

Selected Issues in Crypto and Blockchain (SC) Dispute Resolution

Question for users, lawyers, regulators

Mark Beckett, DTL

Ho Chi Minh City, 30 September 2022

Substantive issues:

- Are new forms (cryptocurrency, smart contracts) comparable to existing legal forms with established rights and obligations?
- Or are new legal concepts and regimes required?

Procedural issues (especially dispute resolution):

- How do dispute resolution rules and procedures apply?
- Is there a need for a new approaches to dispute resolution in crypto/blockchain disputes?

Types of disputes to consider

- Crypto trading platforms
- Crypto network operators
- Crypto lenders
- Crypto issuers (project creators)
- Smart contracts on blockchain

Trading platforms: Binance arbitrations

1. 2021 trading halt

- Alleged trading halts execution delays during May 19, 2021 outage
- High volume, price volatility
- Traders unable to access their accounts and/or trading positions
- Trading halt prevented claimants from limiting their losses and meeting margin calls to avoid liquidation

1. 2022 trading of Terra USD/Luna and use of Anchor Protocol

Trading platform cases: Issues

Substantive issues:

- Did platform breach trading agreement with or duties to traders?
- Related:
 - Are platforms illegal unregistered broker dealers that failed to follow trading execution rules, e.g.?
 - Is crypto an unregistered security?

Procedural issues:

- How do dispute resolution provisions function (or not function) in this context?

Arbitrations against Binance re 2021 trading disruption

ICC Arbitration on behalf of one trader/holder - \$140 million

HKIAC “class” arbitration:

- 700 or more account holders trading in crypto derivatives
- Six individuals allege losses of over US\$20 million in aggregate
- Size of total more than US\$100 million.

Binance agreement contained a class action waiver

3. Class Action Waiver. You and Binance agree that any claims relating to these Terms or to your relationship with Binance as a user of Binance Services (whether based in contract, tort, statute, fraud, misrepresentation, or any other legal theory, and whether the claims arise during or after the termination of these Terms) shall be brought against the other party in an arbitration on an individual basis only and not as a plaintiff or class member in a purported class or representative action. You and Binance further agree to waive any right for such claims to be brought, heard, or arbitrated as a class, collective, representative, or private attorney general action, to the extent permissible by applicable law. Combining or consolidating individual arbitrations into a single arbitration is not permitted without the consent of all parties, including Binance.

International arbitration class/mass actions

- E.g. Abaclat ICSID case with mass claimants
- HKIAC rules and HK model law silent on issue
- Class arbitrations are a fraught issue in US
 - Line of Supreme Court cases that effectively restricts use of class arbitration mechanism
 - Issue of parties' intent under the contract and not policy (e.g., efficiency or fairness)
 - Clause's "silence" on the issue not sufficient to allow a class
 - Class action waivers enforceable

How issue may play out

- Claimants will attack enforceability of Binance's click-through terms as constituting a negotiated contract.
- Another well travelled issue in the US:
 - Does on-line contract put reasonably prudent person on "inquiry notice" of the terms of the contract
 - Browsewrap v. clickwrap

In contrast: Binance US class action arising out of Terra

Lockhardt v. BAM Trading Services Inc., Case No. 3:22-cv-03461, U.S. District Court (N.D. Calif. 2022)

- Case about Binance's trading in and support of Terra USD ("UST")/Luna and Anchor Protocol
- Claimants have to find a way around arbitration clause and class action waiver
- Plaintiffs argued arbitration clause and class waiver were unconscionable

Plaintiffs attacked mandatory Binance pre-arbitration procedure:

- Customer must “open a ticket with Customer Service” (ToU silent as to how)
- then “work with Customer Service to resolve [the] issue.”
- If no resolution customer must email Binance U.S. and provide detailed information
- This triggers a review period.
- There is no outer time limit constraining the review period.
 - At a minimum, it will last 30 business days (typically, approximately 45 days).
 - But even then, Binance U.S. may seek to indefinitely extend the “deadline”
- Company not bound by same terms
- Resolution email non-functioning

Court: Requires “users to jump through multiple, antecedent hoops before initiating arbitration . . . [t]here is no legitimate commercial need for this many burdensome obstacles prior to arbitrating disputes”

Relied on earlier Coinbase class action decision in same court

- Court found that Coinbase’s arbitration “scheme”
- imposed an unfair, burdensome “informal complaint process” only on customers “no obligation on Coinbase itself to submit its disputes with users to binding arbitration,”
- meaning Coinbase could file claims in court, while its customers had to arbitrate their claims.

Bielski v. Coinbase, Inc 2022 WL 1062049 (N.D. Cal. Apr. 8, 2022)

Court voided arbitration clause and class action waiver:

- Binance *unilaterally amended its arbitration terms in June 2022 following crypto crash*
- Court found that Binance made the process even more burdensome (“punitive”) designed to “discourage customers from obtaining relief”
- Lack of “mutuality” in that “gateway disputes about the scope of arbitrability to an arbitrator unconscionable and unenforceable” are given to the arbitrators but not when Binance sues
- Make arbitration agreement INCLUDING the “dependent class action waiver” unconscionable.
 - No express warning of delegation
 - Reference to AAA rules but no specific rules
 - Contract of adhesion
 - Unilateral right to modify on part of company

Observations

- “Lack of mutuality” arguments generally not successful in commercial arbitration
- Pre-arbitration dispute resolution steps usually enforceable
- Here court seems to have concluded they were not in good faith and amounted to a sham

Tezos class action against “issuer”: US 2014

Class action concerning Tezos blockchain project

- Browsewrap agreement
- Not an arbitration provision: choice of forum clause – courts in Zug, Switzerland
- Question whether on “notice inquiry”
- Buried in tenth page of twenty-page document
- Single sentence directed users to “refer to the legal document that will be issued by the Foundation for more details.”
- No hyperlinks to the contract itself, language indicating the user’s purported agreement, or other indicia tending to validate a browsewrap agreement

Inquiry notice: Would language put “a reasonably prudent user on inquiry notice of the terms of the contract.” *Nguyen v. Barnes & Noble Inc.*, 763 F.3d 1171, 1177 (9th Cir. 2014).

Observations

- Level of documentation of varying quality
- Under lawyered

Liability of network operators for lost private keys:

Recent case in English High Court concerning *Tulip Trading Limited v. Van Der Laan and others* [2022] EWHC 667 (Ch)

Facts:

- Plaintiff Craig Wright's company Tulip Trading Ltd
- Wright asserts he is Satoshi Nakamoto
- Computers in his home office hacked – lost private keys for BTC
- Sued various BTC networks
- Relief: order requiring network operators create patch
- to allow him to recover keys
- Feasibility of patch not at issue
- Claimed to be able to prove ownership through other means

TTL alleged networks owed users a fiduciary duty

- Users: entrusted care to n/w; had no control except for keys
- There was a reasonable expectation that operators would not act unreasonably
- Network users “an anonymous and fluctuating class with whom defendants have no direct communication”

Court dismissed case: Found that TTL did not have a “good arguable” case

No fiduciary duty owed by network to user that lost private keys

- No obligation to make software changes as it may be in interests of BTC owners
- Defendants not reasonably expected to have assumed this risk as operators
- May expose defendants to risk from other parties (from a rival claimant to keys eg)

No other duty of care owed by network operators

- Alleging failure to change how networks work rather than to address a defect
- Claimed existence of special relationship by virtue of network control and a requirement to take positive action
- Court:
 - Duty could be owed to a potentially unlimited class
 - Owners have duty to protect keys
 - Developers a fluctuating body of individuals

Observations

- Court distinguished between fixing a bug and adding a patch that would change fundamental aspects of the network
 - Left door open to duty to fix bugs
- Effectively ruled that BTC network was not a bank
- On appeal to Court of Appeal (except for BSV network)

Crypto lenders

- Seem to follow more traditional forms
- Not unlike commercial lending or trading agreements
- Margin ratios and calls
- Loan terms
- Lending in crypto
- Risk management
- Dispute resolution: International arbitration

Crypto creators (or “issuers”) – legal issues

Outright fraud – no actual project – **Modern Tech** in Viet Nam

Empires X Corp. – US – 100 mm crypto Ponzi scheme – promised 1% return per day
Trading bot that uses algorithm

False representations or claims

- Misrepresentations about design or features of stable coin: Terra USD/Luna algorithmic stablecoin (reserves or function)
- Misrepresentation as to level of USDT fiat currency (USD) reserves (Tether) 2021:
 - Backers paid \$18.5 million in a settlement with the New York Attorney General
 - Paid \$41 million fine by regulators the same year over allegations they misrepresented its reserves
 - Tether now publishes limited details about its reserves holdings daily

How to execute court orders regarding crypto in pseudonymous peer to peer network?: Recent NY case: *LCX AG v. John Doe 1-25*

- Complaint alleged theft of 8 MM of virtual assets in digital wallet
- Defendants were unknown “John Does” and “Jane Does”
- Thieves converted into ETH all of the non-ETH using several cryptocurrency exchanges
- Defendants then sent the stolen crypto to Tornado Cash, a mixing service that disguises b/c transactions by mixing assets with the deposits of other users
 - Thieves withdrew the ETH to withdrawal addresses
 - Used ETH to purchase USDC
 - Plaintiff used third-party analytics company to trace to an address

Address under control of defendant Centre Consortium

- Centre controls the underlying USDC protocol
- Has capability to deny addresses from transacting USDC
- Centre that maintained address had a policy to deny access and blacklist and address “[t]o comply with a ...legal order from a [U.S.] court of competent jurisdiction.”
- Judge issued order (OSC) freezing address

How to serve unknown parties regarding orders concerning address?

LCX Court approved novel service method

- Service by NFT:
 - Lawyers created an ETH-based NFT (ERC-20)
 - NFT contained hyperlink to court order
 - Airdropped NFT to address
 - Court ruled in circumstances this was valid service

Similar approach approved by English courts in *Fabrizio D'Aloia v. Persons Unknown, Binance Holdings Ltd. and Others*, Case No. BL-2022-001008, Doc. No. 2022 EWHC 1723, in the Business and Property Court of the High Court of Justice of England and Wales.

BSV new freezing protocol that enforces court orders

In *Tulip Trading* case, Wright settled with one defendant: Bitcoin Association (BSV network) on court-ordered freezing software

- Bitcoin Association agreed to develop and publish software that can be used on the BSV network to translate court orders) into a format capable of being broadcast to miners on their network.
- BA to attempt to find a suitable legal entity to operate the software, as well as develop and publish software that the miners can use to implement the digitized version of the order by freezing or unfreezing specific assets.
- Implementation up to miners

Awarding damages/relief in crypto disputes

Can't have an award for damages denominated in non-fiat currency?

- To some degree this may beg the question of what crypto is
- Tribunal could order the transfer of specified crypto tokens into a wallet
- But this is in the nature of positive injunctive relief
- May not be as enforceable as an award for money damages
- Could award damages in monetary currency equivalent to value

Chinese position on crypto arbitral awards

Gao Zheyu v. Shenzhen Yunsilu Innovation Development Fund Enterprise (L.P.) and Li Bin, (2018) Yue 03 Min Te No. 719

Claimant sought an award equivalent to monetary value of crypto held by wealth manager

- Arbitral tribunal found for claimant
- Tribunal determined price by looking at okcoin.com in USD
- Ordered respondent to pay that amount in CNY at USD:CNY rate on date of award

Court set award aside on public policy grounds

- Circulars by People's Bank of China prevent redemption or trading in cryptocurrency
- Court held that award amounted to a disguised redemption of BTC
- This contravened spirit of Chinese regs preventing redemption of crypto into fiat

Are arbitral awards denominated in crypto enforceable?

2021 Greek case: dodges specific issue but refused to enforce

- US dispute between lender and borrower
- Loan was in BTC
- On-line dispute resolution in US
- Award in favor of creditor
- Apparently denominated in BTC non-fiat currency
- German national sought to enforce in Greece
- Court refused to enforce on grounds of public policy largely because court concluded BTC was used to evade taxes

Western Continental Greece Court of Appeal 27.09.2021, unreported.

Does NY Convention prohibit an award awarding damages in crypto?

- Silent on issue
- Public policy under Art. V(2)(e) may be implicated
- Award ordering transfer as opposed to money damages

Resolving disputes (?) in smart contracts

- Self-executing code: Not supposed to be any disputes
- Not really designed for disputes

Are they legal contracts?

- “code is law” but is there a point at which the code is sufficiently specific and coherent that it becomes a legally binding contract sufficient to create enforceable legal obligations ?
- Ricardian contracts or hybrid smart contracts: Also in human language or supplemented by human language legal contract terms
- Wrapper agreement – sets out key legal provisions including choice of law, arbitration
- How to resolve disputes in automatically executing code especially if “code is law”

Off-chain DR

Trigger/pause/resolve

- Code allows a party to trigger an arbitration
- Trigger pauses execution of transaction
- May use conventional arbitration to resolve dispute

Multi-signature transaction

- Coins in a digital wallet accessible by three keys
 - - One for each party and a third for a neutral preselected “arbitrator”
 - - Two keys required for transfer
 - - In normal sequence, two parties operate keys and transaction completed
 - - Where there is dispute, arbitrator votes
- What if resolution is not binary?

Methods of so-called on-chain resolution

- Most involve human arbitrator
- Arbitrator as “human oracle”
- Allow “arbitrator” to change/supplement code

On-chain arbitration – “arbitration” (or dispute resolution) as an oracle

Hadera Hashgraph

- developer to deploy the smart contract with a list of public keys of arbitrators
- arbitrators have the authorization to subsequently edit the contract code to fix bugs, add features, or reverse specific transactions.
- if the designated arbitrators subsequently agree that the contract should change, then a transaction with the new contract bytecode, signed by the keys of those arbitrators, will be approved by the network, and the change will be implemented
- the “arbitrator’s” decision is binding.
- Is this arbitration?

Kleros

- Uses anonymous, non-deliberative “jury”
- Jurors stake native token (PNK) for ability to sit
- Are rewarded for a “coherent decision” – split
- Schelling game theory (focal point)
- A decision according to governing law?

LawTech Digital Dispute Resolution Rules

- On-chain automatic dispute resolution
- Parties can remain anonymous
- Arbitrator may modify code directly at any time
- Tribunal shall have power to “operate, modify, sing or cancel any digital asset relevant to the dispute” using “any digital signature, cryptographic key, password or other digital access or control mechanism” available
- May also direct “any interested party” to do any of these things

Streamlined procedure giving arbitrator control

- Arb has “absolute discretion” over procedure and what evidence and argument it receives
- No right to an oral hearing
- Tribunal may determine solely on papers
- 30 days for award unless otherwise agreed
- Award must be signed and by digital signature or crypto key if appropriate

JAMS Smart Contract Rules

Semi-inquisitorial process (R 12) Arbitrator “is empowered to take initiative in ascertaining the facts and the law” and may:

- “require additional factual submissions” including witness statements/documents
- “interview important witnesses” after giving notice
- request and consider expert reports and legal briefings

Other features:

- “Code will govern interpretation of the Smart Contract, and the terms of the Smart Contract, to the extent they are reduced to the English language, shall be considered only if there is an ambiguity or logical contradiction in the code.” (R. 13)
- Discovery limited to deposition “of one competent individual expert witness as to the meaning of the Smart Contract coding”
- The only documentation to be reviewed and considered by the Arbitrator is “the written contract, the computer code, and the witness’s testimony”

Observations

1. Do decisions or actions result in an enforceable arbitral award?
2. Under NY Convention ?
3. No set aside procedure ?
4. What is “seat” of “arbitration”?
5. What is the “governing law”?
 - a. Lex cryptographica
 - b. Lex mercatoria?
 - c. Specified somewhere in SC?
6. Do the on-chain dispute resolution provisions immunize parties from subsequent legal actions?

Regulation of crypto in US

- Heating up
- SEC Chairman has said that all tokens except BTC are securities
 - **“Of the nearly 10,000 tokens in the crypto market, I believe the vast majority are securities. Offers and sales of these thousands of crypto security tokens are covered under the securities laws.”**
- Subject to registration and regulation under the Securities Act of 1933
- And that all crypto exchanges are stock exchanges regulated under Securities Exchange Act of 1934

Two emerging US regulatory theories (untested):

- Staking in POS coins is lending and therefore a form of investment subject to the securities acts
 - Staking theory may be a way to get around Hinman (if SEC cares)
- Jurisdiction over digital assets based on physical location and “density” of operating nodes of network in US

Observations

- SEC is appearing to regulate by enforcement
- Very focused on crypto regulation
- Regulators concerned about abuses and volatility
- But want to reach a balance
- Singapore regulator:
 - Crypto investors “irrationally oblivious”
 - Motto: “Yes to Digital Asset Innovation, No to Cryptocurrency Speculation”
- EU: MiCA: Markets in Crypto Assets regulatory memo (Sept. 2020)
- HK: SFC and HKMA issued “2022 Crypto Regulation Circular”