Kluwer Arbitration Blog

Blockchain and Cryptocurrencies: The New Frontier of Investment Arbitration?

Armand Terrien (Terrien Avocat) and Alexandra Kerjean (Quinn Emanuel Urquhart & Sullivan LLP) · Thursday, October 18th, 2018

Blockchain and cryptocurrencies (including bitcoin) have garnered significant attention in legal scholarship over the last few years, mirroring and to some extent anticipating on the public debate over the impact of blockchain technology on the new world economic landscape and the adequate level of regulatory response to such impact – Is a cryptocurrency taxable income or property (the IRS thinks so)? Is it an asset subject to lien or attachment (courts are starting to think so)? Is it an investment contract (security) susceptible to make initial coin offerings (ICOs) subject to certain securities regulations (the SEC thinks so)? Or perhaps a commodity (the CFTC thinks so)?

When it comes to arbitration, the literature (including on this blog, here, here, here, here, here, here and here) largely focuses on how the technology is going to change the way disputes are settled, *i.e.*, how it will revolutionise the ADR game, either by boosting Online Dispute Resolution (ODR) or by altogether substituting smart contract dispute resolution mechanisms to arbitration as we know and practice it. In other words, what blockchain can do for arbitration.

Of equal interest, but much less in the spotlight, is what arbitration can do for blockchain. In particular, we submit that within the next few years, blockchain technology and cryptocurrency industries will become an increasingly active playing field for investment arbitration. Blockchain technology and crypto industries are therefore arguably set to replace solar and renewable energy ventures as the new frontier of investment arbitration.

In this post, we anticipate some of the ways investment arbitration can serve blockchain and crypto actors in light of the uniqueness of this digital industry, as well its rapidly evolving regulatory framework.

1. **Crypto ventures and assets as the object of foreign investment legislation**

Leaving aside jurisdictions unfriendly or downright hostile to blockchain and crypto (such as Brazil, which in early 2018 elected to prohibit investments in crypto by investment funds and ruled that cryptocurrencies are not financial assets), there are arguably two strands to the regulatory rush to address the development of the industry. First, regulators and legislators can chose to tackle, on a piecemeal basis, discrete legal issues raised by the industry, notably as they relate to tax and securities regulation. Second, countries that have identified the potential for development of the industry and which are eager to attract foreign capital, can decide to embrace liberal, far-reaching, legislation.

In December 2017, Belarus became the first country in the world to enact such broad legislation. The Belarus "Digital Economy Development Ordinance" not only authorises ICOs at national level, it also recognises crypto mining (the act of creating bitcoin or other cryptocurrencies by solving complex algorithms), exchange services, and the use of smart contracts, as legitimate business activities. Compared to more restrictive regulatory frameworks, such as the one in place in Russia, the new Belarus legislation is evidently designed to attract foreign investors willing to develop blockchain and crypto activities in the region.

Other countries, such as Switzerland, have already signalled their positive stance towards cryptocurrencies. France is preparing legislation legalizing ICOs and generally establishing an attractive regulatory framework for companies using cryptocurrencies so as to attract financial start-up businesses. Venezuela, a country no stranger to investment arbitration, has even gone further and launched its own cryptocurrency pegged to oil, called the "Petro", so as to sidestep U.S. sanctions.

2. **Crypto ventures and assets as protected investments under international law**

Having established that States may increasingly identify blockchain and crypto technology ventures as worthy objects of foreign investment legislation, we must first turn to the question of whether this investment can be a "protected investment" under international law. To our knowledge, there is no publicly available award discussing the jurisdiction of an arbitral tribunal over a dispute concerning blockchain or crypto investments. There are however a number of staple issues in investment arbitration which call for reasonably obvious comments as they apply to blockchain and crypto-related investments, with the risk, of course, of fuelling long-standing and lively debates.

- **"Protected investment" under traditional BIT definitions**

Moving from the obvious (but not to be overlooked) to the more novel, there are a number of elements of any blockchain or crypto venture that would qualify as protected investments under traditional BIT definitions.

First, it is worth recalling that the *production* of bitcoin and other cryptocurrencies is costly and time consuming. Mining farms require significant capital commitment (lease of land; purchase of servers) and generate massive operating costs (mostly electricity). In this sense, a crypto-mining farm is just like any industrial plant, and easily identifiable as a protected investment. By way of example, the majority of mining farms are located in Canada, Iceland, or China, where energy is less expensive, and investors are setting up farms in Siberia, the Ukraine, or Kazakhstan, in an effort to reduce production costs as they might in any other industry (see here and here). Any change in legislation or political shift in one of these countries may potentially trigger investment claims similar to those we have become accustomed to in the past 20 years.

Second, the question arises whether the *crypto asset itself*, the bitcoin for instance, can be a protected investment for purposes of a BIT. In this respect, the use of the word "currency" is somewhat deceiving, as a cryptocurrency is not a legal tender or fiat currency (with the notable exception of Japan, where bitcoin is indeed a "legal tender"). However, much like money which is kept in bank accounts held at financial institutions, cryptocurrencies can be held in so-called "wallets" (more accurately, it is the private keys necessary to access one's bitcoin and sign off on transactions which are held, or stored, in the wallet). There are different types of wallets, including "custodial wallets", which are held by third-parties to whom one entrusts storage of one's private keys much like one would trust one's bank to place valuables in a safe. Investors and tribunals have been toying with the notion that money held in a bank account could constitute a form of protected investment under a BIT. Reasoning by analogy, if a bitcoin or other cryptocurrency "held" (with all the ambiguity that attaches to this term, see *infra*) in a wallet became unavailable to its owner through any act of a State (such as new legislation forbidding the use of crypto, or nationalising the wallet's custodian), an arbitral tribunal could likely find that the contents of the wallet are a form of protected investment.

Third, expending from the narrow definition of "currency" (as vague as it is) to other uses of the blockchain technology, one could easily envision "coins" as protected investments. The reasoning would indeed be even more intuitive if the tribunal were to find that the crypto-asset was more akin to a financial instrument or intangible asset (a "coin" acquired through ICO for instance), than traditional currency. In this situation, and depending on the definition of "protected investment" in BITs potentially applicable to the dispute, an investor could make a colourable case that their crypto asset is indeed a "protected investment".

The move towards regulating crypto assets of various shapes and forms as securities, taxable income, or intangible property for tax and securities law purposes, would suggest that in the not so distant future, tribunals could be amenable to extend the protection of BITs not only to blockchain businesses and industries, but to the very assets they generate, or trade in, as well. Of course, as soon as such a trend is identified in investment arbitration case law, there is a good chance that States will tailor the definitions of protected investments in their model BITs in an effort to rein in any such trend. The extent to which States will adapt their model language, however, will largely depend on the impact blockchain technology will have had on international trade when the issue finally arises.

Finally, of course, the investment must be located in the territory or dominion of the host State to be deemed "protected" under a BIT. This will not be an issue where the arbitration concerns a mining farm. The situation is however much more complicated where the crypto assets (coins or tokens of various shapes and forms) exist only in the blockchain, *i.e.*, in a distributed ledger system that by definition knows no geographical border. However, a colourable claim that the investment is located in the territory of a host State can be made in cases where certain rights or obligations linked to the asset only arise in the territory of that State, or where sufficient connections can otherwise be established under more traditional tests. For instance, a "coin" deemed a financial asset by the Japanese regulator, issued by an issuer registered with the Japanese regulator, and traded on a crypto exchange under the supervision of the Japanese regulator presents evident connections to Japan, such that Japan could be identified as the home State of an investment in such a "coin" for investment arbitration purposes.

- **"Protected investment" for purposes of Article 25 of the ICSID Convention**

The ICSID Convention provides no definition of the notion of investment. In determining whether a certain crypto asset or venture qualifies as such for purposes of Article 25 of the Convention, a tribunal may seek to ascertain whether the asset or venture meets the requirements of the so-called Salini test: (i) a contribution of money or assets; (ii) a certain duration; (iii) an element of risk; and (iv) a contribution to the economic development of the host State.

For purposes of this post, we will simply open two avenues for future discussion.

First, there is no apparent bar to a crypto asset constituting the *means* of acquisition or holding of an investment for purposes of the first prong of the Salini test. Second, the nature of blockchain technology and decentralised ledgers will in some cases make it more difficult for an investor to meet the fourth prong of the test (contribution to the economic development of the host State). This criterion has of course come under fire in recent years. Even if the criterion is retained, however, there will likely be colourable arguments to be made on a case-by-case basis that a specific crypto-asset meets this requirement (see *supra*).

Investments in mining farms, made *via* traditional currencies or cryptocurrencies, would of course constitute a more traditional form of investment, falling less controversially under the Salini test.

3. **What about substantive protections and damages ?**

Once a protected investment has been identified, the whole gamut of substantive protections should be available to the investor, along easily identifiable lines. If legislation banning cryptocurrencies is enacted and a mining farm shuts down as a result, there is ample expropriation and legitimate expectations precedent that would readily translate to the situation. If new tariffs or barriers are enacted, legitimate expectations and fair & equitable arguments likewise immediately come to mind. The list could go on.

As for damages, under the scenarios outlined above, the much-discussed volatility of cryptocurrency should not be a dominating factor of any quantum analysis. Specifically, it should not serve as a means for substantial diminution of any award on damages, should a tribunal recognise the liability of a State for violation of its international obligations towards a more traditional form of blockchain or crypto-related investment. This issue may however be worth revisiting, for instance in situations where the investment was made by commitment of cryptocurrency, or where issues of assumption of risk are particularly salient – for instance were the form of investment is most akin to an investment in a financial instrument.

The authors are senior associates in the international arbitration practice of Quinn Emanuel Urquhart and Sullivan's Paris office. *They would like to thank Mauricio Pizarro Ortega and Magdalena Bulit Goni for helpful research assistance in the preparation of this post.* *The views expressed in this post are the authors' personal views, and do not reflect the opinions of Quinn Emanuel.*

---

uncover potential conflicts of interest.

This entry was posted on Thursday, October 18th, 2018 at 7:39 am and is filed under Blockchain, Cryptocurrency, Investment Arbitration
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.