

Study on Dispute Resolution of Tort Liability Disputes Between Digital Currency Platforms and Users

— Case Analysis in China and Abroad

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Abstract: Numerous tort liability disputes have arisen from individuals registering to use digital currency trading platforms and investing in digital currencies in China. This paper mainly adopts the case analysis method and comparative research method through the analysis of the current situation and controversial focus issues of judicial rulings on tort liability disputes between digital currency platforms and users in China, combined with classic overseas cases, summarizes the lessons learned and put forward the proposed ideas for improving the comprehensive governance of digital currency. The study finds that the focal issues of disputes over tort liability between digital currency platforms and users include, but are not limited to, the definition of the nature of the digital currency, the compensation obligations of digital currency platforms, and the damage compensation methods of digital currency transactions. The dilemma of the judicial ruling is due to the incomplete legal system and inconsistent policy interpretation on the one hand and influenced by the macro regulatory attitude on the other. The experience of classic overseas cases in this paper can provide China with improvement ideas to a certain extent.

Keywords: digital currency, tort liability disputes, dispute resolution, platform and users

1. Introduction

In the past, digital currencies have rapidly entered the Chinese market with their decentralization and high-yielding characteristics. Digital currency is a virtual currency based on digital cryptographic algorithm and network of nodes. Among them, digital currency trading platforms play a significant role in digital currency trading and attract more and more users to join the use. There have been numerous cases of private individuals registering to use digital currency trading platforms and investing in digital currencies, which has given rise to many tort liability disputes.

Although China once again denied the legal status of virtual currencies and the legality of business activities related to virtual currencies in *The Notice on Further Preventing and Disposing of the Risk of Speculation in Virtual Currency Trading (2021 Notice)* in 2021, this does not mean that China has completely banned private digital currency trading and has not entirely prevented users from continuing to invest in digital currencies, but instead has stimulated people's investment enthusiasm

due to the soaring prices of digital currencies. However, there is no perfect law to regulate digital currency-related transactions in China. When a tort liability dispute arises between digital currency platforms and users, judicial decisions vary, making it impossible for users to seek help, and the status of dispute resolution is not optimistic.

Currently, the research on digital currency in China is mainly from the perspective of macro risk regulation. However, there needs to be more research on the transaction behavior between digital currency platforms and users. The dispute cases between digital currency platforms and users should be addressed, and related rights holders' interests should be protected. Therefore, this paper focuses on the dispute resolution of tort liability disputes between digital currency platforms and users. This paper mainly adopts the case analysis method and comparative research method, and then through analyzing the current situation of a judicial adjudication of tort liability disputes between digital currency platforms and users in China, summarizes the current controversial issues in judicial practice, and puts forward the reasons for the formation of disputes, selects the specific overseas solutions in a targeted manner for reference. The significance of this paper is to summarize the shortcomings of the current state of judicial adjudication based on the previous research and suggest improvements to improve digital currency's comprehensive governance.

2. Current Status of Judicial Decisions in China

As evidenced by the existing adjudication cases, there have been numerous judicial decisions regarding tort liability disputes between digital currency platforms and their users. The results of the relevant judicial decisions on private digital currencies are also uneven, and there are even cases of different decisions on the same case.

This chapter will summarize the main controversies and causes from the classic judicial precedents.

2.1. Controversies in Judicial Practice

As of April 2023, a case search on China Judgements Online (wenshu.court.gov.cn/) using “digital currency” as the keyword revealed 2,235 cases involving digital currency. A similar case search on the WK Advance Legal Database (law.wkinfo.com.cn/) revealed 2,623 cases of this type. In the aforementioned judicial determination, there are specific differences in the factual determination and adjudication standards. The main focus of the dispute includes but is not limited to determination of the nature of the trading behavior, platform's liability for damages, and damage compensation method.

2.1.1. Determination of the Nature of the Trading Behavior

Determining whether the trading behavior between digital currency platforms and users is protected by law not only affects the outcome of the court's judgment on the case but even directly affects whether the case is established and also involves the definition of the nature of the digital currency. Currently, neither the academic nor the legal practice circles in China have fully unified their views, and there are apparent differences in the results of different courts' determinations.

Some courts believe that digital currency has the characteristics of a proper object and meets the constitutive elements of virtual property. Although it does not have the legality of currency circulation, it should be given the attributes of virtual property or commodity objects, including the exchangeability of things [1]. Therefore, the properties of digital currency as virtual property and commodity and the corresponding property rights and interests should be affirmed and protected by law. As stated in a judgment made by the Beijing Haidian District People's Court, virtual currency is a specific virtual commodity with a particular value. The parties registered, logged in, and deposited virtual currency on the website, and they have property rights to the virtual currency in the account [2].

Some courts have held that digital currency is not a real currency but a virtual commodity, which cannot be issued and financed, and cannot be used as currency in the market. It is the network platform that supports its buying, selling, exchanging, and pricing [3]. Now the state has banned the exchange and sale between digital currency and legal tender. Therefore, due to the illegality of the subject matter itself, the trading behavior involving the subject matter is not protected by law. Although citizens are free to trade “virtual currencies,” the civil action is invalid due to violating national mandatory regulations. The investors themselves should bear the consequences and risks caused by the trading behavior [4].

2.1.2. Platform's Liability for Damages

The digital currency trading platform is one of the main subjects of tort liability disputes related to digital currency and plays a significant role in the whole transaction process. Whether the platform should bear the liability for damages depends mainly on the determination of the platform's fault.

Some courts have held that a network service contract relationship is formed between a user trading virtual currency on a platform and the platform operator. Both parties should follow the principle of fairness to determine the rights and obligations of each party [2]. As the service provider of the network service contract, the trading platform should ensure the safety of the property in the user's account. Because of the high value of the property involved, it has a higher obligation of care than the user as the operating party. On the other hand, since the website operator fully controls the data of the trading website, the website operator has a heavier burden of proof in case of disputes. In general, the platform should play a prudent duty of care, take adequate measures to stop the loss when the abnormality occurs, notify the user, or take remedial measures afterward. Otherwise, it shall be deemed to be at fault.

However, according to the relevant provisions of *the Notice on Preventing the Risks of Token Issuance and Financing (the Notice)*, any so-called token financing trading platform engaged in intermediary services such as exchanging and trading bitcoins is illegal. All domestic virtual currency trading platforms have been retired, and their operational teams have been relocated overseas. 2021 Notice stipulates that foreign virtual currency exchanges providing services to residents in China via the Internet are also illegal financial activities. On the one hand, it has become difficult for domestic users to access digital currency trading platforms through formal channels. On the other hand, it has become challenging to supervise and investigate digital currency trading platforms for evidence. In tort liability disputes between digital currency platforms and users, there is often more than one operating entity involved, but multiple platform servers at home and abroad, which also leads to confusion in the division of tort liability and damage liability, causing difficulties for judicial decisions.

2.1.3. Damage Compensation Method

After a tort liability dispute between a digital currency platform and a user, the party involved will often ask the other party to return the funds or digital currency they have invested. There is considerable controversy at this point as to how the court will rule on the return of the property of the transaction.

On the one hand, if a case involving a virtual currency transaction dispute is ruled invalid because the underlying property is not legal, then, according to *2021 Notice*, which stipulates that the relevant civil legal action is invalid, and the parties themselves shall bear the resulting losses, users or platforms face a significant practical obstacle if they want to recover property losses arising from tort liability disputes. On the other hand, some courts have held that the properties of digital currencies as virtual property and commodities and the corresponding property rights and interests arising from

them should be affirmed and found to be protected by law. Then, according to the Tort Liability Law, if one infringes on another person's property, the loss of property shall be calculated according to the market price at the time of the loss, that is, the discounted legal tender.

Depending on whether the parties involved put in or delivered legal tender or digital currency, the decision made by the court also changes [5]. According to the current state of judicial decisions in China, if one party involved in the case invested in virtual currency, the other party delivered other kinds of virtual currency, the court usually does not rule that both parties return the property invested by each other but requires each party to bear its own losses. If one party involved in the case puts in legal tender and the other party delivers virtual currency, then when the contract is invalid, claiming that one party returned the legal tender and the other party returns the virtual currency, the court usually will not support such litigation request because the delivery obligation of both parties has been fulfilled, and it involves the pricing of virtual currency and the execution of the judgment. Only when one party in the case pays legal tender and the other party has not delivered the virtual currency or is at fault, may the court decide to return all or part of the legal tender assets. As for the issue of discounted compensation, the court recognizes the trading properties of virtual currency or the price of market transactions only if both parties have agreed on the amount of compensation discounted in advance, which is to avoid the disguised recognition of the investment status of virtual currency.

2.2. Reasons for the Formation of the Dispute

There is considerable controversy in tort liability disputes between platforms and users arising from digital currency exchanges in the judicial adjudication process because the courts have different focuses on interpreting policies.

In December 2013, the Central Bank and five other ministries and commissions issued *the Notice on Preventing the Risks of Bitcoin (2013 Notice)*, which clarified that Bitcoin does not have monetary attributes such as legal compensation and compulsion but is a specific virtual commodity. In September 2017, the Central Bank and seven other ministries and commissions issued *the Notice on Preventing Risks of Token Issuance and Financing (the Notice)*, emphasizing that any so-called token financing trading platform shall not provide pricing and intermediary information services for tokens or "virtual currencies." In September 2021, the Central Bank and other ten ministries and commissions issued *2021 Notice*, which pointed out that any legal person, unincorporated organization or a natural person who invests in virtual currency and related derivatives, contrary to public order and morality, the relevant civil legal action is invalid and they shall bear the resulting losses [6].

Although the *2013 Notice* and the *Notice* deny the monetary properties of private digital currency, they also recognize the legitimate existence of private digital currencies as virtual goods. Some courts have expanded the understanding of private digital currency as an illegal subject matter, which confuses the nature of the "act of transaction" with the properties of the "subject matter" itself [7]. In addition, although *the Notice* prohibits token financing trading platforms from providing services such as fiat currency exchange, pricing, information brokerage, and trading, this does not mean that the prohibition extends to all acts related to private digital currency trading and investment. The scope of the prohibition is "token issuance and financing activities," not trading and investment activities between investors. The legality of private digital currency trading and investment activities between individuals and organizations should be recognized and protected.

In the process of judicial adjudication, courts have to respect the compulsory nature of established policies and regulations, as well as safeguard the legitimate rights and interests of the parties, and resolve the conflict between freedom of contract and public interest, all of which are the reasons for the chaotic judicial adjudication of tort liability disputes between digital currency trading platforms and users in China at this stage.

3. Overseas Typical Cases

As the development of the financial system varies from country to country, the acceptance of digital currency also varies, which directly leads to the different attitudes of countries toward digital currency disputes. In this chapter, we will analyze typical cases from overseas based on the controversial focus of Chinese judicial decisions summarized in the previous article and dig deeper into various countries' attitudes and regulatory approaches towards digital currencies to provide references for improving judicial decisions in China.

3.1. U.S. RFIA: Digital Currency Nature Definition

Unlike China's determination of the nature of digital currencies, in the United States, digital currencies such as Bitcoin are considered non-monetized property-like commodities.

As the first country to use Bitcoin, the U.S. is also more mature in its research on Bitcoin. In 2013, the U.S. federal Senate held a hearing to recognize Bitcoin as a legitimate financial service [8]. In 2014, the Internal Revenue Service (IRS) treated virtual currencies such as bitcoin as property and officially taxed bitcoin. In 2015, the U.S. Commodity Futures Trading Commission (CFTC) publicly declared virtual currencies represented by Bitcoin as commodities and imposed equivalent regulatory measures on them [9]. In 2017, the U.S. Uniform Law Commission passed *the Uniform Regulation of Virtual Currency Commerce Act*, which considers them an expression of digital value but not the nation's legal tender [10]. The bill establishes a legal framework for commercializing virtual currencies to regulate their commercial activities better. Various states in the U.S. have also passed bills recognizing the legal status of virtual currencies. New York State passed a bill recognizing digital currencies as a financial asset and issued related licenses to license bitcoin trading platforms.

On June 7, 2022, U.S. Senators introduced *the Responsible Financial Innovation Act (RFIA)* to establish a comprehensive regulatory framework for digital assets. One of the essential elements is that it expands the outreach of digital assets by standardizing the definition of essential concepts of crypto-digital assets. Digital assets include virtual currencies, affiliated assets, and payment-based stablecoins. This bill again exemplifies the U.S. approach to determining the nature of digital currencies from the side.

3.2. EU MiCA: Claims Against Intermediaries Such as Trading Platforms

Digital currencies are widely considered legal throughout the European Union, but laws on digital currency transactions vary within individual member states [11]. On September 24, 2020, the European Commission introduced *The Markets in Crypto Assets Regulation bill (MiCA)*. After less than two years, the Presidency of the European Council and the European Parliament reached a historic interim agreement on the *MiCA* on June 30, 2022, expected to enter into force in 2024. The *MiCA* clarifies crypto-asset service providers' payout obligations to investors.

As mentioned earlier, intermediaries such as trading platforms are one of the main subjects of digital currency tort liability disputes. Trading platforms that suffer frequent hacks, failures, fraudulent users, and unauthorized actions are even more hard hit by regulation and litigation. MiCA clarifies the intermediary's custodial obligations, thus extending the intermediary's responsibility for the segregation and payout of customer assets. Accordingly, in the event of an intermediary's insolvency, the investor's cryptocurrency will not be part of the estate, while the intermediary will bear losses due to technology or hacking.

If passed, the bill will have a direct legal effect on the 27 member states. It will replace all regulatory frameworks for cryptocurrencies within each EU member state to form a unified regulation. The provisions of this bill regarding the obligation of crypto-asset service providers to pay

compensation will undoubtedly provide a basis for future judicial proceedings and arbitration in the relevant areas.

3.3. Japan Mt.Gox Legal Black-hole: Compensation Calculation Method

In Japan, digital currencies are legally solvent, but not from the start, and the Mt.Gox legal black-hole bankruptcy and its subsequent compensation fiasco coincidentally reflect this process.

The Japanese Mt.Gox exchange was abruptly shut down in February 2014. Poor security contributed to several thefts. Only 202,000 of the 850,000 customers' bitcoins remained. The employees involved were imprisoned for embezzlement and data manipulation regarding the losses. The remaining bitcoins were placed in the custody of court-appointed lawyers to complete subsequent compensation. At first, in the same way as traditional asset calculations in the event of a Japanese bankruptcy, customers' bitcoin claims were calculated in Japanese yen at the market rate on the day the exchange closed. On February 24, 2014, one bitcoin was worth 50,058 yen. However, surprisingly, the value of bitcoin has increased more than 12 times since then, and Mt Gox is no longer technically insolvent, yet still insists on paying out at the 2014 valuation, which means customers will receive only 8% of the current value of their bitcoin [12].

Compared to the rising price of digital currencies such as Bitcoin, the former inherent way of calculating damages has undoubtedly caused much damage to the property rights of users. On April 1, 2017, Japan's *Payment Services Amendment Act* came into effect, which defines Bitcoin as an exclusive value and stipulates that virtual currencies such as Bitcoin are legal forms of payment in Japan. Bitcoin exchanges were also licensed to implement the regulation [13].

4. Ideas for Improvement in China

When domestic courts hear tort liability disputes between digital currency trading platforms and users, there are different factual determinations and adjudication standards, ultimately related to policy interpretation. Although the regulation of digital currencies in China is stringent, and many relevant regulations have been introduced, there is no perfect legal basis for judicial litigation and adjudication. In interpreting the relevant established policies, the courts have to respect the compulsory nature of laws and regulations, safeguard the rights and interests of the parties, and balance the freedom of contract and public interest. All these create difficulties for the unification and optimization of judicial adjudication paths.

While it is true that China cannot lift the strict restrictions on digital currencies and digital currency transactions in a short period, it is also true that it must recognize the reality of the current confusion of judicial decisions. There are many experiences overseas which can be learned. For example, many countries, including the United States, have recognized the digital value and property attributes of digital currencies such as Bitcoin and have made unified regulatory programs; the *MiCA* makes explicit provisions on the compensation obligations of crypto-asset service provider to investors, further regulating the rights and obligations of trading platforms; Japan has provided for the legal compensability of digital currencies such as Bitcoin, and has improved the damage compensation methods and commutation methods.

In response to the difficulties and shortcomings faced in the civil judicial adjudication of digital currency, China can try to optimize with the following ideas.

Protecting the parties' rights and interests should be critical in judicial decisions. China prohibits specific market subjects from providing delivery and pricing services for private digital currency, which is market behavior. At the same time, the infringing party to bear the damages for infringement is essentially a judicial behavior of fixing responsibility and damage. The two are essentially different and should not be confused. The courts cannot ignore or indulge in the illegal and infringing behavior

of any party to the dispute on risk-bearing grounds. The courts should respect the freedom of transaction between civil subjects, protect the security and stability of transactions in civil subject transactions, and safeguard the legitimate rights and interests of civil subjects based on not disrupting the existing order of transactions.

In terms of the current judicial environment, the judiciary tends to steer the domestic public away from digital currency trading by denying judicial protection to the underlying transactions because of the negative attitude of regulators toward digital currency trading. However, this is not conducive to a truly fair, reasonable, and convincing court decision.

The legal status and legislative hierarchy of digital currencies should be raised. China can legally define the value attributes of digital currencies and then strictly regulate them concerning a specific payment method or a particular property. At the same time, the monitoring and supervision of intermediaries such as digital currency trading platforms and service providers should be strengthened. The space for digital currency transactions should be purified through clear regulations, unified management, raising the threshold and risk prevention and control to create prerequisites for the improvement of subsequent laws and regulations in order to standardize the judicial adjudication path and reduce the difficulty of dispute resolution of tort liability disputes in digital currency transactions.

5. Conclusion

This paper provides an overview of the current situation of dispute resolution between digital currency platforms and users in tort liability disputes, summarizes the focus of disputes, analyzes the reasons for the formation of disputes, and looks for typical cases in foreign countries corresponding to them to provide good ideas for improvement in China.

Due to different policy interpretations and incomplete legal bases, there are different factual decisions and adjudication standards when domestic courts hear tort liability disputes between digital currency trading platforms and users, and there are specific difficulties in dispute resolution. In order to solve this problem, China can learn from the experience of classic overseas cases and provide for multiple aspects, such as the definition of the nature of the digital currency, the compensation obligations of digital currency platforms, and the methods of compensation for damages of digital currency transactions, in order to unify and optimize the judicial trial path. What should be determined is that the freedom of transaction between civil subjects needs to be respected, the security and stability of transactions of civil subjects need to be protected, and the legitimate rights and interests of civil subjects need to be safeguarded. The current negative attitude of regulators towards digital currency transactions has affected the judicial environment, reminding us that we should make long-term efforts to improve relevant laws and regulations and promote truly fair, reasonable, and convincing court rulings.

Owing to the space limitation, the selection and analysis of domestic and foreign jurisprudence and classic cases in this paper are not exhaustive, and there is still some room for improvement. In the subsequent study, we can further consider the suitability of overseas classical cases to China's policy environment and look for more targeted and suitable solutions to China's national conditions.

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