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# Kluwer Arbitration Blog

## The Impending Binance Arbitration: a Primer on the World of Cryptocurrencies, Derivatives Trading and Decentralised Finance on the Blockchain

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### Introduction - What is Binance?

The rise of the cryptocurrency industry has spawned some of the fastest growing and most profitable companies since the original dotcom boom, with those like Coinbase, which was valued at almost US\$100 billion after its [recent IPO](#), being prime examples. However, Coinbase, as a cryptocurrency exchange, is dwarfed by the runaway success and size of the Chinese-founded exchange, Binance. On average, around [US\\$100 billion](#) is traded there daily. The current size of this exchange and trading platform is equally impressive in light of the fact that the company was originally founded in 2017 (five years after Coinbase). The reasons for Binance's rapid development have obviously mirrored the cryptocurrency industry's massive expansion, but they are also likely due to its unorthodox approach to providing its services in every corner of the globe over the past four years. This latter point is one of the many interesting parts of the impending arbitration to be filed by disgruntled traders against the platform.

News of a dispute involving Binance originally broke in mid-August 2021, when mainstream news outlets such as CNBC and the Financial Times released stories about a recently created third-party funder based in Switzerland called [Liti Capital](#), which was planning to fund a 'class action' style HKIAC arbitration with potentially up to 700 claimants. The circumstances of the dispute arise out of a shutdown of many parts of the Binance online trading platform on 19 May 2021, the day of one of the largest percentage drops in the value of Bitcoin ever, and allegedly resulting in huge losses for traders who could not access their accounts.

What has brought a lot of mainstream media attention to this dispute is Binance's long-standing, ambivalent approach to regulation when providing its services around the globe. The corporate entities behind the platform have shifted around the world

regularly as its success has grown, avoiding stricter regulation as regulators have reacted to Binance's presence within their remit. Critics have pointed to comments by Binance's CEO Changpeng Zhao (known colloquially as 'CZ') repeatedly touting Binance's 'decentralised' - implying "stateless" or "lawless" - nature. Let us look at the publicly-known facts.

From a corporate legal point of view, Binance appears to have originally been founded in mainland China in 2017, before [moving its servers and headquarters to Tokyo, Japan](#) later that year in advance of China's crackdown on Bitcoin exchanges and initial coin offerings (ICOs). After hints of stricter regulation in Japan in 2018, Binance [announced](#) plans to move some of its operations to Malta, and later also to [Bermuda and Jersey](#). Today, the platform has entities in the Cayman Islands, The Seychelles, Singapore, South Korea, Uganda, Ireland, U.S.A and the UK, amongst many other countries, without any clear indication as to which of the entities are parent companies, which are subsidiaries or how they are related.

However, in an [article](#) published by the South China Morning Post on 16 September 2021, CZ admitted that the platform would need a centralised entity to "work well with regulators". This marks a turning point from Binance's prior "catch-me-if-you-can" approach to regulation, and the platform's recognition that it cannot continue to operate wholly outside of national regulatory boundaries. This recent sequence of events puts to rest the media narrative that Binance as a whole is a stateless and decentralised set of entities with no corporate foundations and therefore a minimal level of obligations to either customers or regulators. An important distinction should be made between the fact that the Binance corporate entities are undoubtedly grounded in the corporate structures of each of their respective countries (and, as such, are clearly subject to their laws) and the fact that a number of services hosted on the Binance platform operate in a legal vacuum, raising the open question of whether the platform is a legal entity distinct from those corporate underpinnings and, if so, what legal regime governs it?

### **The Dispute, and the Billions behind Cryptocurrency Derivatives**

While no requests for arbitration or other statements of case have been made publicly available (it is not known, for example, which Binance entity is a respondent), a [video interview](#) by CNBC with Liti Capital CIO, David Kay, along with other [print interviews](#), have revealed some details around the potential allegations involved and approximate quantum of the claims. Of the 700 potential traders as claimants, six individuals allege losses of over US\$20 million in aggregate, with the size of the total claims possibly reaching more than US\$100 million. From the information available, most if not all of the potential claimants appear to have been trading cryptocurrency derivatives, a factor which is key not only to understanding the crux of the dispute but also Binance's commercial success and the recently heightened regulatory scrutiny of

cryptocurrency trading in jurisdictions around the world. Generally speaking, derivatives are contracts created on top of financial assets that have set correlations in relation to those assets.

Crypto derivatives on exchanges like Binance are almost identical to those that one might see on stocks, commodities or indexes in traditional financial markets, except for the fact that the underlying financial assets are obviously cryptocurrencies. Where crypto derivatives can be especially risky, and potentially catastrophic, for traders is through the high volatility of cryptocurrencies, especially over short periods of time.

What is alleged by the potential claimants in the Binance dispute is that they were unable to access their accounts and/or trading positions during one of the most volatile days in the history of cryptocurrencies. This was due to Binance's platform shutting down, preventing them from either limiting their losses, or posting more collateral to avoid liquidation. These types of claims are not unheard of in regulated traditional markets (see [India's NSE outage for four hours in February 2021](#)). However, in the case of Binance, cryptocurrency trading is unregulated by any jurisdiction other than by subjecting it to *de facto* bans on crypto derivatives trading in countries such as the U.S., China and the U.K.

### **Unique Aspects of the Binance International Arbitration**

On the surface, this is a dispute that presents several features in common with many other disputes regularly brought to international arbitration:

- Binance has Terms of Use that provide a clear reference to HKIAC arbitration, a seat of arbitration in Hong Kong and Hong Kong law as governing law;
- Binance has a number of corporate vehicles behind the platform, one of which is Binance Holdings Limited, a company incorporated and with an address in the Cayman Islands and another being Binance Limited, a company incorporated and with an address in Hong Kong; and
- Although, according to the information shared by Liti Capital, the prospective claimants may attempt to file a class arbitration against Binance, the Terms of Use provide a waiver of class arbitrations, albeit this could have been added after the current dispute started.

However, some aspects of this dispute present very unique challenges arising from the world of cryptocurrencies. Some of these challenges include the following:

*i. Identifying Proper Parties*

While the consistent media characterisation of Binance as an ephemeral, stateless and decentralised platform may be overblown, from a contractual point of view, the Terms of Use for Binance.com remain equivocal as to what Binance corporate entities control and are responsible for the platform's operations. The Terms of Use refer only to "Binance Operators" as being the parties that run Binance, without naming any incorporated legal persons, and conversely, including language to the effect that the identities of these operators are subject to change. This is likely to be a very hotly contested legal issue in the impending arbitration due to the fact that Binance's global corporate structure continues to be opaque and unknown, even to regulators such as the UK's FCA, who reportedly requested this information and was refused by Binance's UK entity.

Further, in a jurisdictional context, the question arises whether Binance would be able to argue that the trading services provided on its platform are decoupled from nearly every Binance entity (especially those which own the majority of its assets) except those entities which Binance could essentially select due to the open drafting of the Terms of Use. This leads to the larger, and unanswered, question of identifying the legal status of the Binance platform itself and how its prior approach to providing its services around the globe has contributed to 'muddying the waters' of its corporate governance.

*ii. Applying Substantive Legal Standards & Potential Arbitrability Concerns*

The next question is which substantive legal and liability regimes govern the derivatives trading services allegedly used by foreign claimants on the Binance platform, considering that Hong Kong law (the governing law of the Terms of Use) does not allow unlicensed derivatives trading in its territory and its residents are ostensibly banned from using Binance derivatives services according to the Terms of Use. While we do not know the nationalities of the claimants, it is likely that they comprise a large number of countries. This raises the question of the propriety of the sole application of Hong Kong legal standards to an arguably international and decentralised set of services, performed by the parties outside that jurisdiction. This also has the potential to bring up serious illegality concerns and the question of arbitrability under Hong Kong law.

*iii. Traditional Enforcement against Cryptographic Assets & On-chain Enforcement*

Decentralised services provided through blockchain technology bring about a range of obstacles, and also opportunities, when confronted with the traditional commercial and corporate world.

Firstly, the legal nature of cryptographic assets remains uncertain in many jurisdictions, leading to doubts as to the enforceability of a successful award over certain amounts of cryptocurrencies. There are a small number of countries where Bitcoin and other cryptocurrencies are **banned or highly restricted** but many other countries have simply not yet legislated for their existence. For example, India has not yet attributed any legal status to cryptocurrencies but a **legislative bill** is being discussed at the present time.

Secondly, and perhaps more interestingly from both a technical and practical point of view, is the possibility of on-chain enforcement, *e.g.* where ownership of cryptographic assets can be automatically transferred to the winning parties of an arbitration through the execution of smart contracts on the blockchain, therefore dispensing with the necessity of resorting to the traditional levers of enforcement such as national courts. Practically, it would appear unlikely that the Binance dispute would culminate with the execution of any type of on-chain enforcement mechanism. However, there are crypto/blockchain disputes which have or currently are **being resolved in this manner**. Traditional arbitral institutions, such as **JAMS**, are beginning to look at drafting arbitration rule sets relating to disputes involving smart contracts.

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