

4 INTERNATIONAL AND COMPARATIVE LAW ХАЛЫҚАРАЛЫҚ ЖӘНЕ САЛЫСТЫРМАЛЫ ҚҰҚЫҚ МЕЖДУНАРОДНОЕ И СРАВНИТЕЛЬНОЕ ПРАВО

IRSTI 10.19.01

UDC 349

JEL K39

<https://doi.org/10.46914/2959-4197-2024-1-4-44-51>

ZHAKSYLYKBAYEVA A.A.,*¹

m.l.s., lawyer.

*e-mail: zhaksylykbayeva@gmail.com

ORCID ID: 0000-0003-2646-456X

ALDABERGENOVA N.A.,²

c.l.s., professor.

e-mail: n.aldabergenova@turana.edu.kz

ORCID ID: 0000-0001-7384-3664

¹Synergy Partners Law Firm,

Almaty, Kazakhstan

²Turan University,

Almaty, Kazakhstan

LEGAL REGULATION OF DIGITAL ASSETS EXCHANGES: ON THE EXAMPLE OF BINANCE

Abstract

Binance's operations have a substantial influence on the development of global norms for regulating digital assets exchanges. The company actively engages in discussions with regulatory bodies, sharing its expertise and insights to shape effective regulations. Binance highlights the significance of establishing international standards that safeguard user security and foster innovation in the realm of blockchain technologies. Consequently, Binance is a crucial player in the field of legalizing digital assets exchanges, working to meet regulatory standards while fostering innovation and collaboration with regulators worldwide. In this article, we explore the fundamental legal principles that govern the operations of a digital asset exchange, using Binance as a case study. The author's article examines the real litigation cases that are being conducted around Binance. The author also conducts a comparative analysis of the legal regulation between Binance Global and Binance Kazakhstan.

Key words: legal regulation, digital assets exchanges, legalizing, digital assets, arbitration.

Introduction

Digital assets exchanges are platforms that allow users to buy, sell, and exchange various cryptocurrencies such as bitcoin, ether, and others. They play a key role in the ecosystem of digital currencies, providing liquidity and market access for traders and investors.

The approaches to regulating cryptocurrency exchanges differ significantly from country to country. In some jurisdictions, cryptocurrencies are recognized as a legal form of payment, and transactions involving them are legally permitted.

In this article, we explore the fundamental legal principles that govern the operations of a digital asset exchange, using Binance as a case study.

Binance, one of the leading digital assets exchanges globally, is a key player in the shaping of the legal framework for the cryptocurrency market. Its actions and engagement with regulatory bodies have a substantial influence on the development of regulatory frameworks in different jurisdictions.

Materials and methods

Throughout the research, real-life legal proceedings against Binance were examined. The stance of the U.S. Securities and Exchange Commission regarding digital asset exchanges was also considered.

The authors sought to explore the issue of whether arbitration rules apply to cryptocurrency disputes and how effective they are.

In essence, this paper aims to examine the limited judicial precedent in relation to a crypto giant like Binance. Recently, Binance has been actively engaging in legal regulation through high-profile legal battles with financial regulators from various countries, as well as its own users.

The literary review of this work consists mainly of judicial practice. The official statements of authorized persons of digital asset exchanges were also analyzed. The SEC's position on digital asset exchanges has also been investigated. This article uses more Anglo-Saxon legal analysis.

Results and discussion

In 2023, the Securities and Exchange Commission (hereinafter – SEC) filed a lawsuit against Binance, the cryptocurrency exchange, and levied 13 charges against it [1]. These charges include, among others, operating an unregistered exchange, providing false information about its control and supervision (a separate American division of the exchange), and offering and selling unregistered securities.

However, the exchange regulator later acknowledged its mistake in classifying Binance's digital assets as securities [2].

However, in June 2024, U.S. District Judge Amy Berman Jackson led a lawsuit against the SEC and Binance. In her ruling, the Judge dismissed several fundamental conditions set forth by the SEC, specifically the assertion that cryptocurrency tokens like BNB and StableCoin BUSD are securities. The court concluded that the SEC had not furnished sufficient proof to support the claim that the sale of these tokens on the secondary market met the criteria for an investment contract under the Howey test.

In this context, regarding the Howey test, the term «Howey test» was introduced in 1946 by the SEC in a lawsuit against Howey Co. [3]. The regulator accused the company of selling unregistered securities. The securities in question were citrus groves, which the company sold to outside investors. The investors were offered the opportunity to lease the groves back, essentially becoming tenants of the company. The market value of these plots increased, primarily due to the harvest.

The Supreme Court of the United States determined that the purchasers had invested in the company in this manner. In essence, a «contract for investment» was executed. It is important to note that this term is not yet explicitly defined in US law. The Supreme Court declared that a contract for investment is essentially a plan for distributing capital or investing funds in a way that generates income or profit from the use of money.

To determine whether a financial transaction qualifies as an «investment contract» and is therefore subject to regulation under the Securities Act, several fundamental criteria have been employed. These criteria, later known as the Howey Test, consist of four questions:

1. Was money invested as part of the transaction?
2. Were investments made in the company as a whole?
3. Did the investor anticipate making a profit from the transaction?
4. Is the anticipated profit linked to the activities of others?

The phrasing of the questions may vary, but the underlying concept remains the same. If all the questions can be answered in the affirmative, then the investment contract has been established, and financial transactions are subject to securities regulation. This, in turn, validates the SEC's oversight of the process.

Therefore, investing in securities is a commercial activity where an investor puts money into a company as a whole with the aim of generating profit. The success of the investment is directly linked to the efforts of the parties involved in the transaction. In essence, it was established that the SEC has the authority to mandate the registration of such transactions with the agency.

Now, the question arises: Does this Howie test have any relevance to the classification of digital assets as securities? However, the SEC is applying the same methodology used in the past century to digital assets in the present day. All SEC actions against crypto companies are based on their compliance with the Howey test criteria. The regulator must demonstrate that investors are investing in a crypto project with the expectation of earning a profit, and the crypto company is actively working to advance its project.

To begin with, the SEC has confirmed the legitimacy of Bitcoin based on the Howey test. In 2019, the agency declared that Bitcoin (hereinafter – BTC) is not a security, stating that it does not require crowdfunding or public backing [4]. Some experts believe that the SEC did not classify BTC as a security because there is no issuer in the first cryptocurrency, making it impossible to hold anyone accountable. However, the SEC has identified other digital assets such as Solana (SOL), Cardano (ADA), and Polygon (MATIC) as potential securities, as evidenced by recent legal actions. The SEC is questioning the classification of these relatively new assets as securities.

Therefore, it is important to acknowledge that the Howie test was the outcome of a legal dispute between the SEC and two small-scale breeders more than seven decades ago. However, the precedent established by this case has allowed the agency to regulate the market for the latest financial technologies today.

To further explore the SEC's case against Binance, Judge Amy Berman Jackson dismissed several charges brought against Binance by the SEC due to the digital assets' non-compliance with the Howie test mentioned above. This did not completely resolve the SEC's legal action against Binance, but it did help to reduce the litigation. The SEC's case against Binance is still ongoing.

A group of investors has also filed a lawsuit against Binance, alleging that the collapse of the FTX exchange was due to unfair competition.

The lawsuit was filed by a California investor, Nir Lahav, against Binance and its CEO, Changpeng Zhao. The plaintiff claims that the defendants attempted to monopolize the market, causing harm to FTX and related platforms.

The lawsuit is based on a tweet that Zhao posted in early November 2022. In the tweet, Zhao announced the decision to liquidate assets owned by FTT. Lahav estimates that this represented up to 5% of the FTX Token utility's supply.

A few days after the distribution, Zhao posted on Twitter that he had signed a letter of intent to fully acquire Binance. FTX.com. However, he later retracted this statement.. The lawsuit alleges that these actions precipitated the swift decline and insolvency of FTX entities, causing substantial financial harm to its customers. Lahav asserts that FTX incurred losses due to transactions conducted on trading platforms prior to their collapse.

The CEO of FTX, Sam Bankman-Fried, has publicly supported the idea of implementing regulations in the cryptocurrency industry. However, as the trial has shown, Binance has rejected this approach.

Binance was not only sued by the securities regulator, but also faced a dispute with its users. For instance, on April 19, 2021, Binance halted operations for four hours due to a technical issue in the world of cryptocurrencies. This resulted in many of its clients who had borrowed funds for trading being unable to log in and adjust their positions. After the technical issue on Binance, users attempted to log in and found their accounts empty. Those affected by the platform failure have contacted Binance to seek compensation, but they have not received a response. Binance maintains that customers «assume the risk of the operations they perform on the platform in accordance with the contractual provisions they must agree to when using the platform.» Engaging in digital asset trading is akin to engaging in risky activities. Therefore, when signing up for most digital asset custodians, it is crucial to carefully review the terms and conditions of the user agreement before proceeding, as many custodians may not fully disclose the potential risks associated with their platform. In this section, we will delve into this issue and present our recommendations to the legislator for safeguarding users.

To recap, the dispute between Binance and users that occurred in April 2021. The aforementioned «unfair demands» are deemed to be in conflict with European case law and other legal systems, as the unfair conditions imposed unilaterally by Binance are deemed invalid. In other words, this implies that in such contractual relationships, the interests of only one party should not be prioritized. It is worth noting that the «equality of interests of the parties» is a fundamental principle of our domestic civil law, as stated in paragraph 1 of Article 2 of the Civil Code of the Republic of Kazakhstan doesn't executed.

CEO Changpeng Zhao (known as CZ) also believes that Binance is decentralized and does not belong to any country and is not regulated by any law. As he notes himself, the company does not have a permanent place of residence or, in his words, «the place of residence of this company depends on my place of residence» [7], which leads to significant difficulties in determining which jurisdiction is suitable for Binance and which law applies.

Binance was founded in Sangai, China, in 2017 and moved to Tokyo, Japan, as China's anti-cryptocurrency legislation intensified. When regulation becomes stronger in Tokyo, the CEO announced that the company will relocate to Malta, Bermuda and Jersey. Today, Binance is headquartered in the Cayman Islands, Seychelles, Singapore, South Korea, Uganda, Ireland, the United States and the United Kingdom, without specifying who the parent company or its subsidiaries are and how they interact with each other. In other words, Binance's corporate structure is complex when creating legal entities, and it is difficult to understand, so determining the responsibility of the parent company or its subsidiaries leads to confusion. The exchange operates all over the world, and its users are everywhere, not just in Europe. In the five years from 2017, when it was founded, to 2022, Binance has grown from a startup to a cryptocurrency giant with employees in dozens of countries. By November 2022, he controlled more than half of the cryptocurrency market.

However, resolving the disagreement between Binance and its users is not a straightforward process.

Approximately 700 individuals filed complaints against Binance. Binance's terms and conditions state: «In the event of any dispute or conflict between the User and the platform, it shall be resolved by the Arbitration Court of the International Arbitration Chamber of Hong Kong» [9]. However, a deterrent factor in this situation is the requirement to pay a fee of \$65,000 from each plaintiff to initiate the arbitration process. This fee is stipulated in the arbitration rules of the International Arbitration Chamber of Hong Kong. Consequently, users who have suffered financial losses due to technical issues must pay this substantial amount to initiate the arbitration process, in addition to other expenses.

The second issue is that the Binance terms of use prohibit class action lawsuits, which are outlined on the official Binance website (35 paragraphs).

This case is still ongoing, but we can draw some conclusions about it:

1. Even if the plaintiffs win in arbitration, it may be challenging for them to receive payments. Firstly, it can be difficult to trace the defendant's assets. Secondly, while many countries recognize arbitration awards, if the circular acts in that country are illegal, some may not enforce decisions regarding digital assets.

Furthermore, due to the unique characteristics of the cryptocurrency sector and the diverse range of participants, calculating and quantifying expenses can be a complex task.

Moreover, some countries believe that enforcing a decision made through arbitration in the context of cryptocurrencies might contradict the government's stance on this matter.

The exclusion of arbitration from public policy is a well-established principle, as evidenced by the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

For instance, the Shenzhen Arbitration Court in China refused to recognize an arbitration award related to government policy, citing the fact that China has banned the circulation of cryptocurrencies and has not recognized digital currencies as having any legal standing.

In particular, in 2018, the Shenzhen Intermediate People's Court examined the arbitration award case between Gao and the Shenzhen Yongxil Innovation Development Foundation. Gao was held responsible for failing to fulfill his obligations to return cryptocurrency assets, which resulted in arbitration proceedings. The arbitration court ruled that Gao must reimburse the equivalent value of the cryptocurrency in US dollars [10]. However, the Shenzhen Arbitration Court in China deemed this decision contrary to the public interest and did not uphold it [11]. This situation demonstrates the

stance of the Chinese judicial system regarding cryptocurrency-related matters and the significance of adhering to national regulations and public interests when addressing such cases.

In this context, such a burden may arise from the potential refusal of state courts to acknowledge the rulings of arbitration courts regarding digital assets in the future.

In 2020, a group of individuals who had suffered losses amounting to 853 million euros due to the debt auction of the Makerdao project in March 2020 [12] filed a class action lawsuit in the cryptocurrency sector. The American Arbitration Association (AAA) was the plaintiff in this lawsuit. In April 2020, Peter Johnson filed a lawsuit against Makerdao, alleging that the platform had misrepresented the risks associated with the DAI stablecoin and provided misleading information that resulted in financial losses for him.

In September 2020, Judge Maxine Chesney of the U.S. District Court for the Northern District of California ruled that the case should be resolved through arbitration, as per the Terms of Use of DAI, which Johnson had agreed to in 2018, stipulated that any disputes must be settled through arbitration.

In February 2023, the court granted the motion to dismiss the second amended collective complaint, indicating that the arbitration process had been completed.

However, the specifics of the arbitration proceedings and their final outcome are not publicly disclosed, as the results of arbitration proceedings are typically kept confidential.

Conclusion

Examining the aforementioned, we draw the following conclusions:

The uncertainty surrounding cryptocurrencies is linked to the following issues:

1. The lack of expertise in state courts to handle crypto-related cases. This, in turn, reflects the varying approaches to regulating this sector across different jurisdictions in relation to digital assets. Additionally, there may be a question of which jurisdiction is considering crypto regulations. For instance, Binance lacks a physical location due to its decentralized nature.

2. Due to the fluctuating nature of the prices of digital assets, even if a court rules in favor of users in the future, the process of assessing and compensating for material losses will be challenging. For instance, if a user purchases a Binance Cab-shamaman 1 BTC for approximately \$30,000, and two months later, due to a hacker attack, they lose the same 1 BTC. If they then file a claim for arbitration, the arbitrator makes a favorable decision, and the Binance user receives a fiat equivalent of 1 BTC. Binance will then reimburse the user for the amount of money, assuming the price of BTC is 50,000 USD. However, if the user does not agree to this and decides to pursue legal action, what happens if the price of BTC is 50,000 USD? This kind of instability in the prices of digital assets poses significant challenges in the future.

3. If cryptocurrency is involved in arbitration, the enforcement and recognition of the arbitral award can also be challenging. For instance, we cited the case where the Shenzhen Intermediate People's Court failed to recognize the arbitral award regarding cryptocurrency assets.

4. The majority of arbitration courts do not accept collective claims. According to the aforementioned study, it is evident that many arbitrators in the Hong Kong International Arbitration District do not accept class action lawsuits. This issue also creates obstacles. However, the rejection of class action lawsuits is not directly related to the arbitration process itself, but rather to the «terms of service» published by each decentralized autonomous organization (DAO) on their website. For example, the Binance «terms of service» mentioned above explicitly state that users cannot file class action lawsuits against Binance. Furthermore, it is important to note that the cost of initiating proceedings in the Arbitration Court is quite high.

5. The operational agreement between the DAC and users does not adhere to the principle of equal treatment. When examining the usage agreements of platforms like Coinbase and Binance, it becomes evident that the interests of the central bank are often given precedence and safeguarded to the fullest extent. In these agreements, users are responsible for assuming all the risks associated with their contributions.

REFERENCES

- 1 SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao. URL: <https://www.sec.gov/newsroom/press-releases/2023-101>
- 2 SEC Lawsuit vs Binance: Crypto Tokens are not Security. URL: <https://www.binance.com/ru/square/post/13521104621298>
- 3 SEC v. W.J. Howey Co., 328 U.S. 293. 1946. URL: <https://supreme.justia.com/cases/federal/us/328/293/>
- 4 Digital Asset Transactions: When Howey Met Gary (Plastic). URL: <https://www.sec.gov/newsroom/speeches-statements/speech-hinman-061418>
- 5 Против Binance подали коллективный иск из-за краха FTX. URL: <https://forklog.com/news/protiv-binance-podali-kollektivnyj-isk-iz-za-kraha-ftx>
- 6 Nir Lahav vs. Binance holdings limited, and Changpeng Chao / Case 4:23-cv-05038. URL: <https://storage.courtlistener.com/recap/gov.uscourts.cand.418891/gov.uscourts.cand.418891.1.0.pdf>
- 7 Binance CEO On What Investors Need To Know About The World's Largest Crypto Exchange. URL: <https://www.forbes.com/sites/stevenehrlich/2021/11/29/binance-ceo-on-what-investors-need-to-know-about-the-worlds-largest-crypto-exchange/>
- 8 URL: <https://www.binance.com/en/terms>.
- 9 Guiding Cases 199–201 issued by PRC Supreme People's Court. URL: <https://www.chinalawvision.com/2023/12/uncategorized/guiding-cases-199-201-issued-by-the-prc-supreme-peoples-court-further-steps-toward-a-pro-arbitration-regime/>
- 10 Notice on Further Preventing and Resolving the Risks of Virtual Currency Trading and Speculation. URL: <http://www.pbc.gov.cn/en/3688253/3689012/4353814/index.html>
- 11 \$30M MakerDAO 'Black Thursday' lawsuit sent to arbitration. URL: <https://cointelegraph.com/news/30m-makerdao-black-thursday-lawsuit-sent-to-arbitration>
- 12 Johnson V. Maker Ecosystem Growth Holdings. URL: <https://casetext.com/case/johnson-v-maker-ecosystem-growth-holdings-inc>
- 13 Johnson V. Maker Ecosystem Growth Holdings. 2020. No. 3. URL: https://law.justia.com/cases/federal/district-courts/california/candce/3:2020cv02569/358097/82/?utm_source=chatgpt.com

REFERENCES

- 1 SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao. URL: <https://www.sec.gov/newsroom/press-releases/2023-101>. (In English).
- 2 SEC Lawsuit vs Binance: Crypto Tokens are not Security. URL: <https://www.binance.com/ru/square/post/13521104621298>. (In English).
- 3 SEC v. W.J. Howey Co., 328 U.S. 293. 1946. URL: <https://supreme.justia.com/cases/federal/us/328/293/>. (In English).
- 4 Digital Asset Transactions: When Howey Met Gary (Plastic). URL: <https://www.sec.gov/newsroom/speeches-statements/speech-hinman-061418>. (In English).
- 5 Protiv Binance podali kolektivnyj isk iz-za kraha FTX. URL: <https://forklog.com/news/protiv-binance-podali-kollektivnyj-isk-iz-za-kraha-ftx>
- 6 Nir Lahav vs. Binance holdings limited, and Changpeng Chao / Case 4:23-cv-05038. URL: <https://storage.courtlistener.com/recap/gov.uscourts.cand.418891/gov.uscourts.cand.418891.1.0.pdf>. (In English).
- 7 Binance CEO On What Investors Need To Know About The World's Largest Crypto Exchange. URL: <https://www.forbes.com/sites/stevenehrlich/2021/11/29/binance-ceo-on-what-investors-need-to-know-about-the-worlds-largest-crypto-exchange/>. (In English).
- 8 URL: <https://www.binance.com/en/terms>. (In English).
- 9 Guiding Cases 199–201 issued by PRC Supreme People's Court. URL: <https://www.chinalawvision.com/2023/12/uncategorized/guiding-cases-199-201-issued-by-the-prc-supreme-peoples-court-further-steps-toward-a-pro-arbitration-regime/>. (In English).
- 10 Notice on Further Preventing and Resolving the Risks of Virtual Currency Trading and Speculation. URL: <http://www.pbc.gov.cn/en/3688253/3689012/4353814/index.html>. (In English).
- 11 \$30M MakerDAO 'Black Thursday' lawsuit sent to arbitration. URL: <https://cointelegraph.com/news/30m-makerdao-black-thursday-lawsuit-sent-to-arbitration>. (In English).

12 Johnson V. Maker Ecosystem Growth Holdings. URL: <https://casetext.com/case/johnson-v-maker-ecosystem-growth-holdings-inc>. (In English).

13 Johnson V. (2020) Maker Ecosystem Growth Holdings. No. 3. URL: https://law.justia.com/cases/federal/district-courts/california/candce/3:2020cv02569/358097/82/?utm_source=chatgpt.com. (In English).

ЖАҚСЫЛЫҚБАЕВА Ә.А.,*¹

З.ғ.м., заңгер.

*e-mail: zhaksylykbayeva@gmail.com

ORCID ID: 0000-0003-2646-456X

АЛДАБЕРГЕНОВА Н.А.,²

З.ғ.к., профессор.

e-mail: n.aldabergenova@turan-edu.kz

ORCID ID: 0000-0001-7384-3664

¹Synergy Partners заң фирмасы,

Алматы қ., Қазақстан

²«Тұран» университеті,

Алматы қ., Қазақстан

ЦИФРЛЫҚ АКТИВТЕР БИРЖАЛАРЫН ҚҰҚЫҚТЫҚ РЕТТЕУ: BINANCE МЫСАЛЫНДА

Андатпа

Binance қызметі цифрлық активтер алмасуды реттеудің жаһандық нормаларын әзірлеуге айтарлықтай әсер етеді. Компания тиімді нормативтік актілерді әзірлеу үшін өз тәжірибесімен және идеяларымен бөлісе отырып, реттеуші органдармен пікірталастарға белсенді қатысады. Binance пайдаланушылардың қауіпсіздігіне кепілдік беретін және блокчейн технологиясының инновацияларына ықпал ететін халықаралық стандарттарды белгілеудің маңыздылығын атап көрсетеді. Демек, Binance бүкіл әлем бойынша реттеушілермен инновациялар мен ынтымақтастықты ынталандыра отырып, нормативтік стандарттарға сәйкес келуге ұмтылып, цифрлық активтерді айырбастауды заңдастырудың негізгі ойыншысы болып табылады. Бұл мақалада біз мысал ретінде Binance-ті қолдана отырып, цифрлық активтерді айырбастау операцияларын реттейтін негізгі құқықтық принциптерді қарастырамыз. Авторлар бұл мақалада Binance айналасында жүргізіліп жатқан нақты сот істерін қарастырады. Авторлар сонымен қатар Binance Global және Binance Kazakhstan арасындағы құқықтық реттеуге салыстырмалы талдау жүргізеді.

Тірек сөздер: құқықтық реттеу, цифрлық активтер биржасы, заңдастыру, цифрлық активтер, арбитраж.

ЖАҚСЫЛЫҚБАЕВА А.А.,*¹

М.ю.н., юрист.

*e-mail: zhaksylykbayeva@gmail.com

ORCID ID: 0000-0003-2646-456X

АЛДАБЕРГЕНОВА Н.А.,²

К.ю.н., профессор.

e-mail: n.aldabergenova@turan-edu.kz

ORCID ID: 0000-0001-7384-3664

¹Юридическая фирма Synergy Partners,

г. Алматы, Казахстан

²Университет «Туран»,

г. Алматы, Казахстан

ПРАВОВОЕ РЕГУЛИРОВАНИЕ ОБМЕНА ЦИФРОВЫМИ АКТИВАМИ: НА ПРИМЕРЕ BINANCE

Аннотация

Деятельность Binance оказывает существенное влияние на разработку глобальных норм регулирования обмена цифровыми активами. Компания активно участвует в дискуссиях с регулирующими органами, делаясь

своим опытом и идеями для разработки эффективных нормативных актов. Binance подчеркивает важность установления международных стандартов, которые гарантируют безопасность пользователей и способствуют инновациям в области блокчейн-технологий. Следовательно, Binance является ключевым игроком в области легализации обмена цифровыми активами, стремясь соответствовать нормативным стандартам, одновременно поощряя инновации и сотрудничество с регулирующими органами по всему миру. В статье мы исследуем фундаментальные правовые принципы, которые регулируют операции обмена цифровыми активами, используя Binance в качестве примера. В статье рассматриваются реальные судебные дела, которые ведутся вокруг Binance. Авторы также проводят сравнительный анализ правового регулирования между Binance Global и Binance Kazakhstan.

Ключевые слова: правовое регулирование, биржа цифровых активов, легализация, цифровые активы, арбитраж.