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Award Concerning Bitcoin Exchange – Bit Too Risky to Enforce?

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In its civil ruling (2018) Yue 03 Min Te No 719 on 26 April 2020, the Shenzhen Intermediate People's Court (the "Court") set aside an award made by a local arbitral institution in Shenzhen (the "Award"), a special economic zone and the bridgehead of the China's reform and opening-up. This judgment was approved by the Supreme People's Court of China (the "SPC"). The Award was set aside on the ground of infringement of Chinese mainland public interest, namely that the financial market order and stability in the Chinese mainland society was considered at stake.

Background

Gao contracted with Li to manage Li's personal assets, as a result of which Gao was in possession of some of Li's assets including cryptocurrencies and their proceeds (the "Prior Arrangement").

On 2 December 2017, a separate contract (the "Contract") was entered into between Yun Si Lu (the "Company"), Gao and Li, under which the Company agreed to sell to Gao 5% of the shares of another company it owned (the "Shares") for Chinese Yuan ("CNY") 550,000 (the "share price"). Partly as an attempt to bring the Prior Arrangement to an end, Li and Gao agreed with the Company in the Contract that Gao would pay CNY 250,000 and Li would pay CNY 300,000 respectively to the Company towards the share price, while Gao shall return the cryptocurrencies, namely 20.13 Bitcoins ("BTC"), 50 Bitcoin Cash ("BCH"), and 12.66 Bitcoin Diamond ("BCD") to Li in 3 installments.

Li alleged that Gao did not perform the Contract and therefore, the Company and Li filed for arbitration in Shenzhen.

The Company and Li sought in the arbitration that:

- the Shares be transferred to Gao;
- CNY 250,000 be paid by Gao to the Company;
- USD 493,158.40 (equivalent of 20.13 BTC, 50 BCH and 12.66 BCD) and interest be paid by Gao to Li; and
- an additional CNY 100,000 be paid by Gao to Li for breach of the Contract.

The Award

The arbitral tribunal found that Gao was in breach of the Contract and shall compensate the Company and Li for failure to return the BTC to Li. The arbitral tribunal also found in favor of the Claimants on most of their claims. In the award, the arbitral tribunal decided to award USD 401,780 (held by the arbitral tribunal to be the equivalent of 20.13 BTC, 50 BCH, and 12.66 BCD, which shall finally be settled in CNY pursuant to the CNY-USD exchange rate at the date of the Award) plus interest to Li, by "taking reference" of the closing price at the material day from the website okcoin.com.

The Court's decision

On 29 September 2018, Gao subsequently applied to the Court to set aside the Award. As mentioned above, the Court allowed the setting aside application. The Court's reasoning is as follows:

First, the Court referred to Article 58 of the Arbitration Law of the People's Republic of China ("PRC"), which provides the circumstances in which a party may provide proof for when applying to set aside an arbitration award. The issue in dispute in the setting aside application is whether the arbitral award is in breach of public policy.[1)]

Second, the Court relied on the Notice on Precautions Against the Risks of Bitcoins (the "Notice") issued by five PRC authorities including the People's Bank of China, stating that Bitcoins do not have the legal status of a currency and therefore shall not be circulated or used in the market as such.

The Court then further cited the Announcement on Preventing the Financing Risks of Initial Coin Offerings (the "Announcement") issued by seven PRC authorities including the People's Bank of China, according to which token fundraising and exchange platforms must not:

- provide exchange services between tokens and fiat currency, and between cryptocurrencies;
- buy or sell tokens for cryptocurrencies, or act as central counterparts facilitating the trading of tokens for cryptocurrencies; or
- provide pricing or information intermediary services for the exchange of tokens for cryptocurrency.

The Court found that the Notice and the Announcement prohibit illegal activities that would disrupt financial order and stability. In the Award, it was decided that Gao shall compensate Li with the fiat currency (CNY) equivalent of the "BTC value". The Award, which granted the Claimants the redeemed value of the cryptocurrencies Gao held in possession for Li and supported the exchange of the cryptocurrency with fiat currency, if enforced, would have facilitated circulation of Bitcoins in PRC which is against the spirit of the Notice, as well as the Announcement which prohibits exchange services between tokens and fiat currency, and therefore would disrupt the "integrity and security" of the finance system and in turn, the public policy of PRC.

The Award was accordingly set aside.

Comments

First, in recognizing disruption of financial order and stability in PRC as the basis to set aside this domestic award, it is consistent with SPC's priority to protect the integrity and security of the finance industry in PRC in the past few years.

It remains to be seen whether, and if so, to what extent financial integrity and security will trigger public policy concern under the New York Convention when it comes to enforcing foreign arbitral awards in PRC.

Claimants in off-shore arbitrations where the place of enforcement includes the Chinese mainland are thus advised to take note of this decision, and carefully frame their claims in a way that would not *de facto* challenge the financial order and stability in the Chinese mainland.

Although the SPC's position on the scope of public policy has arguably been narrow, such scope has evolved over the years. In 1997, the SPC held in a case that the performance of rock and roll music under a performance contract violated public policy. On later occasions, the SPC ruled against claims of breach of public policy in relation to arbitral awards involving breach of tax law, *res judicata* and violation of mandatory laws of China (the "non-enforcement cases").

Second, the Announcement did not set out the PRC government's position on cross border initial coin offering ("ICO") activities or exchanges. Therefore, it remains unclear whether courts in PRC will consider public interest concerns when asked to enforce arbitral awards relating to cross-border ICO activities.

Third, it leaves open the question as to whether the SPC will or should apply the same reasoning, when it is asked to enforce arbitral awards relating to "integrity and security" of finance systems in other jurisdictions. To shed light on this topic, we may look at the Arrangement Concerning Mutual Enforcement of Arbitral Awards Between the Mainland and the Hong Kong Special Administrative Region, pursuant to which a PRC court may refuse enforcement of an arbitral award if it would be contrary to the public interest of the Chinese mainland only. Also, the public policy discussed in the non-enforcement cases so far have all been restricted to domestic matters in PRC. No other jurisdiction has ever been involved in such non-enforcement cases where the public policy ground was considered.

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References

?1 It is noteworthy that the legal ground the Court relied upon in its ruling is Article 58, which stipulates that if the court finds the arbitral award to be contrary to public interest, it shall set aside such award. It is often understood that the term “public interest” is equivalent to the term “public policy” under the New York Convention.

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