Dipping its 'cryptoes' in the water: poor litigation strategy ruins a valid arbitration agreement

Written by **ALEXANDER LYALL**

In *Beltran, Julian Moreno and another v Terraform Labs Pte Ltd and others*,[1] the Singapore High Court dismissed a cryptocurrency exchange's application to have a dispute resolved by arbitration. As Terraform Labs Pte Ltd (Terraform) found the hard way, a party can succeed in showing a valid arbitration agreement but fail because of its litigation strategy.

The decision not only demonstrates the dos and don'ts of an arbitration strategy but provides key analysis on the intricacies of agreements in the crypto world.

Background

Terraform, stablecoins and LUNA

Terraform is a Singapore-based company that develops software and applications running the Terra blockchain. The company was co-founded by crypto entrepreneur Do Kwon in Seoul, in 2018.[2] The next year Terraform launched its own cryptocurrency, LUNA. In 2020, Terraform launched a stablecoin[3] called TerraUSD (**UST**).

Terraform also operates an ecosystem providing projects, platforms and applications atop Terraform's blockchain. This includes the Anchor Protocol on which users stake their UST in consideration for promised returns, calculated on an annualised yield basis.

A crypto-bubble pops

The final months of 2021 marked the beginning of crypto's dramatic fall in price. Bitcoin, Ether and Dogecoin saw massive slumps. In December 2022, Bitcoin was down 70%. Commentators dubbed it the "crypto winter".

The crypto winter did not spare holders of LUNA and UST. On 7 May 2023, a series of transactions saw the UST depegged[4] from the USD and the price of the cryptocurrencies plunged. In May alone, both LUNA and UST fell 97%. Neither coin recovered.

1 *Beltran, Julian Moreno and another v Terraform Labs Pte Ltd and others* [2023] SGHC 340.

2 Kwon has since experienced significant legal issues. In September 2022, Kwon was arrested in Montenegro after a South Korean court issued a warrant for his arrest. In February 2023, the United States Securities and Exchange Commission charged Kwon with fraud. In January 2024, Terraform filed for bankruptcy in the United States.

3 A stablecoin is a type of cryptocurrency that is pegged to another currency. Terraform intended TerraUSD to be pegged to the United States Dollar.

4 A process where the value of a stablecoin significantly deviates from the currency to which it had been attached.

The wrong kind of challenge

→ The Singapore High Court criticised the litigation strategy of Terraform.

Class action suit against Terraform by its users

The collapse led to legal action. The proceedings forming the topic of this article commenced after 375 users of the platform joined together in a class action suit.

Claims of misrepresentation by Terraform served as the central grounds for the class action suit. The users alleged that Terraform had made a number of representations based on:

- the stability of the coin;
- the structure of the platform's exchange mechanism;
- the size of UST's returns; and
- the size of Terraform's reserve funds.

According to the claimants, these representations induced the holders to hold onto their UST as the price plummeted in the crash.

The court or the arbitrator: who decides whether Terraform's actions made the crash worse for its users?

In a pre-case conference, Terraform stated that it intended to challenge the jurisdiction of the court. Terraform argued that through Terraform's terms of use, the users had entered into an agreement to arbitrate any disputes resulting from their use of the website. Under the

agreement, all disputes would be heard through an arbitration institute in Singapore.

In that same month, Terraform filed a defence. Crucially, it went beyond a mere challenge to the jurisdiction of the Court. The defence included statements on the merits of the argument and counterclaims. This would prove costly for Terraform.

Terraform eventually applied to stay the proceedings on the grounds that the dispute was to be resolved through the arbitration agreement. The assistant registrar (the **AR**) dismissed Terraform's stay application. In the AR's view, Terraform could not make out a prima facie case that the arbitration agreement was valid. The AR's findings included that the location of the relevant hyperlink for the terms of use lacked prominence, to the point of being obscure.

Was there an agreement to arbitrate?

The bells and whistles of an online agreement

Terraform appealed to the High Court. In assessing whether the arbitration clause was valid, Justice Nair paid close attention to the physical presentation of the agreement. Online contracts, Justice Nair explained, can be put into three categories:[5]

a. "clickwrap" agreements where the user scrolls through the terms of use and affirmatively clicks a button stating words to the effect of "I agree";
b. "sign-in wrap" agreements where users are notified of terms available by way of hyperlink; and
c. "browse-wrap" agreements where a website displays a notice notifying the user that they agree to the site's terms of use by way of using the site. The user is not required to click anything, nor take affirmative action indicating their acceptance of the terms.

The parties agreed that the agreement resembled the "browse-wrap" kind.

The claimants argued that this "browse-wrap" presentation could only function as an agreement if, as users of the website, they were given substantial notice of the relevant terms. However, Justice Nair noted that the cases cited by the claimants for this argument did not concern arbitration clauses.

Justice Nair looks to the prima facie standard

As the decision concerned Terraform's application to stay the proceedings, Terraform only had to establish on a prima facie basis that there had been an arbitration agreement. Justice Nair rejected arguments by the claimants that a higher standard applied.

Article 16(1) of UNCITRAL Model Law instructs that the arbitral tribunal may rule on its own jurisdiction. This means courts should intervene on questions of jurisdiction as infrequently as possible. The importance of the distinction saw Justice Nair reject several submissions by the claimants because cases they had cited had not assessed those arbitration clauses to the *low and unexacting* prima facie threshold.

Agreements to arbitrate at two key levels

Justice Nair accordingly looked at whether, prima facie, there had been an arbitration agreement in two key areas of the Terraform system.

The Terraform terms of use

The claimants argued that the relevant hyperlink in the Terraform terms of use was obscure. However, the significance of that obscurity was contextual.[6] Justice Nair found that the point at which the users saw the representations must have been as they were browsing the website for more information, not when they were carrying out a transaction. Once a user had moved from browsing to transacting, it was not unreasonable for them to have paid attention to the link. Justice Nair accordingly found an arbitration agreement had been formed once a user commenced carrying out a transaction.

The Anchor Protocol

Some of the claimants also stated that while they purchased UST on the Anchor Protocol, Terraform had made misrepresentations. Similarly, the claimants argued that the arbitration clause was obscure and therefore should be void. However, Justice Nair noted the significance of the presence of a pop-up notification.[7] Purchasing UST required users to connect their

5 Justice Nair looked to *Dialogue Consulting Pty Ltd v Instagram Inc* [2020] FCA 1846 as a guide here.
6 *Beltran*, above n 1, at [144].

"wallet" to the platform. In doing this, a user would see a pop-up notification. This notification would inform the user that their purchasing action signified an acceptance of Anchor's terms of service. With the context in mind, Justice Nair again found a prima facie agreement to arbitrate.

Terraform trips itself up by taking a "step in the proceedings"

Although a prima facie case for an arbitration agreement had been established, the saga was not over for Terraform. At section 6(1) of the International Arbitration Act 1994 (2020 Rev Ed) (**IAA**), a party wishing to stay the proceedings in favour of arbitration must serve that notice of intention before taking a step in the court's proceedings. Referring to Terraform's defence, the claimants argued that Terraform had dipped its toes into the substance of the claim without first making its jurisdictional challenge.

What happens when there has been a step in the proceedings?

Justice Nair first considered what the IAA meant by the term *a step in the proceedings*. This could be any act which indicates an intention for the disputed matter to be dealt with by court proceedings, rather than arbitration.[8] The step taken could not be regarded as anything other than acknowledgement of the court's jurisdiction in the matter.

Acknowledging that it can be difficult to assess whether an action taken amounts to a *step*, Justice Nair restated what the court should assess: *whether* [the action] *enables, or advances, a future engagement of the merits of the action.* The assessment should consider all circumstances and do so in a practical and commonsense way.

In Justice Nair's view, it was clear that Terraform had attempted to engage the court and had filed a defence and counterclaim, in order to try and defeat the claim on its merits. Aspects of Terraform's legal strategy had included making:

- an application for further and better particulars;
- an application for striking out the claim; and
- an application for the production of documents relating to the consent of the parties represented in the suit.

Further, their arguments were made without it being explicit that they were only intended to be on a "fallback" basis.

The better option for Terraform would have been to simply file a defence challenging the jurisdiction of the Court.[9] Justice Nair referred to Terraform's strategy and noted that that the application for further and better particulars would not have necessarily disrupted that strategy. Had the application been to decide whether to bring a jurisdictional challenge, then it would not have been considered *a step*.

It was clear that Terraform had taken steps in the proceedings; and having done so, the claimants were not required to have the dispute heard through arbitration.

Conclusion: a wishy-washy defence strategy will not do in an unpredictable market

Courts in numerous jurisdictions, including Singapore and New Zealand, actively take a pro-arbitration stance. However, arbitration agreements do fail from time to time. Often that is because of poor drafting.

In the cryptocurrency space, some arbitration agreements have failed for public policy reasons. Unfortunately for Terraform, it was their litigation strategy which let them down. Getting this right will be crucial. While there are indications that we may be entering a "crypto-spring", disputes over cryptocurrency will likely remain frequent. If cryptocurrency platforms wish to keep these disputes out of court, then their litigation teams need to get the memo early.

7 *Beltran*, above n 1, at [157].
8 *Beltran*, above n 1, at [38].
9 *Beltran*, above n 1, at [51].

About the author

Alexander Lyall is a Research Clerk in The ADR Centre's Knowledge Management team, working with NZDRC and NZIAC. He gained his LLB from the University of Canterbury, and he also holds a BA in political science, media studies, and Te Reo Māori. His writing has previously been published by Radio New Zealand, The Spinoff and The Press.