Kluwer Arbitration Blog

Arbitration Tech Toolbox: Is a Mexican Court Decision the First Stone to Bridging the Blockchain Arbitral Order with National Legal Orders?

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On 28 May 2021, for the first time in blockchain arbitration history, Mexican courts enforced an arbitral award relying on a blockchain arbitration protocol ("Blockchain Arbitral Award"), as explored in the report found here ("Carrera Report") (see the Appendix for the Blockchain Arbitral Award, which is in Spanish).

This decision is of great significance for the development of blockchain arbitration. However, in this case, the Blockchain Arbitral Award was not enforced directly but was rather incorporated by reference into a traditional arbitral award in order to ensure its full compatibility with the existing arbitration framework.

The present post is an analysis about how the existing arbitration legal framework can be used as a tool to bridge the blockchain arbitral order with national legal orders.[1] [2]

The Background of the Case

The facts and procedure of this case are simple but unprecedented. The dispute arose out of a rental estate leasing agreement between two natural persons. Such agreement provided for a novel arbitration mechanism: a hybrid process. The clause stated that, after receiving the claims of the parties, the arbitrator should draft a Procedural Order addressed to the decentralized justice platform 'Kleros', which would then issue a decision based on its blockchain arbitration protocol. Kleros is a decentralized application ("Dapp") deployed on Ethereum which provides its users with decentralized arbitration services. Interestingly, the clause stated that the arbitrator shall incorporate the decision received from Kleros into his arbitral award to govern the substance of the ruling, issue it in writing and indicate the date, place, name and signature of the arbitrator.

On the 3 November 2020, after the landlord had initiated the arbitration proceeding, the arbitrator followed the procedure agreed by the parties in their arbitration agreement and issued an arbitral order titled "for referral to Kleros", thus remitting the merits of the dispute to the Dapp Kleros. After running its blockchain arbitration protocol, Kleros communicated to the arbitrator on 23 November 2020 the decision reached by the three jurors selected for the case. Four days later, the sole arbitrator rendered an arbitral award in Guadalajara (Mexico) incorporating the decision from

Kleros. However, interestingly, the blockchain arbitration process and its decision are only detailed (and thus incorporated) in the "Arbitral Procedure" part of the award while the "Decision" (or operative part) of the award does not mention the Kleros process and seems to indicate that the award is in the name of the arbitrator only, without clearly reflecting the decision-making role played by Kleros.

Subsequently, the landlord requested enforcement of the arbitral award before Mexican courts. The latter issued a decision by 28 May 2021 granting enforcement of the award.

Features of Blockchain Arbitration and the Blockchain Arbitral Order

Due to its decentralized nature, blockchain arbitration currently presents some incompatibilities with the existing arbitration legal framework due to, for example, the cryptographic form of the arbitration agreement and the lack of a seat of arbitration.

On the one hand, trying to assess the possibility to enforce a blockchain award before national courts seems meaningless. Because blockchain arbitration operates as an oracle able to trigger smart contracts, it enjoys self-enforcement capabilities. In that way, blockchain arbitration is autonomous from national courts and allows us to acknowledge the existence of a Blockchain Arbitral Order. On the other hand, the blockchain economy is not totally detached from national legal orders given that some blockchain assets are linked to national legal orders.

In the present case, the matter of the dispute (a property subject to a rental agreement stipulated in Mexican pesos) existed only off-chain, in the 'real world'. Thus, despite resorting to a blockchain arbitration protocol, it was necessary to connect the Blockchain Arbitral Award with the Mexican legal order for enforcement purposes. After a decision was reached by the on-chain jurors, the off-chain arbitrator issued an arbitral award incorporating the Blockchain Arbitral Award. Doing so, the off-chain arbitrator indirectly gave legality to the Blockchain Arbitral Award which, under the existing traditional arbitration framework, might not have been considered as legally enforceable. As rightly argued in the Carrera Report, resorting to traditional arbitration can be effectively used as a tool to enforce blockchain awards.

This author would go even further, by stating that the involvement of an off-chain arbitrator is a bridge between the Blockchain Arbitral Order and national legal orders.

Legal Tools to Connect the Blockchain Arbitral Order with National Legal Orders

This recent decision issued by the Mexican courts represents one example of how the existing legal framework can be used as a tool to grant legality to blockchain arbitral awards. The Carrera Report suggests that the parties' choice to resort to blockchain arbitration could be envisaged both as a transactional agreement, or as a tool for *Ex Aequo et Bono* decision making. We remain skeptical in this regard. First, it is uncertain whether relying on blockchain arbitration to adjudicate the dispute could qualify as a transactional agreement since the parties do not make reciprocal concessions but simply resort to a third party to make a decision. Secondly, envisaging blockchain arbitration as a simple tool for *Ex Aequo et Bono* might frustrate parties' expectation in a case where, because it enjoys full discretion, the off-chain arbitrator would adopt a decision in total

contradiction with the blockchain arbitral award.

Alternatively, we rather suggest that party autonomy and the *res judicata* doctrine should be credited as the key considerations for connecting the blockchain arbitral order with national legal orders.

Party autonomy

Under Article 19(1) of the Model Law, parties are free to agree on the arbitration procedure to be followed by the tribunal, provided it does not contravene the applicable *lex arbitri*. Parties might, for example, opt to resolve their dispute by way of a coin toss, chess game, or race, with the arbitrator acting as a referee, so long as it does not contravene national public policy. Consequently, as the recent decision from Mexican courts demonstrates, nothing stands in parties' way of opting for the determination of all or certain aspects of their dispute by a blockchain arbitration protocol, with an off-chain arbitrator then incorporating the result into its arbitral award – at least for now in Mexico. Being a Model Law jurisdiction, this recent decision from the Mexican Courts could pave the way for many other jurisdictions across the globe.

However, this practice might be impacted by the law governing the arbitration agreement and by its interpretation. In the present case, the arbitration agreement stipulated that "the arbitrator shall incorporate it [the Kleros award] into his arbitral award to govern the substance of the merits". One might thus wonder: does "incorporate" mean that the arbitral tribunal is bound to adopt a similar ruling, or should the blockchain award simply be part of the reasoning, such as an expert opinion? More importantly, while on the one hand disregard by the arbitrator(s) of the procedure agreed by the parties might lead to an annulment of the award (article 34(2)(a)(iv) of the Model Law), on the other hand it is today well settled that arbitrators enjoy full discretion regarding the merits of the case, which mostly escape to the scrutiny power of national courts.

The res judicata *doctrine*

Resorting to the *res judicata* doctrine might also be a way to legitimately incorporate the blockchain award into a traditional arbitral award. Applied to international arbitration, the *res judicata* or issue estoppel doctrine comes into play when an issue already determined by a legitimate authority (mostly national courts or arbitral tribunals) arises in a subsequent arbitration proceeding. Seeking consistency, arbitrators usually tend to respect what has already been decided. For example, to show the importance of such doctrine, Hong Kong courts recently decided that an arbitral award that was inconsistent with a previous award issued by another arbitral tribunal and concerning the same parties was manifestly invalid. However, the decision will produce a *res judicata* effect on condition that the tribunal that issued the decision is recognized, by the tribunal in front of which the *res judicata* is invoked, as a legitimate authority. In our opinion, if off-chain arbitrators acknowledge the idea of the existence of a blockchain arbitral order, they will have no issue with recognizing a Blockchain Arbitral Award under the *res judicata* doctrine. Thus, even if not recognized as a legally enforceable award under the existing arbitration legal framework, a previous decision reached by way of blockchain arbitration could be considered by arbitrators as producing an issue estoppel effect and, consequently, could be incorporated as such in their arbitral award to be enforceable off-chain.

Potential Risks Regarding the Procedural Rights of the Parties

This process is not exempt from risks for the parties. Because the blockchain award is not legitimized by a national court but by an arbitral tribunal, the scrutiny power is switched from national courts to off-chain arbitrators, who will have to make sure that parties' procedural rights have been respected during the blockchain arbitration process. Indeed, once incorporated in a traditional award, the control from national courts might focus on the off-chain arbitral award only and not anymore on the blockchain award.

Conclusion

To conclude, this first historical decision from the Mexican courts is illustrative of the potential interactions between the blockchain arbitral order and national legal orders. While blockchain awards might not yet be enforceable before national courts, traditional arbitration can be used as a tool to give legitimacy to blockchain arbitration. In this respect, party autonomy and the *res judicata* doctrine seem to be the most promising mechanisms available to parties and arbitrators to incorporate the in-chain arbitral award in an off-chain arbitral award.

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References

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