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Investing in Cryptocurrencies under the Existing Investment Arbitration Regime

Paata Simsive (Uppsala University Law School) · Tuesday, May 19th, 2015

Over the past few years, the business community has discovered a new form of investment: this new type of capital formation is broadly known as investment in cryptocurrencies. The capital interest in these investments involves large financial institutions such as investment banks, rating services, assets management and consultancy agencies. According to the CoinDesk, the short list of large financial institutions involved in cryptocurrencies' include: UBS, JPMorgan, Goldman Sachs, Fitch Ratings, Fortress Investment (Pantera) and Silicon Valley. ?he total amount of investments in the last two years exceeded hundreds of millions of USD. However, despite this growing interest, the legal nature as well as the regulatory framework governing the cryptocurrencies is still unclear.

The first legal uncertainty, at this point in time, is that it is not definite whether economic activities of this newly developed industry can be classified as an 'investment' under existing regime at all. Such characterization could be possible under the broad definition of an 'investment', provided by the majority of investment treaties. On the other hand, in case where the tribunals follow the so-called 'double keyhole approach' taking into account the 'Salini' or 'Salini like' test, it will be more difficult to argue that investments in cryptocurrencies constitute a form of investment. The weakest point of cryptocurrencies, out of five criteria of Salini test, is the one that refers to 'contribution to economic development of the host country'. Nevertheless, while this issue is a matter of a separate research, this post is based on the assumption that investments in cryptocurrencies could be characterized as 'investments' under the international investment agreements. Also, for the purposes of this post, the term 'investor' refers to *a legal or natural person who develops certain facilities in the territory of another state in order to get involved in the process of generating cryptocurrencies*.

When it comes to regulatory framework, the regulatory policy adopted in the United States offers the most illustrative example of the complexity of the subject. In the past few years, the majority of investments in cryptocurrencies have been made in that country for two main reasons. First, the US developed the relevant regulations and thus provided legal certainty for the treatment of these particular investments. The second reason is that the US Courts, in a number of cases, treated the cryptocurrencies as a form of money. On July 23, 2013, the United States District Court of Texas rendered the first decision (*Securities and Exchange Commission v. Trendon T. Shavers and Bitcoin Savings and Trust*, Memorandum Opinion Regarding the Court's Subject Matter Jurisdiction, Case No. 4:13–CV-416) concerning the key issue related to the nature and the legal classification of cryptocurrencies. The Court characterized them as 'currency or some form of money'. The above position was confirmed by numerous subsequent decisions of the US Courts (see the most recent one, United States District Court, Southern District of New York, *United States of America vs. Robert m. Faiella, "BTCKing" and Charlie Shrem*, Memorandum Order, 14-cr-243, JSR).

The approach adopted by the US Courts was confirmed by the Financial Crimes Enforcement Network (FinCEN) in early 2013, which issued an interpretive guidance clarifying that cryptocurrencies are a 'form of money', and thus any entity operating in money services business ('MSB') is subject to FinCEN's registration, reporting and recordkeeping regulations. However, about one year after this regulatory measure, on March 25, 2014, another authority of the same Country, the Internal Revenue Service ('IRS') issued a notice declaring that it will treat cryptocurrencies as property rather than currency for federal tax purposes. For the foreign investor, as defined above, this means different regime of taxation with considerably negative financial effects. In the words of MTD v. Chile tribunal (ICSID Case no. ARB/01/7, Decision on Annulment, March 21, 2007), two different arms of the same state had acted in contradictory manners, setting up different standards for the same subject in a different time frame.

It is an established fact that every investor makes decisions based on the assessment of risks and profits. In the case of cryptocurrencies, in which the geographical and other criteria have no importance, the foreign countries' legislation seems to be the only decisive factor for the investor. Under the existing investment arbitration regime, laws of a state may be attractive for the investors to make their investments or otherwise, in the words of Total S.A. v. Argentina tribunal, be 'inherently prospective' (ICSID Case no. ARB/04/01, Decision on Liability, 27 December 2010, para. 99). But when it comes to investing in cryptocurrencies, is it possible to define which national laws could be characterized as 'inherently prospective' in nature? From the perspective of the investor, every legislative act could be 'inherently prospective'. At the same time, according to the decision in Enron v. Argentina (ICSID Case no. ARB/01/3, Award, 2007, paras. 264 – 268) and CMS v. Argentina (ICSID Case no. ARB/01/8, Award, 2005, para. 274), the state may be held responsible for the breach of the investor's legitimate expectations when it modifies the laws which were an incentive for an investor to invest.

The concept of 'inherently prospective' laws that was endorsed by the Total tribunal could only be understood as a division between the specific investment laws of the state, on one hand, and the general regulatory framework, on the other. In the case of specific investment laws, it could be accepted that these laws entail a certain legal expectation since they refer explicitly to the investors. In the latter case, however, the general regulatory framework is more difficult to be understood as to create such expectations (*Total S.A. v. Argentina*, para. 122).

The Total case is one of many that seem to move from strict adherence to a 'stable framework for the investment' taking into account the opposing rights of the states. One of the main concerns regarding cryptocurrencies, which might justify the change of the regulation by the states, is that the transactions are anonymous. Anonymity means that transactions normally fall outside of the regulatory authorities' 'radars'. The Central Banks and the governments around the world are ratcheting up warnings about cryptocurrencies and underlining some major concerns, such as: the cryptocurrencies are used to support criminal activities, for example, money laundering, trafficking, terrorism and the exchange of illegal goods. Moreover, the governments often fear that transactions in cryptocurrencies could underestimate their national currencies, allowing third parties to speculate with the prices of goods and other crucial issues of sovereign nature. Another problem related to the area of cryptocurrencies is that they are an incentive for tax evasion. The tax evasion issues can be traced back again to the cryptocurrencies' very nature, i.e., their anonymity.

Any income related to cryptocurrencies can be potentially concealed, and thus, taxes can be evaded. To date, many governments have already taken the lead to address an emerging legal framework related to the taxation of cryptocurrencies. These measures, however, are not always successful.

Considering the legal uncertainties related to the cryptocurrencies, the need of the state to regulate and protect its principal rights seems even more logical and imperative. These investments are made in an evolving economic and legal environment, and this parameter is a part of the assessment of risk of every investment (ICSID, *El Paso Energy Int'l Co. v. Argentine Republic*, Case no. ARB 03/15, Award, para. 352). When observing the downsides of investments in cryptocurrencies, the investors are aware firsthand of the particular risks related to their investments. In the words of the tribunal in *Continental Casualty Company v. Argentina* (ICSID Case no. ARB/03/9, Award, 2008, para. 258), "reasonable expectations presuppose reasonable investors". Given the high risk arising out of these type of investments, one can conclude that protecting the investments in cryptocurrencies, even under the broadest protection standard such as the Fair and Equitable Treatment, could not, substantively, amount to "freezing" the state's right to regulate.

In a more general context, the right of a host state to regulate its own laws constitutes the principal manifestation of the sovereignty of the state and its restriction may only be justified by an explicit undertaking by the state (*Total S.A. v. Argentina*, paras. 117, 429). In other words, the companies or the individuals who have invested in cryptocurrencies can legitimately claim damages as a result of the alteration of the general regulatory framework, only if additional guarantees are made by the host states. Such guarantees could constitute an express contractual commitment, such as a stabilization clause or a specific unilateral declaration attributable to the state. Thus, foreign investors having invested in cryptocurrencies in the US could benefit from the relevant investment treaty provisions, such as NAFTA, by invoking the breach of FET standard of Article 1105, only if, in addition to the FinCEN's, US national courts' and IRS's contradictory regulatory practices, the US government had committed further specific undertakings.

Concluding remarks

In some cases, including that of investment in cryptocurrencies, the competing rights and interests go beyond the traditional conflict between the right of the state to regulate for public interest, on one hand, and the right of the investors to be protected on the other. When the high risk investments are made in a newly developed and unpredictable legal environment, no reasonable investor can expect a general regulatory framework to serve as an inducement to invest, or the promise that certain laws of the state will not change in the future.

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