Kluwer Arbitration Blog

Cross-Jurisdictional, Quasi-Instantaneous Enforcement: Fact Or Fiction?

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"Crypto assets" are a relatively new phenomenon. Born in 2008 with the creation of Bitcoin, they have since massively increased in price, adoption rate, and popularity, at least until 2021, when the overall market value peaked. After such highs, we entered a "crypto winter" (explored on the blog here), with a reported drop of over US$ 2 trillion in value.

Along with the chills, have come the fights. New crypto disputes boomed in 2022 and are predicted to trend in 2023. Absent legislation, as is often the case for emerging fields, case law has played a crucial role in developing a legal framework for the crypto industry. This notwithstanding, successful claimants have historically faced extraordinary, and sometimes insurmountable, hurdles when attempting to enforce judgments concerning crypto assets. The main reason is intrinsic to the nature of crypto assets, which remain inaccessible to anyone – including court bailiffs – without the key to the digital wallet they are held in.

Creditors of non-crypto assets may rely on a central entity (ultimately, the State) with sovereign powers over ownership. But how to ensure enforcement, which is ontologically reliant on central authorities, in a decentralised world? A lawsuit in the English courts may have prompted a technical solution to this problem: the recently launched Blacklist Manager, the first software tool to enable compliance with court orders to freeze lost or stolen bitcoins. Yet, the legal implications of this development remain to be discussed.

After a brief presentation of the background to, and functioning of, Blacklist Manager, this post will explore the potential benefits and the legal challenges it poses, as well as the implications for international arbitration.

Background to the Creation of Blacklist Manager

In 2021, Tulip Trading Limited (TTL), whose CEO is Dr Craig Wright – the self-proclaimed person behind the pseudonymous Satoshi Nakamoto, creator of Bitcoin – sued the core developers

of four relevant crypto asset networks: a) The Bitcoin Satoshi Vision ("BSV");[1] b) The Bitcoin Core; c) The Bitcoin Cash; and d) The Bitcoin Cash ABC. These are networks generated by

different "hard forks" of the Bitcoin blockchain.[2] The claim related to digital assets valued at over £3 billion allegedly owned by the Claimant, who was unable to control or use them due to an

alleged hack. TTL sought a declaration that it owned the assets and orders requiring the Defendants to take steps to ensure the Claimant had access to and control of them, or for equitable compensation or damages.

On 25 March 2022, the High Court of England and Wales issued its decision on certain of the Defendants' challenges to the jurisdiction of the High Court in Tulip Trading Ltd v Bitcoin Association For BSV & Ors [2022] EWHC 667 (Ch), ruling that the Claimant had not established a serious issue to be tried on the merits of the claim (a necessary step to serve a claim outside the jurisdiction). Read more about that decision here.

A contentious point in the case was over the Defendants' alleged control of the Networks. On the one hand, the Defendants portray a *decentralised model* maintaining that they are "part of a very large, and shifting, group of contributors without an organisation or structure" and that miners would refuse to run the software patch requested by TTL, which "could lead to a 'fork' in the Networks, resulting in the creation of additional networks rather than a resolution of the issue." On the other hand, TTL disputes this on the basis that "there is no mechanism among miners that could allow for a collective refusal to accept a software update," and since all core developers are parties to the proceedings, there is no actual risk of a fork ever occurring.

In any case, despite having obtained a favourable decision, Bitcoin Association for BSV reportedly agreed to a settlement with TTL, whereby the Association undertook to release software enabling the freezing of Bitcoin in compliance of court orders to this effect.

On 5 October 2022, the Association released Blacklist Manager. This measure attracted much criticism, but some BSV community members replied that Satoshi himself once discussed the concept of a "kill switch," a mechanism for rendering stolen tokens useless. Satoshi never implemented this feature, however, and the question remains whether this was just a brainstorming conversation or something in which *he* actually believed. Interestingly, the price for BSV, the native token of the BSV blockchain, seems not to have been affected by the launch of Blacklist Manager.

On 3 February 2023, the Court of Appeal upheld TTL's appeal[3] in Tulip Trading Limited v Wladimir van der Laan and ors [2023] EWCA Civ 83, thereby granting TTL permission to pursue its claim for breach of fiduciary duties and/or a duty of care against the defendants on the basis that there is a serious issue to be tried as to whether bitcoin network developers owe such duties to crypto asset owners. Lord Justice Birss did not mention the launch of Blacklist Manager but concluded:

> "*[i]f the decentralised governance of bitcoin really is a myth, then in my judgment there is much to be said for the submission that bitcoin developers, while acting as developers, owe fiduciary duties to the true owners of that property*."

Whatever the outcome, this case will be one to closely watch.

The Functioning of Blacklist Manager

The Blacklist Manager works in 3 steps:

1. A judge issues a court order.
2. A notary translates the order into a machine-readable document through the notary protocol and transmits it to the mining network. Upon confirmation that enough miners have received the order, the notary activates a "consensus freeze order". From now on, honest nodes shall reject any attempt to spend the frozen assets.
3. Reassignment of misappropriated/lost assets occurs on-chain, in compliance with the court order.

Full operativity may still be some time away, as neither the notary tool (step 2) nor the software for asset reassignment (step 3) seem to be available on the BSV website.

Once implemented, however, the system may deliver on the promise of cross-jurisdictional, quasi-instantaneous enforcement. Initially, this will only concern BSV, but – according to BSV's press release – it would be compatible also with the Bitcoin and Bitcoin Cash networks. In the future, it could become standard for any blockchain.

Aside from the technology, the legal functioning of the system appears rather underdeveloped. Despite the centrality of "notaries" in the 3-step process, they are simplistically defined in the operations guide as "*A person or company operating a DARA [Digital Asset Recovery Alert] tool.*" There is no other requirement. A "court order" is defined as "*[t]he document that specifies the action to be taken*" and a "law court" as "a meeting which issues court orders."

In short, there appears to be very little attention to basic legal questions, such as the type of court documents that may trigger the application of the Blacklist Manager (e.g., are arbitral awards included?), let alone any checks and balances to ensure the reliability of the system. When comparing the Blacklist Manager with a State-led court enforcement system, the legal safeguards appear strikingly medieval. What happens to the funds, for instance, if third parties have transacted in good faith with the hackers before or after the issuance of an order? Or if there are conflicting decisions from courts in different jurisdictions?[4] It is not a coincidence that courts are involved not only for the issuance of an order, but also for its enforcement.

Marcin Zarakowski, General Counsel and Chief of Staff at Bitcoin Association, seems to have considered at least some of these questions when mentioning that "*legal entities like banks, custody providers, law firms or eventually courts themselves will first validate a court order*" and that "*[t]he service does not allow anyone to arbitrarily enforce a freeze, and miners will only accept a court order or document of equivalent value.*"

Certainly, the main focus in this initial phase was shielding liability for the Association. Each miner is entrusted with the installation of the software, and not the Association, which claims that: "*If miners do not respect the order they can expect to face legal implications. It will no longer be possible for miners and exchanges to argue that it is 'not technically possible' to retrieve your assets.*"

Developments for International Arbitration

International arbitration may constitute a natural choice for crypto disputes, allowing the parties to appoint an arbitrator with the necessary background knowledge for efficient decision making. It

may also allow for quick and broad implementation of innovative tools such as the Blacklist Manager. If arbitral institutions were able to act as "notaries," the enforcement stage could entirely by-pass state courts, bringing about almost instantaneous enforcement of awards. A market interest in this regard may be empirically evidenced by various attempts to bring arbitration on-chain,[5] with *inter alia* the aim of facilitating enforcement over crypto-assets. As we move towards increasing digitalization of physical assets, a software for on-chain enforcement may indeed revolutionise the way we recover crypto-assets, reducing transaction costs. And international arbitration may be best placed to take full advantage of this innovation.

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References

?1 It should be noted that Dr Wright is the founder of BSV and a fervent advocate thereof.

?2 A "hard fork" is the implementation of a software update which is not backwards compatible on a specific blockchain. As a consequence, the chain is split in two depending on whether or not a node has accepted the software update. More here.

?3 Of which Association for BSV is not a defendant, in light of the settlement reached with TTL.

?4 This question is also posed by Lord Justice Birss in Tulip Trading Limited v Wladimir van der Laan and ors [2023] EWCA Civ 83, at § 83.

?5 Notable examples include Kleros, Jur, Aragon, OpenCourt, Mattereum, CodeLegit.

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