UAE Appeals Court invalidates cryptocurrency agreement and defines Ponzi scheme in ‘OneCoin’ transaction dispute

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In a rare judgment, the Appeals Court of Ras Al-Khaimah (UAE) applies the elements of contract formation of the Federal Civil Transactions Law to invalidate a cryptocurrency transaction – finding that the object of the agreement did not fulfill the requirements of being “*possible, specified or specifiable, and negotiable*”.

Furthermore, the Appeals Court classified the transaction as a Ponzi scheme and provided a definition thereof falling within the general understanding of a Ponzi scheme, but with a wider net that requires persons engaged in the digital asset economy in the UAE to be better attuned with the recent rules and regulation surrounding digital assets.

Also notable, the transaction in dispute involved the infamous OneCoin.

Claim

The claim alleged that the defendant (Seller) sold to the plaintiff (Buyer) 40,000 units of OneCoin at a value of AED 100,000 and despite the Buyer’s payment for the exchange, the Seller did not deliver the tokens/units.

The Seller sued the Buyer before the Primary Court of Ras Al-Khaimah.

Primary Court technical analysis and judgment

The Primary Court adopted the following technical provisions/understandings:

1. An encrypted digital currency is a virtual currency or a digital asset based on a network and is distributed across a large number of systems known as “Blockchain.” Due to this decentralized structure, an encrypted digital currency is considered not subject to the control of governments, authorities, and centralization. Bitcoin, Litecoin, and Ether are among the most popular of these currencies and in order to be converted into cash, a cryptocurrency must be traded on a special exchange.
2. To verify the actual value of that currency, a variety of sources on the internet were surveyed but no exchange trading OneCoin was found, and based on the information available on the internet, the OneCoin exchange known as “XCoinx” was closed without any notice and therefore the current and past value of this coin cannot be confirmed.

This Primary Court ruled to rescind the sale contract and obligated the Seller to return the purchase price of AED 100,000 and pay AED 10,000 in comprehensive compensation to the Buyer.

Appeals Court procedures

The Seller appealed the Primary Court judgment before the Appeals Court arguing that the sale is valid as it was conducted through a “Deal Shaker” platform, and it does not violate the law nor public policy.

The fact of the agreement – as argued by the Seller in appeal – between the two parties is that the Seller would maintain the cryptocurrency in accordance with the Seller’s terms and conditions as listed online and release it for transfer to the Buyer between certain periods of time.

The Seller argued that they had explained to the Buyer the rules of the exchange and the possibilities of profit and loss and the risks that might occur to the Buyer.

The Seller alleged that they had informed the Buyer of the period to acquire the OneCoin units but did not receive any confirmation from the Buyer.

The Buyer refuted any communication to acquire the units during that period had occurred.

Appeals Court judgment

The Appeals Court rejected the Seller's appeal on the following reasoning.

The Court found that OneCoin (and its related companies and its founder Ruja Ignatova), as being the object of the underlying agreement, was deemed associated with fraud that tempts investors to join a Ponzi scheme.

The Court defined a Ponzi scheme as "…a form of defrauding investors by paying dividends to early investors based on money deposited by newer investors. This scheme leads its victims to believe that profits come from sales of products or other investment means and remain unaware of the fact that other investors are the source of funding without real investment in valid means."

The Court concluded that the sold currency and its circulation constitutes fraud, which makes it an invalid transaction and a violation of law and public policy.

Consequentially – the Court found – the agreement does not fulfill the necessary elements for the formation of a contract under Article 129(b) of the Civil Transactions Law that is:

"The object of the contract must be something possible, specified or specifiable, and negotiable."

Which invalidates the contract and renders it *void ab initio* and restores the contracting parties to the state prior to the coming into effect of the agreement, with the obligation on the Seller to refund the moneys paid to the Buyer.

Takeaway

The majority of cryptocurrencies derive their value and increase thereof from their supply and demand on exchanges, so within the wide-encompassing definition of the Ponzi scheme by the Appeals Court, there is a risk of cryptocurrency transactions falling afoul of Article 129(b).

In the past few years, the UAE Central Bank, the Securities and Commodities Authority, the ADGM and the DIFC have set out in regulating digital assets with instruments such as:

- Central Bank Circular No. 6/2020: Stored Value Facilities (SVF) Regulation
- Securities and Commodities Authority Decision No. 23/RM/2020: Concerning Crypto Assets Activities Regulation
- DIFC Dubai Financial Services Authority: Consultation Paper No. 143 – Regulation of Crypto Tokens
- Abu Dhabi Global Markets Guidance – Regulation of Virtual Asset Activities in ADGM (VER04.280922)

The regulations set forth, those above and others in the digital asset industry, provide for various forms of licensing depending on the activity in the digital asset economy.

Failing to operate within the confines of the rules and regulations, or license accordingly, may lead to the invalidation of digital asset transactions on the premise that they do not conform with Article 129(b) of the Civil Transactions Law, or be considered a Ponzi Scheme within the definition adopted by the Appeals Court.

And for buyers who may have suffered from questionable

transactions, the Appeals Court judgment provides a sign of relief in the technical competency of the UAE courts to deduce and adjudicate digital asset disputes.

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