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**Computer Law
&
Security Review**



Asia-Pacific news

Gabriela Kennedy *

Mayer Brown JSM, Hong Kong

A B S T R A C T

Keywords:

Asia-Pacific
IT/Information technology
Communications
Internet
Media
Law

This column provides a country by country analysis of the latest legal developments, cases and issues relevant to the IT, media and telecommunications' industries in key jurisdictions across the Asia Pacific region. The articles appearing in this column are intended to serve as 'alerts' and are not submitted as detailed analyses of cases or legal developments.

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1. Hong Kong

Gabriela Kennedy (Partner), Mayer Brown JSM (gabriela.kennedy@mayerbrownjism.com); Karen H.F. Lee (Senior Associate), Mayer Brown JSM (karen.hf.lee@mayerbrownjism.com).

1.1. Money for nothing: bitcoin platform "Bitfinex" hacked in Hong Kong

On 2 August 2016, Hong Kong-based bitcoin exchange, Bitfinex, was hacked, resulting in 119,756 bitcoins worth approximately US\$65 million being stolen. The exchange immediately halted trading and alerted its users of the security breach. This was the second-largest heist in a spate of hacks that have rocked the crypto-currency industry, the largest being Mt. Gox back in 2014, which ended up filing for bankruptcy after hackers stole about US\$460 million in bitcoins.

Following the hack, Bitfinex has announced that it plans to issue tokens to its users equal to their losses, which may later be redeemed for shares in its parent company or exchanged for money. Bitfinex also stated that it intends to spread the loss equally amongst all of its users, including those that were not directly impacted by the hack. All users would stand to lose about 36% of their deposits.

1.1.1. What are bitcoins? Are they fungible?

Bitcoins are a peer-to-peer digital currency, which can be used to purchase goods or services. Bitcoins are fully decentralised and are not backed by any central bank or government, and therefore have no fixed exchange rate.

To avoid the risk of "double spending", the blockchain public ledger was created, which records every single transaction that occurs in the bitcoin economy. In addition to public blockchains, private blockchains are also available. As the name suggests, they are private networks that allow participants to update the ledger themselves. While blockchains successfully eradicate the "double-spending" problem, what about the fungibility of bitcoins as a crypto-currency? The blockchain allows bitcoins to be traced back to their origin, and thus stolen bitcoins can be tracked and rejected by merchants or trading platforms. This means that bitcoins are not necessarily interchangeable, and cannot be said to be fungible.

In May 2014, the United States Internal Revenue Service confirmed that it would not treat bitcoins as a currency, but that it would view them as property or stock. Similarly, in Hong Kong, the regulatory authorities have consistently stated that bitcoins are a virtual commodity, rather than a virtual currency. It is therefore likely that bitcoins will not be treated as fungible in Hong Kong either. This will impact the remedies available to individuals whose bitcoins are stolen.

For further information see: www.mayerbrown.com.

* Mayer Brown JSM, 16th–19th Floors, Prince's Building, 10 Chater Road Central, Hong Kong.

E-mail address: gabriela.kennedy@mayerbrownjism.com.

<http://dx.doi.org/10.1016/j.clsr.2016.09.002>

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The Hong Kong Financial Secretary announced in his latest 2016–2017 Budget Speech, that the Hong Kong Government intends to encourage organisations to explore the potential application of blockchain technology for financial services, with the aim of reducing anti-money laundering or other shady transactions, and to reduce costs.¹ It is likely therefore that we may see more interest in private blockchains in Hong Kong in the future.

1.1.2. Recovering losses

Bitcoins are not specifically regulated under Hong Kong law nor are they subject to the supervision of the Hong Kong Monetary Authority or the Securities and Futures Commission. However, the general laws concerning anti-money laundering, anti-terrorist funding, fraud, theft and computer crimes may still apply in relation to certain bitcoin activities. For example, the person who hacked into Bitfinex's system and stole the bitcoins may be guilty of an offence in Hong Kong on the basis that they gained unauthorised access to a computer with a view to dishonest gain or to cause loss to another (Section 161 of the Crimes Ordinance (Cap. 200)).

Users who suffered a loss as a result of the hack may seek civil remedies. This has not yet been tested in the Hong Kong courts, and there is uncertainty as to the level of liability of bitcoin trading platforms. Users may try to argue that the trading platform owed them a duty of care and acted negligently by failing to have in place sufficient security measures to prevent the cyber-attack from taking place. Alternatively, users could try to bring an action on the basis of breach of contract. Whether such negligence or breach of contract claims could be successful will depend significantly on the circumstances of each case.

In the event of liquidation of the bitcoin trading platform, would the customers have a claim against the trading platform and could they be entitled to the platform's assets as creditors? In the Mt. Gox case (where about US\$460 millions worth of bitcoins was stolen in 2014), during the liquidation proceedings, the company was found liable for all losses suffered by its customers, as the funds received from its customers were co-mingled into a single pool and so ownership and title to the actual bitcoins was deemed to be held by Mt. Gox (not the customers). Mt. Gox therefore owed its customers an amount equivalent to the bitcoins, and not the bitcoins themselves, meaning that its customers were entitled to part of Mt. Gox's assets as a creditor.

In contrast, Bitfinex segregated the amounts it received from its customers and held them separately. In such circumstances, ownership and title to the bitcoins appear to remain with Bitfinex's customers, with Bitfinex merely acting as a custodian. Customers of Bitfinex may not be regarded as creditors and therefore they may not be able to make a claim against Bitfinex's assets. They may only be entitled to their actual bitcoins still held by Bitfinex in the relevant customer's account (if any).

With regard to the stolen bitcoins, the blockchain system may allow victims to trace their bitcoins to find out the identity of the recipient. As bitcoins are generally viewed as non-fungible property (rather than as a currency or cash), victims of hacks may be able to recover their stolen bitcoins from the ultimate recipient.

1.1.3. Conclusion

Despite the latest stream of hacking incidents, the use of bitcoins is gaining popularity. In most countries, including Hong Kong, bitcoins and bitcoin trading platforms are largely unregulated, with little or no protection expressly provided to users under the law. In the event of fraud on a bitcoin trading platform and/or hacking incidents, bitcoin users may be left with little recourse against the trading platforms.

The continued growth of bitcoins cannot be ignored, and it is likely that before too long the bitcoin market will begin to be regulated. For example, in May 2016, Japan passed an amendment to its current financial laws requiring the regulation of virtual currency exchanges by the Japan Financial Services Agency. The amendments will come into force within a year after its official publication, and will require all cryptocurrency exchanges to be registered and subject to the supervision of the Financial Services Agency. Japan is one of the first jurisdictions in Asia to expressly impose bitcoin regulations. Bitcoin trading in Japan has spiked this year, which may be tied to the passing of the virtual currency legislation.

Regulation of the bitcoin market will help to further encourage the uptake of bitcoins by individuals and service providers, with protections in the bitcoin market becoming enshrined in legislation. Until such time, *caveat emptor!*

2. China

Gabriela Kennedy (Partner), Mayer Brown JSM (gabriela.kennedy@mayerbrownjism.com);

Xiaoyan Zhang (Of Counsel), Mayer Brown JSM (xiaoyan.zhang@mayerbrownjism.com).

2.1. China releases guidelines to strengthen cybersecurity standardisation

On 12 August 2016, the Cyberspace Administration of China ("CAC"), the General Administration of Quality Supervision, the Inspection and Quarantine of China ("GAQSIQ"), and the Standardisation Administration of China ("SAC") jointly released *Several Guidelines to Strengthen National Cybersecurity Standardisation* (the "Guidelines"). Under the Guidelines, mandatory national standards will be introduced to regulate critical fields such as major information technology infrastructure and classified networks in an effort to harmonise the current divergent local practice.

The National Information Security Standardisation Technical Committee will be the agency solely responsible for the review, approval, and release of national cybersecurity standards. The Guidelines propose to enhance the role of cybersecurity standards in guiding industrial development by, *inter alia*, establishing a standard-sharing mechanism for major cybersecurity projects as well as by incorporating standard requirements into the evaluation criteria of such projects and setting up professional qualifications. The Guidelines also stress the importance of establishing essential standards such as the "Internet +" Action Plans, "Made in China 2025," and "Action Plans for Big Data" for critical projects such as big data security and cybersecurity audits. Finally, the Guidelines call for

¹ <http://www.legco.gov.hk/research-publications/english/essentials-1516ise15-blockchain-technology.htm>.

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