



## THE ARBITRABILITY OF WEB3 DISPUTES: AN EFFECTIVE COURT OF FIRST WORLD PROBLEMS?

This article explores the arbitrability of blockchain, cryptocurrency, NFT and metaverse disputes and considers the issue of what arbitration and its supporting ecosystem must do, in order to remain an effective forum for the resolution of such disputes.

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## What are blockchain, cryptocurrency, NFT and metaverse disputes?

For the sake of simplicity, we shall refer to all such disputes within this article as, “Web3 disputes”. Web3 disputes are disputes which are connected with the rapidly-growing range of decentralised technologies which utilise blockchain and smart contracts to record transactions, and to automate particular functions. These technologies include those powering cryptocurrencies and non-fungible tokens (NFTs), the records of transfer of which are stored on blockchains and are publicly viewable. Web3 disputes may also encompass disputes connected with the metaverse, a virtual-reality (VR) ‘world’, accessible through VR headsets, within which participants may engage with each other and interact in a computer-generated environment.

Disputes in the Web3 space may arise in a multitude of different ways and may fall within a number of categories of law (or within multiple categories). There may, for example, be disputes arising from criminal acts, such as hacks or exploits, or the theft or unauthorised movement of cryptocurrencies or NFTs. There may be tortious actions which give rise to liabilities and claims, either within or outside of the context of contractual relationships. Alternatively, disputes

pertaining to Web3 may fall within the category of regulatory disputes, such as issues falling within the remit of the Securities and Exchange Commission or the Commodity Futures Trading Commission in the U.S., or within the regulatory scope of the Monetary Authority of Singapore – the question of whether particular cryptocurrencies are securities, for example.

However, at the heart of a tremendous number of Web3 disputes lies private law. In most cases, given the internet-based global nature of Web3, this means private international law. While the above description of Web3 sounds – and is – incredibly tech-driven, what is not always immediately apparent is that there is a raft of considerably more traditional legal contractual relationships and structures at play behind a significant amount of this technology. Those legal relationships are formed of bilateral and multilateral private contracts, most commonly written in plain language (as opposed to code), and which refer disputes between their various participants to a range of traditional forums for dispute resolution, pursuant to their chosen governing laws. It is those contracts, and the disputes which arise thereunder, which form the primary focus of this article.

## How do Web3 disputes arise?

Web3 disputes may arise in a vast number of different ways – the majority of which have most likely not even been contemplated yet, such is the rapid pace at which the relevant technology is developing.

Taking a few examples which have already occurred, we have seen examples of each of the following:

- Disputes between users and operators of centralised cryptocurrency exchanges (CEXs) pertaining to the trading, deposit and withdrawal of their cryptoassets; platform hacks; blackouts; exploits or bugs, which may have caused losses for users.
- Disputes arising out of Simple Agreements for Future Tokens (SAFTs) or similar contracts, entered into between investors and intended future issuers of tokens, in the event that promises made under such contracts do not materialise.
- Disputes arising from interactions with smart contracts which do not proceed as intended, possibly for reason of errors in code or vulnerabilities, giving rise to losses.
- Disputes between participants in Decentralised Autonomous Organisations (DAOs) regarding issues relating to the DAO’s governance or administration.

- Users of the metaverse suffering grievances, such as disagreements relating to the 'ownership' and transferability of virtual metaverse 'real estate', which have a tangible impact on them in the real world.

### Are Web3 disputes arbitrable?

By and large, Web3 disputes are not only arbitrable but in many cases, arbitration would be the most suitable forum for their resolution.

The reasons for this being so are in many cases down to the very same set of fundamental reasons why arbitration is so popular as a dispute resolution forum in international contracts generally. In brief summary, such reasons include:

- Privacy and confidentiality – which may be particularly relevant where, for example, confidential code under development is the subject matter of the dispute.
- Enforceability of arbitral awards (in contrast with court judgments), pursuant to the New York Convention<sup>1</sup> – of particular significance, given the inherently decentralised and international nature of Web3 disputes, and the fact that participants in ventures such as token issuers; CEXs; network verifiers or node operators; and sellers and buyers, may all be located in different geographies and legal jurisdictions.
- The ability of parties to select subject-matter experts as arbitrators to determine the disputes between them, rather than finding themselves before a judge who is not familiar with the subject matter.
- The flexibility in rules and procedure which may be adopted at the contracting stage and which may result in the rapid resolution of disputes, in comparison with court proceedings.
- The potential, subject to the applicable procedural laws of the seat, for arbitration proceedings to be final and binding in nature, and incapable of appeal.

There already exist a very significant range of Web3-related contractual relationships which incorporate traditional arbitration agreements, and which refer disputes to arbitration under a variety of institutional rules. Some examples of such contractual relationships are set out below:

- The terms of use or service of a number of the world's most popular CEXs, such as Binance, KuCoin and Coinbase, refer disputes to arbitration in jurisdictions such as Hong Kong and Singapore, and there have been proceedings initiated under such arbitration agreements.
- The terms of use for front-end user interfaces of decentralised exchanges (DEXs) such as those operated by Uniswap Labs, which may be used for interaction with smart contracts on the relevant blockchain, also refer disputes to arbitration.
- NFT trading platforms such as OpenSea and Nifty Gateway LLC include arbitration provisions in their terms of use, and the latter was successfully able to obtain a stay English court proceedings at first instance in favour of such reference<sup>2</sup> (more of which, later).
- Metaverse platforms, such as those operated by metaverse creator The Decentraland Foundation, and the auction house, Sotheby's, Inc., refer disputes to arbitration in Panama and New York respectively.
- Bilateral and multilateral Web3-related agreements, such as SAFTs; Multisig participation or administration agreements; and DAO governance agreements and terms of service, all commonly refer disputes to arbitration. The Maker Ecosystem Growth Foundation and others associated with the decentralised finance (DeFi) protocol, MakerDAO, were successful in compelling arbitration, following the commencement of a class action lawsuit against them by purported users in the Northern District Court of California<sup>3</sup>. The claim was referred to arbitration

on an individual basis, pursuant to the rules of the American Arbitration Association, further to the inclusion of an arbitration agreement in MakerDAO's terms of service.

- The documentation underpinning the on-chain tokenisation of real-world assets (e.g. as collateral or security, or for fractionalisation purposes) commonly refers disputes to arbitration, most frequently aligning with other pre-existing contractual arrangements pertaining to the underlying physical asset.
- E-Sports participation agreements frequently refer disputes amongst operators and participants, or between participants, to arbitration.
- Arbitration agreements (as well as a choice of governing law) may now be 'baked in' to code in relation to new token issuances, referring disputes to traditional or on-chain arbitration. In some cases, determination of disputes may take place on-chain, with the decentralised pseudonymous 'arbitrators' being asked to vote on the issue and, in some cases, with direct execution of the 'award' through the use of smart contracts.

### What are the limits to the arbitrability of Web3 disputes?

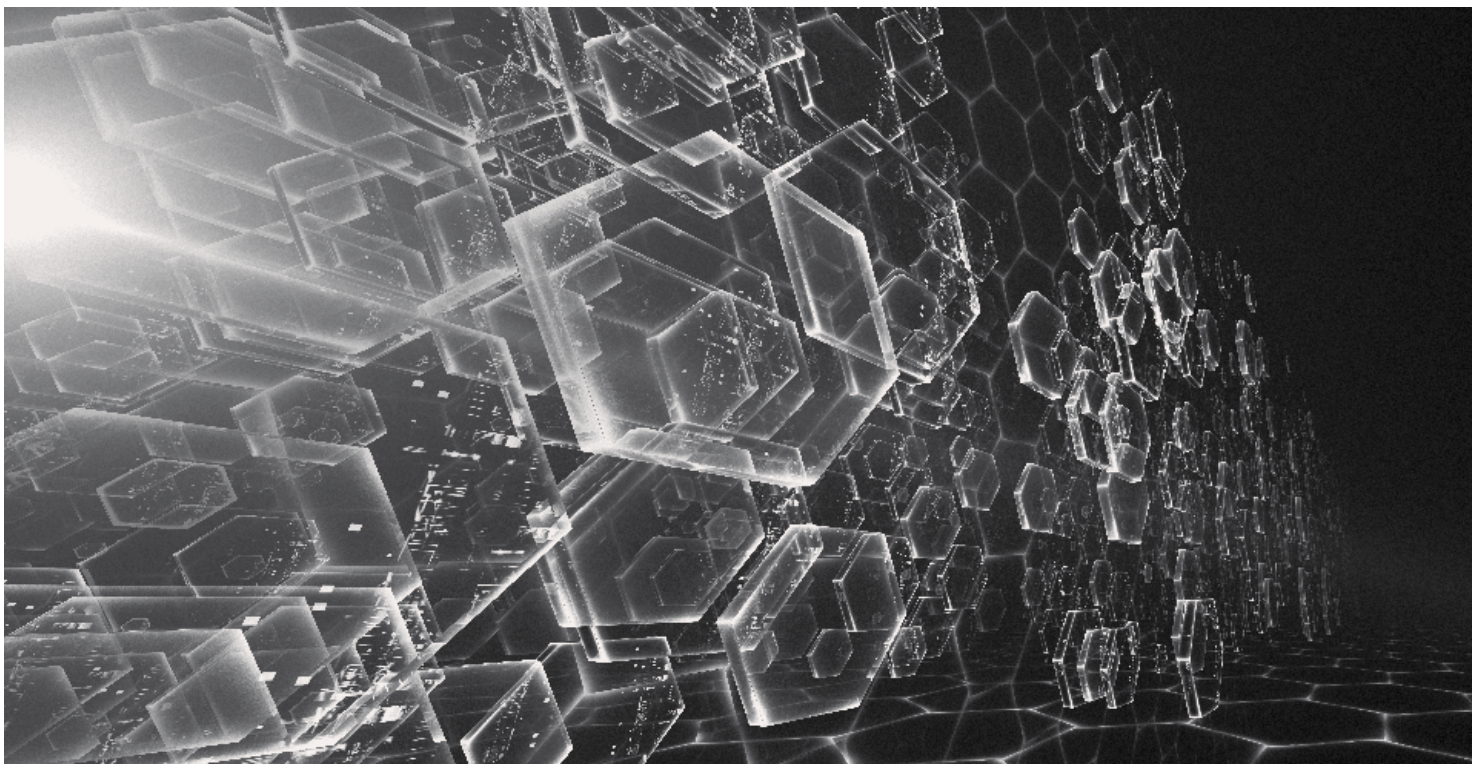
There are, however, limits to the use of arbitration as a dispute resolution tool in the Web3 space. We discuss a number of the relevant issues below.

- **Disputes involving consumers:** In relation to consumer-facing products or services, such as (for example) CEXs and NFT marketplaces, consumer protection laws may come into play in particular jurisdictions. In the English case of *Nifty Gateway v Soleymani* referenced above, and in contrast with the position taken in California pertaining to MakerDAO, the Court of Appeal overturned the first instance stay granted by the High Court, taking the view that there was, at least, a valid question to be tried over the validity of a consumer-facing

<sup>1</sup> The Convention on the Recognition and Enforcement of Foreign Arbitral Awards of New York, USA, 10 June 1958

<sup>2</sup> *Nifty Gateway v Soleymani* [2022] EWHC 733 (Comm)

<sup>3</sup> 20-2569 - *Johnson v. Maker Ecosystem Growth Holdings, Inc. et al*, United States District Court Northern District of California, 9th Circuit;



arbitration agreement, for reason of unfairness to the consumer<sup>4</sup>. A similar position was also adopted in the case of *Chechetkin v. Payward Ltd & Others*<sup>5</sup>, where the English High Court determined that the existence of an arbitral award in relation to the subject matter of the dispute - while potentially highly relevant to the outcome of the case - did not impact on the fact that still it had jurisdiction to hear a claim commenced by a consumer of services.

- **Impact of local law:** Do the laws of the chosen seat support both arbitration and the arbitration of Web3 disputes? For example, do the national laws of the seat recognise smart contracts as binding legal relations? Or do they recognise cryptoassets as a specie of property? Is code considered to be a writing? And, at its most basic level, is holding, trading or otherwise interacting with cryptoassets lawful? In certain jurisdictions, it is not, or not entirely. It may therefore be legally or practically impossible to hold an arbitration seated in such jurisdictions, and the enforcement of awards in such jurisdictions is unlikely to be supported by the national courts, for reasons of public policy or illegality.

- **Intellectual property disputes:** In certain jurisdictions, disputes pertaining to intellectual property are incapable of being arbitrated, or limits are placed on their arbitrability. As such, in circumstances where intellectual property may be in dispute, the parties' choice of both governing law and seat is critical to their ability to resolve such disputes at arbitration.
- **Arbitration agreements contained in underlying code:** In relation to arbitration agreements baked into the underlying code attaching to cryptoassets, there exists a valid question as to whether or not such code may qualify as a writing, so as to be comparable with the terms of Article II of the New York Convention, and whether it may be said to be binding on persons who cannot easily read and understand such code on a plain reading – not least, where relevant, on the basis of the consumer protection principles mentioned above.
- **“On-chain arbitration”:** There are significant questions as to whether decentralised pseudonymous “on-chain arbitration” may constitute arbitration in a traditional sense at all, and whether it may

possibly meet all of the necessary requirements for enforceability pursuant to the New York Convention and national law. Whether that really matters, in circumstances where execution against the ‘award’ may be effected immediately by the ‘arbitrators’, is debatable – but, as a minimum, this may give rise to challenges before national courts, for reason of failures of due process or public policy.

These limitations give rise to the need to consider a range of factors when determining whether to refer Web3 disputes to arbitration.

### **How may these limits to arbitrability be mitigated?**

While arbitration may be an excellent forum for the resolution of many Web3 disputes, the adoption of arbitration must still be carefully considered by the parties at the contracting stage, to ensure its suitability for the particular circumstances. The current limits of, or impediments to, the arbitrability of Web3 disputes are broad-ranging and for this reason, it is necessary to give specific consideration to the question of whether an arbitration agreement is suitable in each instance, as well as to the choice of institutional rules, and the seat of the arbitration.

<sup>4</sup> *Soleymani v. Nifty Gateway LLC (Competition And Markets Authority intervening)* [2022] EWCA CIV 1297

<sup>5</sup> [2022] EWHC 3057 (Ch)

- Choosing a Web3-favourable, progressive seat, with laws which appropriately recognise, categorise and support the development of cryptoassets and Web3 technology, may be critical to the successful arbitrability of Web3 disputes, and enforceability of arbitral awards.
- Adopting procedural rules which permit the granting of interim emergency reliefs may be a distinct advantage, in relation to disputes pertaining to digital assets which may fluctuate wildly in value in a short time frame.
- The application, from the very outset of contracting, of bespoke dispute resolution rules such as the Digital Dispute Resolution Rules developed by the UK Jurisdiction Taskforce<sup>6</sup>, may also be advisable. As Web3 technology develops further, we would expect to see more tailored procedural rules being developed by a greater range of interested parties.
- Consumer-facing service providers may wish to adopt specific procedural rules such as the Consumer Arbitration Rules of the American Arbitration Association<sup>7</sup> which permit mass arbitration, or for batches of arbitration claims to grouped, which may offer a better chance of withstanding jurisdictional challenges and remaining compliant with consumer protection laws in certain jurisdictions.

### How can arbitration remain the forum of choice for Web3 disputes?

There will be constant developments in the Web3 space over the coming years, both in terms of technological and legal advances. It will be critical for arbitration, and the national laws and international conventions which underpin it, to continue to adapt, in order to embrace technology as it develops and to remain relevant to, and suitable for, the resolution of Web3 disputes.

Adapting to developing technology may involve pushing the existing boundaries of international arbitration, and the fundamental norms which we associate with it.

For example, could parties' mutual contractual agreement as to what constitutes due process, and their submission to directly enforceable decentralised on-chain arbitration, be capable of recognition and enforcement without challenge? Could parties in the Web3 space freely agree at the contracting stage that ex parte applications for interim reliefs shall be permissible, in the context of arbitration? May we see arbitration commenced by or against pseudonymous persons who wish to retain entire anonymity, even within the confidential confines of arbitration, or against persons unknown, in the manner which court action in certain jurisdictions may be? Could we potentially see the development of Web3-specific arbitration rules within a particular metaverse, and agree to seat our arbitrations there, in an effective private 'bubble', removed from the complexities of conflicts of often outdated national laws, and the vagaries of "public policy"?

While some of these concepts may seem far-fetched and outlandish, as both technology and law continue to develop, we may see issues of this nature being considered in all seriousness in years to come. The resolution of some of these legal issues may indeed bring greater confidence to the development of Web3 projects, and ultimately aid the adoption of the underlying technology, which presently suffers from a significant degree of legal uncertainty in many jurisdictions. The resolution of issues of this nature will be necessary, in order for arbitration to remain the most relevant and effective court of First World problems.

For more information, please contact the authors of this briefing:



#### DAN PERERA

Partner, Singapore

T +65 6411 5347

E dan.perera@hfw.com



#### JUSTINE BARTHE-DEJEAN

Senior Associate, Singapore

T +65 6411 5344

E justine.barthe-dejean@hfw.com

Additional research conducted by Missba Nizami, Trainee Solicitor.

<sup>6</sup> <https://resources.lawtechuk.io/files/2.%20UKJT%20Digital%20Disupte%20Rules.pdf>

<sup>7</sup> <https://www.adr.org/sites/default/files/Consumer-Rules-Web.pdf>

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