LALIVE

Insight

Payward v Chechetkin: Consumer protection trumps enforceability of crypto award

A recent ruling from the English Commercial Court highlights the potential challenges faced by crypto platforms in enforcing arbitral awards in England against consumers due to public policy considerations.

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I. INTRODUCTION

In Payward v Chechetkin [2023] EWHC 1780 (Comm), Mr Justice Bright declined to enforce a foreign arbitral award rendered by a US arbitrator on the basis that the enforcement was contrary to public policy under s. 103(3) of the Arbitration Act 1996.

In his decision, Mr Justice Bright found Mr Chechetkin to be a consumer within the definition of the Consumer Rights Act 2015 ("**CRA**"). As a result, enforcement of the arbitral award – which did not take into account his status as consumer under the CRA or his claim against the Payward Group under the Financial Services and Markets Act 2000 ("**FSMA**") – was found to be contrary to public policy.

Although the judgment helpfully confirms that the mere fact that a consumer contract provides for disputes to be resolved in arbitration does not make it inherently unfair, it also makes it clear that (particularly in the consumer context) arbitration agreements should be tailored to the relevant jurisdiction in which business is undertaken. Failure to do so may lead to any resulting awards being treated as unenforceable in England and Wales.

II. BACKGROUND

The dispute concerns the Payward Group, which operates the Kraken global cryptoasset exchange, and Mr Chechetkin, a British citizen in England who had a trading account on the Kraken website.

In March 2017, Mr Chechetkin contracted with Payward Ltd, the English Payward Group entity, by setting up a trading account on Payward's online platform (the "**Contract**"). On his application form, Mr Chechetkin provided the following details:

- He was a lawyer whose only source of income was derived from his employment.
- He did not work in the crypto or fintech industries.
- He did not provide any details regarding any existing cryptocurrency trading experience.
- He responded in the negative to questions as to whether he was creating the account on behalf of a third party and whether he intended to use the account as a bitcoin reseller or reseller of other digitals as a business. Answering in the affirmative to either of these questions would have required him to apply as a corporate client.

- Out of the different levels of accounts available, he applied for a “Pro” account, which has the highest limits for withdrawals and deposits, indicating on the form that he did so because of the higher withdrawal limits.

By applying for an account, Mr Chechetkin accepted Payward’s terms of services. These were set out in a clickwrap agreement on the website and included a dispute resolution clause (clause 23) providing for arbitration seated in San Francisco, California under the JAMS Comprehensive Arbitration Rules and Procedures (the “**JAMS Rules**”) and governed by the laws of California and applicable US law. The JAMS Consumer Arbitration Minimum Standards, which apply where a company systematically places an arbitration clause in its agreements with individual consumers and there is minimal or no negotiation between the parties, are also relevant here.

Over the next three years, Mr Chechetkin began placing trades using his account on the Kraken trading platform. Until March 2020, he was reasonably active and made some gains and some losses.

Between March and June 2020, he made deposits to his account totalling £613,000, which are the subject of the present dispute. Having deposited £289,000 in March 2020, his trading positions turned negative. He subsequently tried to recover the situation by topping up his account, hoping to trade his way out of trouble, but the repeated deposits and trades led to the loss of his whole balance in the account.

The FSMA proceedings and JAMS arbitration

In January 2022, the Payward Group entities commenced arbitration proceedings against Mr Chechetkin under clause 23 of the Contract, asserting that (i) the arbitration should be under the JAMS procedure in California and (ii) the laws of California applied.

On 23 February 2022, Mr Chechetkin commenced English High Court proceedings against Payward Ltd and other entities in the Payward Group for breaches of FSMA (the “**FSMA Proceedings**”). In particular, he argued that Payward Ltd did not have the necessary authorisation at the relevant time to carry out regulated activities under FSMA and that the Contract was therefore unenforceable under s. 26 of FSMA.

The Payward Group entities issued an application disputing jurisdiction of the English courts in the FSMA Proceedings, but made no application to stay the proceedings under s. 9 of the Arbitration Act 1996 (notwithstanding the fact that they had already started arbitration proceedings by then).

Mr Chechetkin sought to stay the arbitration pending the outcome of the FSMA Proceedings, but his arguments were rejected by the sole arbitrator. He subsequently submitted a motion challenging the arbitration and the arbitrability of the dispute, arguing that clause 23 was legally unenforceable under English law and that it violated the JAMS Consumer Arbitration Minimum Standards. However, the sole arbitrator issued an order, followed by a partial award, denying Mr Chechetkin’s challenges to arbitrability and jurisdiction.

The arbitration continued and on 18 October 2022, following a merits hearing and post-hearing submissions, the sole arbitrator issued the Final Award, deciding *inter alia* that:

- Mr Chechetkin anticipatorily breached the Contract with Payward Ltd by commencing the FSMA Proceedings.
- Payward’s assertion that the arbitration was not a consumer arbitration was rejected and, accordingly, the JAMS Consumer Arbitration Minimum Standards applied to the arbitration.

- Mr Chechetkin assumed the risks of trading on Payward's platform and thus his claim that Payward should repay the £613,000 he had deposited into his Kraken account was rejected.

English court proceedings subsequent to the Final Award

On 23 October 2022, the Payward Group entities sought recognition and enforcement of the Final Award in the English courts (the "**Enforcement Proceedings**"). Mr Chechetkin resisted enforcement of the Final Award under s. 103(3) of the Arbitration Act 1996, primarily on the basis that enforcement would be contrary to public policy as embodied in FSMA and the CRA.

On the same date, the Payward Group entities also applied for an injunction under s. 44(2)(e) of the Arbitration Act 1996 and s. 37(1) of the Senior Courts Act 1981 in the context of the FSMA Proceedings, requesting that (i) Mr Chechetkin not take any further steps in the FSMA Proceedings, and (ii) the hearing of their challenge to English jurisdiction also be adjourned, until a final determination of the Enforcement Proceedings. Mr Chechetkin argued that, as he was a consumer within the definition of s. 15E of the Civil Jurisdiction and Judgments Act 1982, clause 23 of the Contract was not effective to prevent the English courts from exercising jurisdiction over the FSMA Proceedings. On 25 October 2022, Miles J rejected the Claimants' jurisdictional challenge in the FSMA Proceedings and the related injunction/adjournment application.1 Miles J agreed with Mr Chechetkin that he was a consumer, and consequently determined that the FSMA Proceedings were to continue unless the outcome of the Enforcement Proceedings were to be in favour of enforcing the Final Award.

III. DECISION AND REASONING

In the context of the Enforcement Proceedings, Mr Justice Bright found that enforcement of the Final Award would be contrary to public policy under s. 103(3) of the Arbitration Act 1996. He considered both the CRA and FSMA to be expressions of UK public policy, including the public policy objective of consumer protection. As the CRA and FSMA are UKwide statutes, rather than England-specific statutes, Mr Justice Bright considered that this underlined their general significance, in policy terms.

The characterisation of Mr Chechetkin as a "consumer"

As an initial matter, Mr Justice Bright found that Mr Chechetkin was a "consumer", which is defined in the CRA as "an individual acting for purposes that are wholly or mainly outside that individual's trade, business, craft or profession".

Mr Justice Bright's reasoning was based on the following considerations:

- Mr Chechetkin's sole profession was as a lawyer.
- At the time that Mr Chechetkin entered into the Contract, his employment as a lawyer was his only source of income.
- Mr Chechetkin did not have significant experience of cryptocurrency trading. He did not work in the crypto or fintech industries. At the relevant time, in March 2017 when Mr Chechetkin contracted with Payward Ltd, he had no material knowledge, experience or sophistication in relation to cryptocurrency.
- When Mr Chechetkin opened his account, he confirmed that he was not acting on behalf of a third party and that he did not intend to use his account as a cryptocurrency reseller.

Although the Claimants sought to rely on Mr Chechetkin's frequent use of his Kraken account to invest reasonably large sums with the intention of generating income, Mr Justice Bright did not consider that this demonstrated that Mr Chechetkin's cryptocurrency transactions were entered into "in the course of a trade, business, craft or profession". He also noted that the suggestion that Mr Chechetkin's investments were reasonably large was "very much in the eye of the beholder". Moreover, the relevant transactions which Mr Chechetkin entered into post-dated the opening of his Kraken account.

Public policy under the CRA

Mr Justice Bright found that enforcement of the Final Award would be contrary to the public policy objective of s. 74 of the CRA. S. 74 of the CRA provides that, if the parties to a consumer contract that has a close connection to the UK have chosen a foreign law as that contract's applicable law, the CRA nevertheless applies. The arbitrator in the JAMS arbitration, however, applied only the laws of California and did not take account of the CRA or any other element of English or UK law. Moreover, the seat of arbitration, San Francisco, required Mr Chechetkin to use expensive US attorneys.

In reaching his decision, Mr Justice Bright relied on the observations of Birss LJ in Soleymani v. Nifty Gateway that (i) an English court was better placed to deal with English law issues than a US arbitrator and (ii) arbitration overseas would place a significant burden on a British consumer.

Mr Justice Bright did, however, note that the fact that a consumer contract provides for disputes to be resolved in arbitration did not make it unfair. Rather, he took the view that a reasonable consumer in the position of Mr Chechetkin would not have agreed to arbitration in California, under the JAMS Rules and subject to the US Federal Arbitration Act. Mr Justice Bright considered it relevant that the US federal courts are not competent to supervise disputes that are concerned with English law and UK statutes, and that the Federal Arbitration Act is not an appropriate statutory framework. Instead, he considered that a reasonable consumer would have agreed to arbitration in the UK, subject to the Arbitration Act 1996, which provides a qualified right to appeal in case of errors of law, such as the CRA or FSMA not being applied correctly.

Public policy under FSMA

Mr Justice Bright also found that enforcement would be contrary to the public policy of FSMA, by preventing the FSMA Proceedings from being determined. He considered that the "stifling" of Mr Chechetkin's claim under FSMA would be contrary to the public policy considerations underlying FSMA. In particular, he referred to s. 26 FSMA, which provides that contracts concluded by unauthorised entities carrying on regulated activities are unenforceable, and that the customer should be entitled to recover his money. He also considered that investigation and criminal prosecution of offences under FSMA are far less likely to occur if customers with grievances are obliged to pursue them in confidential arbitration proceedings seated in California, rather than through the UK courts, or at least in arbitration proceedings seated in the UK.

Finally, Mr Justice Bright noted that while he had the discretion to consider any other "fresh circumstance" such as another agreement or an estoppel that may affect the decision to refuse recognition or enforcement of the Final Award, he determined that no such circumstance existed in this case. Consequently, he held that the Final Award would not be recognised or enforced.

IV. COMMENTS

Arbitration remains a viable option for cryptocurrency disputes

Many virtual asset service providers, including cryptocurrency exchanges, use arbitration clauses in their terms and conditions because of the various advantages of arbitration, such as flexibility and confidentiality. Given these benefits, Mr Justice Bright's finding that resolving consumer contracts through arbitration is not inherently unfair (but only that the supervisory jurisdiction of the English courts is an important consideration) is a welcome confirmation for players in the crypto industry that arbitration is still a viable option to resolve disputes. His conclusion is particularly noteworthy in light of the English High Court's pending decision in Soleymani v. Nifty Gateway on the validity of an arbitration agreement in the terms and conditions of one of the largest online marketplaces for NFTs.

Tailoring arbitration clauses for crypto disputes

This judgment does, however, signal that cryptocurrency exchanges and other virtual asset service providers should carefully assess the dispute resolution clauses in their terms and conditions. It is particularly important for cryptocurrency exchanges and other such platforms to tailor arbitration clauses to the relevant jurisdiction to reduce the risk that an arbitral award will be found to be unenforceable due to public policy considerations. In this case, UK customers of the Payward Group contracted with the UK-incorporated entity, Payward Ltd. Thus, Payward Ltd could have included an arbitration clause providing for an English seat and English law as the governing law in its terms and conditions, rather than the standard boilerplate clause used by the US Payward Group entities. This approach would have ensured that questions of English public policy would have been dealt with by a tribunal well-versed in English law, and that the English courts would have had supervisory jurisdiction over the arbitration (including, notably, the possibility of limited appeal to the English courts on the basis of an error of law under s. 69 of the Arbitration Act 1996). Alternatively, the Payward Group entities could have agreed to vary the Contract by agreeing to arbitration seated in England when the dispute arose. Since cryptocurrency exchanges operating globally are likely to have customers around the world, they should also be mindful that other consumer protection regimes may also become relevant.

Characterising users of cryptocurrency exchanges as "consumers"

Mr Justice Bright's judgment also provides some helpful guidance on the characterisation of consumers in cryptocurrency disputes that is likely to be relied upon in future cases. In assessing whether a customer of a cryptocurrency exchange is a "consumer", courts may take into account (i) their profession, (ii) their experience in crypto and fintech, (iii) the primary source of their income and (iv) any confirmations provided at the time of entering into the contract that the trades will be carried out in a personal capacity. While the value of the cryptocurrency trades was not decisive in this case, it remains to be seen whether future cases will take account of such considerations. Although Mr Chechetkin arguably gained experience in trading over time – which the Claimants sought to rely on – it was his experience at the time at which he entered into the Contract that was ultimately decisive. Given the rise in cryptocurrency trading, and growing experience of consumers in this field, it may become more complex in the future to determine whether a user of a cryptocurrency exchange is in fact a consumer.

Users of cryptocurrency exchanges should be aware that information provided in creating accounts may become relevant in possible future disputes and should take care to ensure that such information, particularly where it relates to their level of experience with trading, is provided accurately.

V. PRACTICAL TAKEAWAYS FOR PARTIES TO CRYPTO DISPUTES

1. Cryptocurrency exchanges and other virtual asset service providers should carefully tailor their arbitration clauses to the relevant jurisdiction in which business is undertaken and in which customers are based.

2. If arbitration clauses cannot be specifically tailored, and when a dispute does arise, cryptocurrency exchanges and other such providers may also consider proposing to seat arbitrations in the customer's domicile when commencing arbitration to avoid potential issues of enforceability of an arbitral award.

3. Users of such platforms (and consumers in particular) should be mindful that arbitration clauses in the terms and conditions may not always be enforceable and should seek legal advice in the event of a dispute.

For further questions or comments about this topic, please contact the authors.