort of conversion has not cast off all the ancient requirements, however. It has long been held that "fungible intangible personal property" such as money is generally not "subject to a civil action for conversion." See H.D. Warren, Annot., "Nature of Property or Rights Other Than Tangible Chattels Which May be Subject of Conversion", 44 A.L.R.2d 927 (1955).

Money may only be the subject of a conversion action where it is "akin to tangible personal property," such as when it is "specifically identifiable." 14 Lee S. Kreindler, et al., "New York Law of Torts" §2:12 (Thomson West 2023 rev.). Thus, as early as 1599, a court in England "first held that money could not be converted…unless it was in a 'bag or chest.'" Warren, supra, 44 A.L.R.2d 927, § 7[a]. Over time, this has evolved into the modern approach where now "an action will lie for the conversion of money where there is an obligation to return or otherwise treat in a particular manner the specific money in question and that money is specifically identifiable." 18 Am. Jur. 2d *Conversion* §7.

Thus, unlike in centuries ago, courts in conversion cases today usually are not confronted with a particular piece of money, such as a "coin or bill" or a physical bag of money. Warren, supra, 44 A.L.R.2d 927, § 7[a]. Instead, courts now look to whether there exists a "specifically identifiable" origin for the money claimed to have been converted. 14 Kreindler, "New York Law of Torts" §2:12.

For example, it is held that the balance in "a checking account, which merely creates a debtor-creditor relationship" between the depositor and a bank, "cannot be converted," but where "specific wrongfully obtained funds can be traced to a particular bank account, a claim for conversion will lie."

This concept also interplays with what is commonly called the "economic-loss doctrine" in tort cases generally.

The economic-loss doctrine bars tort liability when the plaintiff has a contract with the defendant, and contract law provides an adequate remedy for the type of injury alleged. Courts similarly hold that the economic-loss doctrine prohibits recovery under tort for purely economic losses resulting from a party's failure to perform under a contract.

Running off with the cash intended for crypto investment

Continuing conversion's journey from the 16th century to the 21st century, conversion has been used to recover money intended for investment in cryptocurrency that was given to unscrupulous promoters who instead simply pocketed the funds for themselves.

For instance, in *Alm v. Spence*, 2022 WL 17826554 (Dec. 15, 2022), *report and recommendation adopted as modified*, 2023 WL 3967790 (S.D.N.Y. June 13, 2023), the plaintiffs "invested in at least one of the [several cryptocurrency investment] funds" (the "'Funds'") promoted by the defendant Spence, who "presented himself as a successful cryptocurrency trader." But in fact "none of the Funds were established as separate legal entities, and none were registered with any appropriate regulatory body." Instead, they "were simply loose pools of money that Spence held and traded in his own name."

Eventually, Spence "announced he was closing the Funds and promised investors [he would] return their full investments." Yet no such return was made and, "out of excuses, Spence admitted his fraud."

The court upheld the plaintiffs' conversion claim against Spence. Plaintiffs specifically "provided funds to Spence for investment in the Spence Funds" but Spence "did not honor the Plaintiffs' demands for withdrawals of their assets from the Funds," nor did he "return funds that Plaintiffs provided for investment in [a business endeavor] that never occurred." The "Plaintiffs [therefore] had a right to return of their funds." Since the defendant "never returned them," the funds had been converted.

Similarly, in *Aquino v. McDonald*, 2023 WL 8627787 (D. Me. Dec. 13, 2023), plaintiffs gave $225,000 to the defendant

"for investment in cryptocurrency," but "Defendant retained and did not return the funds when requested." Because the providers of the $225,000 "had an interest in the funds…a demand was made for the funds, and Defendant did not return the funds," the court held that the plaintiffs had "established that they are likely to recover" on their conversion claim for purposes of obtaining an attachment upon defendant's property.

Conversion of cryptocurrency itself

Courts have had to consider conversion claims arising not just from misappropriating money intended for investment in cryptocurrency, but also from misappropriating cryptocurrency itself. Conversion claims have proved viable in this context as well.

An early such case was *Lagemann v. Spence*, 2020 WL 5754800 (May 18, 2020), *report and recommendation adopted*, 2020 WL 7384009 (S.D.N.Y. Dec. 16, 2020), which involved the same defendant Spence as in *Alm*. In *Lagemann*, "Plaintiffs transferred different types of cryptocurrency . . . into the Funds." Spence "actively misrepresented the valuation of the cryptocurrency" and had ultimately "induced Plaintiffs to invest [bitcoin] and then concealed his fraudulent conduct as the value of their holdings declined." Spence was "holding Plaintiffs' funds" and "prevented Plaintiffs from accessing, withdrawing, or reclaiming those funds."

The court noted that it was "unaware of any case that has explicitly considered whether cryptocurrency is the proper subject of a cause of action for conversion," but concluded that finding the defendant liable for conversion of cryptocurrency "is consistent with cases allowing a conversion claim against other assets and funds," such as money. Indeed, "[w]hether characterized as money or personal chattel, plaintiffs transferred cryptocurrency to Spence," who "wrongly procured them by fraud and misrepresentation."

Additionally, the "plaintiffs did not authorize Spence to use their funds in the way that he did." He "kept all or a portion of plaintiffs' assets after plaintiffs requested their return" and therefore had "interfered with plaintiffs' ownership interests in those holdings and [] deprived Plaintiffs of their property." The court thus granted plaintiffs' motion for summary judgment on their claim that the defendant had converted their cryptocurrency.

Another such issue was presented very recently in *Power Block Coin v. Song*, 2023 WL 8437788 (D. Utah Dec. 5, 2023), which the court described as raising "novel issues involving cryptocurrency lending." The defendant in the case was a Bitcoin miner who took out a loan under a note from the plaintiff, a cryptocurrency exchange and trading platform. Defendant sought the loan to "generate funding for his mining operations," using "his Bitcoin as collateral."

Given the "volatile market price" of Bitcoin, the loan the defendant took out was "highly collateralized," in that under the loan terms the defendant "secures his loans with Bitcoin in an amount that is worth more than the U.S. dollars he receives." The parties thus agreed that "the amount of collateral [would] be adjusted during the term of the note" due to the volatility of the market price. In the event "the price of Bitcoin dropped too low," then the plaintiff lender "could issue a margin call and ask for additional collateral," and "if the price rose too high," then the defendant borrower "could demand the return of excess collateral."

Due to a rise in the price of Bitcoin, the defendant's loan became overcollateralized, and defendant asked for the excess collateral to be returned to him. Eventually, though, the plaintiff lender claimed the defendant was in default on his loan and brought suit. The defendant, who previously had asked for the return of his excess collateral, then counterclaimed for conversion of his collateral, alleging that the plaintiff had "wrongfully exercised control over his collateral."

The plaintiff moved to dismiss the counterclaim. It argued that "its control cannot be wrongful because [the defendant] has failed to repay the loan in full and is therefore not entitled to current lawful possession of the collateral."

To determine who had current lawful possession of the Bitcoin collateral—a necessary requirement for a conversion claim—the court looked to the terms of the parties' underlying note. The note provided that the plaintiff lender "must return collateral in excess of the required collateral value once the value of that collateral exceeds" a specified level, which level had in fact been exceeded.

The court held that the defendant borrower "plausibly alleged that he gave notice to [the plaintiff lender] of his demand for [plaintiff] to return the excess collateral." Furthermore, because the defendant had adequately alleged that "the value of the collateral exceeded the contractual benchmark," the plaintiff lender was therefore "required to return some of the excess collateral on a date before [the defendant's] loan came due." The court accordingly denied the plaintiff's motion to dismiss the defendant borrower's claim for conversion of his Bitcoin, because under these facts the defendant borrower "has alleged a current—and not merely a future—right to possession" of the excess collateral.

A claim for conversion of cryptocurrency was upheld in another recent case, *Akhtar v. Compound Labs*, 2023 WL 8870134 (C.D. Cal. Nov. 6, 2023). There, the plaintiff alleged after initially investing $28.37 pursuant to an "agreement" he had with the defendants, he then "invested close to $8,000.00 by depositing in his Coinbase wallet account," which then "grew to a little over $12,000.00 within a few weeks." Plaintiff alleged that the defendants had earlier promised him that this was a risk-free investment such that "his funds would always be safe as long as he did not reveal his password," but then "over $12,083.28" worth of "Plaintiff's crypto currency (digital currency) was withdrawn from his wallet by the Defendants without any valid reason."

The plaintiff brought suit alleging, among other claims, breach of contract, fraud, and that the defendants had converted his "digital investment." The defendants moved to dismiss the conversion claim, arguing that "if the court finds a contract between the parties exists, the economic loss rule bars plaintiff's fifth cause of action for conversion." The court denied the motion, explaining:

> "Because the court finds plaintiff fails to plead sufficient facts regarding the existence of a contract, the court cannot dismiss plaintiff's conversion claim at this stage on the basis the breach of contract claim and the conversion claim are mutually exclusive under the economic loss rule."

Further, because plaintiff made a subsequent $8,000 deposit into his Coinbase wallet after his initial $23.87 investment, "the economic loss rule would not bar the plaintiff's conversion claim because the plaintiff's ownership interest in the $8,000 he deposited in his Coinbase wallet existed independent of his alleged contract with the defendants." The court thus denied defendants' motion to dismiss the conversion claim based on the economic loss rule.

Applying 'specifically identifiable' requirement from money conversion claims to crypto conversion claims

In analyzing claims for conversion of cryptocurrency, courts have essentially applied the requirement from money conversion cases that the allegedly converted assets be "specifically identifiable" in order for conversion to lie. This has taken the form of requiring the converted cryptocurrency to be traceable from the conversion plaintiff to the defendant.

For example, in *Schober v. Thompson*, No. 1:21-cv-01382-GPG-NRN, slip op. (D. Colo. Dec. 19, 2023), the plaintiff alleged that the defendants converted his bitcoin through the use of malware that "has a 'clipboard hijacking' function," whereby "it detects when a user copies bitcoin wallet addresses and replaces these copied addresses with similar—but slightly different—addresses [so that] he or she will actually paste the address supplied by the malware" and thus "send bitcoins to the incorrect address."

However, the court found the plaintiff's efforts to connect the defendants to his stolen bitcoin to be insufficient to permit plaintiff to obtain partial summary judgment on his conversion claim. It held that "the gaps in plaintiff's tracing analysis would permit a reasonable jury to find in the [defendants'] favor."

First, plaintiff was unable to "conclusively prove that it was [the key defendant] who converted his bitcoins." While admittedly "if bitcoin addresses contained in the malware transacted with a bitcoin address [that the key defendant] controlled, a jury might infer that [such defendant] was responsible for the malware attack (because he was at some level the beneficiary of transactions possibly associated with the malware)," his "receipt of proceeds from the embedded addresses does not mean that [he] necessarily controlled the embedded addresses—a different person controlling the malware could have sent the bitcoins to [him]." In addition, the fact that this defendant "may have received bitcoins from

other implicated addresses does not conclusively mean that he ever received *Plaintiff's* bitcoins from another address contained in the malware" (emphasis in original).

The plaintiff faced other tracing difficulties, in part because allegedly "the thief converted his bitcoins to Monero—a cryptocurrency that is more difficult to trace because Monero transactions do not create publicly auditable blockchains—and then sent his bitcoins to a Monero address," whereupon "the trail apparently went cold." Plaintiff's attempts to rely on an unsworn hearsay blockchain analysis allegedly performed by a pseudonymous Reddit user was also rejected as insufficient. Other alleged evidence of defendants' culpability to which plaintiff pointed was deemed "circumstantial" and merely raised a jury question, but was not "sufficient to support a grant of summary judgment in plaintiff's favor."

The plaintiff in *Blum v. Defendant 1*, 2023 WL 8880351 (N.D. Fla. Dec. 23, 2023), was more successful, however. That plaintiff sought an emergency TRO against a defendant who allegedly "fraudulently represented that she was a cryptocurrency investor who would assist [plaintiff] in investing his cryptocurrency." This defendant, along with others, allegedly had "deceived [plaintiff] into transferring approximately $1,160,615.58 worth of cryptocurrency into the defendants' private cryptocurrency wallet addresses." The plaintiff allegedly was led to believe that "he had downloaded a legitimate and regulated cryptocurrency exchange smartphone application but instead downloaded and ultimately transferred his cryptocurrency assets to a smartphone application that facilitated the transfer of his cryptocurrency assets into Defendants' Destination Addresses."

The court held that because plaintiff's verified complaint combined with "an investigator's report that used blockchain analytics to trace the path of [his] cryptocurrency assets" were sufficient to show that his funds had been transferred to the defendants' addresses, plaintiff had "demonstrated a strong likelihood of success on the merits" of his conversion claim so as to warrant injunctive relief:

> The record at this stage shows that Defendants fraudulently acquired [plaintiff's] cryptocurrency assets and have no right to claim either possession or ownership of them. The stolen cryptocurrency assets are specific and identifiable property and have been traced to Defendants' Destination Addresses.

Similarly, *Din Yuan Steven Sun v. Defendant 1*, 2023 U.S. Dist. LEXIS 220110 (S.D. Fla. Dec. 8, 2023), involved a claim for conversion of cryptocurrency where the plaintiff adequately traced the cryptocurrency throughout the conversion, so as to support the granting of a default judgment. The plaintiff alleged that the defendant "induced the plaintiff to interact with a fraudulent electronic platform, misdirected and thwarted the plaintiff's inquiries, and converted the plaintiff's cryptocurrency." The plaintiff further alleged that "the defendant maintains and continues to maintain private cryptocurrency wallets and cryptocurrency exchange accounts…in which all or a portion of the plaintiff's stolen cryptocurrency currently sits." Moreover, "the plaintiff tracked the stolen cryptocurrency to identified electronic wallets." The court held that the "the plaintiff properly alleges a conversion claim" under these facts.

Conversion of NFTs

In the realm of digital assets, conversion claims have not been limited just to cryptocurrency disputes. Conversion claims also have been used in disputes relating to non-fungible tokens, NFTs.

XMOD Indus. v. Kennedy, 2023 WL 3572379 (D. Mass. May 19, 2023), is a recent NFT-related conversion case where the lead defendant, an independent contractor to the plaintiff, allegedly "converted [the plaintiff's] money and engaged in a scheme to gain control of other [of plaintiff's] assets through fraudulent use of [the plaintiff's] social media, marketing outlets, and partner relations." Specifically, after the plaintiff "held a NFT sale…on a third-party website," it subsequently "learned that [the lead defendant] instructed the third-party website to transfer over $564,000 in proceeds from the sale to his own personal digital wallet without [the plaintiff's] knowledge or consent," and when the plaintiff "requested return of the funds," the lead defendant "refused."

The plaintiff sued on various grounds including conversion. On the plaintiff's motion for default judgment, the court held "that Plaintiffs have stated a cognizable claim…for conversion" against the lead defendant because he "improperly retained

the plaintiffs' proceeds from the NFT sale for his own use despite repeated request for return, which resulted in an economic loss to the plaintiffs."

Whereas *XMOD* involved a conversion claim for misappropriating the monetary proceeds of an NFT sale, *Luminor Consulting v. Elmessiry*, 2023 WL 4675668 (M.D. Tenn. July 19, 2023), presented a claim for conversion of NFTs themselves. There, in an endeavor "to develop the software protocol necessary for the development of an innovative, renewable energy based Blockchain protocol," the counter-plaintiff had earlier delivered certain NFTs to the counter-defendants as part of the protocol, although not "the software and keys to the protocol." However, the counter-plaintiff alleged that it did not receive full payment under the contracts related to the development of the protocol and alleged various claims for relief, including one for conversion of the delivered NFTs.

Moving to dismiss the conversion claim regarding the NFTs, the counter-defendants argued that the parties' agreements "included the creation and delivery of NTFs" and "show that delivery of the NFTs triggered an assignment of rights from counter-plaintiff to counter-defendants." They thus argued that the pleading "fails to state a claim for conversion because it does not indicate that counter-plaintiff retained any ownership rights in the NFTs at the time of the alleged conversion."

The court held that because the counter-plaintiff failed to respond to this argument about the sufficiency of its allegations, but simply asked for the issue of ownership to be deferred to the summary judgment stage based on evidence that might later be developed, it had failed to plead that it had "an ownership right in the allegedly converted chattel at the time of the alleged conversion," or that it "retained ownership rights in the NFTs after delivery." The conversion claim was therefore dismissed.

Conclusion

In a world of rapid technological change, fitting modern fact patterns into legal frameworks developed centuries ago can be no insignificant challenge. This is particularly so when the subjects of disputes leave the physical realm entirely and shift to one that is virtual, intangible and digital. Such transformations can leave courts struggling to fit the proverbial modern square peg into a medieval round hole.

While courts have had centuries to grapple with conversion claims over physical property and even money, keeping pace with new forms of virtual property and digital assets under this cause of action can be like shooting at an ever-moving target. Nevertheless, courts have not retreated from the task. The venerable tort of conversion has been called into service even in this new world, and it continues to provide viable avenues for relief.

By requiring that specific funds or assets be clearly identifiable and continuously traceable from the plaintiff's control to that of the defendant, courts have been able to liken misappropriated cryptoassets to a stolen bag of physical cash.

Courts have been called upon to confront what the right of possession looks like in a world of intangible assets, so as to determine whether a plaintiff has the possessory rights required to bring a conversion claim. By taking the effort to keep up with and understand this new technological world, courts have continued to keep the ancient tort of conversion relevant, useful and necessary for our modern world.