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A study of legal status of “E-coins” under PRC Law

By Xun Yang | Jianqi Yang

Since the birth of block chain technology in 2008, the most realistic and also controversial usage is, without doubt, the offering of e-coins. Bitcoin, Ethereum and their derivatives have been receiving great controversies from the very beginning. Those who support e-coins view them as “golden asset” for the next generation, whilst the opponents treat them as a new version of “tulip bubble”. China government concerns that unregulated offering and exchange of bitcoins will impact the financial market orders and, at the same time, recognizes the actual existence of e-coins and transactions thereof. Therefore, from legislation to judicial practice, Chinese government holds a dilemma attitude towards e-coins derived from the block chain technology — keeping them away from financial market and recognizing them as a factual existence.

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I. Forbidden Zone of E-coins

Block chain technology, in essence, enhances security protection of information in a system at the expense of efficiency by allocating storage and verification functions every node of the system so that the information cannot be easily erased or altered. Therefore, the primary practical application of block chain technology is the issuance and trading of digital currency, known as e-coins. China's regulatory authorities have long been cautious about e-coins, and have built a “forbidden zone” in China.

(i) Notice on prevention of bitcoin risks

In December 2013, when the annual growth rate of Bitcoin exceeded 900%, the People's Bank of China and the other five departments jointly issued a “Notice on the Risk Prevention of Bitcoin” (“Bitcoin Notice”). This is the first time that the regulator in China dealt with the impact of e-coins. In view of the fact that other types of e-coins at that time were not as popular as today, and “Ethereum”, which has significant meaning for reformation of e-coins, has not yet been well-known. As a result, the target of Bitcoin Notice was bitcoin itself. The Bitcoin Notice mainly covers the follows:

1. Bitcoin must not be used as a currency in the market. It is not a currency which is mandatory to be accepted and must be regarded as a virtual commodity in principle.
2. All types of financial institutions and payment institutions are not allowed to use Bitcoin to price for products or services, to buy or sell or trade Bitcoin as a central counterparty, to cover Bitcoin-related insurance business or to include Bitcoin in insurance coverage, and nor are they allowed to provide customers with other Bitcoin-related services directly or indirectly
3. Bitcoin site operators who provide services, such as Bitcoin registration and transactions on Internet must file their site with telecommunications regulators and fulfill their anti-money laundering duties.

The above provisions are to prevent licensed financial and payment institutions from participating in Bitcoin-related business, so that bitcoins related services (such as registration and settlement) will be isolated from the Chinese financial market. At the same time, strict regulatory requirements were imposed on private Bitcoin site operators.

(ii) Risk alert on e-coin risks

Three years later, in September 2017, seven departments including the People's Bank of China and the Cyberspace Administration of China issued the "Alert on Preventing Token Fundraising Risks" (the “Risk Alert”). The alert indicates that regulatory attitude in China is further stricter: the government

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does not only isolate e-coins from the financial system of China, but also further prohibits the promotion of initial coin offerings in China so as to prevent possible financial risks. Under the Risk Alert:

- E-coins are no longer considered “virtual commodities,” which indicates that the regulatory authorities do not recognize the value of e-coins;
- Token financing and trading platforms are not allowed to provide exchanges between e-coins and legal currencies;
- Token financing and trading platforms are not allowed to provide “information intermediary” services for other token financing trading platforms besides obligations stipulated by Bitcoin Notice.

The Risk Alert imposes new legal requirements for e-coins transactions:

Firstly, regulators no longer recognize e-coins as virtual commodities, which steps back from the previous position.

Secondly, token financing and trading platform must not engage in the exchange between legal currency and e-coins, which caused the closures of several major e-coins trading platforms after September 2017, and the closures result in a large number of disputes (including in particular roll-back transactions).

Thirdly, token financing and trading platforms must not provide “information intermediary” services. From the perspective of revenue, the prohibition of providing information intermediary services for token financing will definitely affect the service fee income of the e-coin platforms. From the perspective of business development, e-coin platforms must consider compliance for future business.

II. The judicial practice regarding e-coin transactions

Since e-coins’ legal status under the current China laws has not yet been formally established, the transactions and legal issues contains therein have caused a great controversy in judicial practice.

One point of view suggests that e-coins can be protected as a “property right”. Article 127 of the Civil Law stipulates that “if other laws have provisions on the protection of data and online virtual assets, such provisions shall apply.” If “e-coins” are considered a type of “online virtual assets”, it will be protected by law. However, there are no law or regulation defining “online virtual assets,” and whether “e-coins” are

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considered a type of “online virtual assets” has not yet been clarified. In accordance with the principle of “determining property rights according to laws,” courts are generally cautious on confirming the “property” status of e-coins.

Some other views suggest that, since e-coins are not considered property rights, they must be considered creditors’ rights. The legal status of e-coins must be determined by the contracts which create such e-coin. current judicial decisions or arbitral awards all focus on such contracts, but different courts or arbitral institutions have adopted completely different attitudes towards obligation relating to e-coins (especially the e-coins transactions), which result in confusions among investors in e-coins.

At present, Chinese courts primarily hold the following positions towards e-coins.

(i) E-coins are a legally recognized property

In 2016, the Intermediate Court of Taizhou made a decision on the appeal for Wu Hongen Theft case, which decision considers the act of stealing e-coins as “theft” and holds the view that “bitcoin purchased by the victim King is not only a specific virtual commodity, but also the property that the victim possesses in real life and, therefore, must be protected by criminal law.” This decision recognized the property feature of Bitcoin. Otherwise, the defendant could only be convict of intrusion into computer information systems rather than theft.

Some arbitration awards also stated the same opinions. In October 2018, the Shenzhen International Arbitration Tribunal decided in a case involving return of e-coins. In the arbitration award, Shenzhen International Arbitration Tribunal held that “although Bitcoin is not a legal currency, it can be protected as a property. Bitcoin has features of property; it is capable of being controlled by individuals, has economic value and generates financial benefits for holders.” Accordingly, the tribunal holds the view that bitcoin is considered property and the transactions involving them must be protected, so as long as it is not illegally sold, issued, pledged, or otherwise received in any illegal activities such as financial fraud and pyramid schemes.

(ii) The contract for e-coin transactions is valid

In the early dispute concerning e-coins, the case “Wang Tiliang v. Huobi”, Beijing Haidian Court held that the contract regarding e-coin transaction was valid. Although Bitcoin (the most popular e-coin) is not considered “money,” the court believes that there is no law or regulation that explicitly prohibits the parties from investing in and trading Bitcoins, and the defendant operates the network in a legitimate way. As such, the court believes that the plaintiff must bear legal risks of the transaction by

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himself. Consequently, the contract between the plaintiff and the defendant was held enforceable and the plaintiff's request for the refund of costs is not supported.

The case does not discuss the features of e-coins. The Haidian Court mainly focused whether the parties had violated the laws in entering into the contract. As e-coins are considered a “creditor's right” legally circulated in the market before September 2017, according to the principle of freedom to contract, the contract for e-coins is valid. However, after the Risks Alert, it remains uncertain as to whether the contracts are still valid.

- (iii) The contract for e-coin transaction is invalid, and both parties must settle the dispute based on invalidation of the contract.

In the dispute over the sale and purchase contract between Ding Jianqiang and Chen Yingguang, the Intermediate Court of Zhejiang Lishuiyuan stated that, according to the Risks Alert, the mark-coin traded by both parties is an “e-coin” that is prohibited by the alert. Therefore, the relevant contract for the sale of the mark-coin is invalid. Consequently, the defendant was ordered to return to the plaintiff RMB 651,000 as the contract under which it receives such fund was invalidated.

The view that the contract is invalid will bring legal uncertainty to both parties. If this principle is adopted, that is properties given under the original (but invalidated) contract is returned (ie Article 58 of the Contract Law), the court appears to have at least recognized the property value of e-coins. However, if the value of the virtual currency changes significantly, the return of the property by both parties may not reflect the intention of the parties.

- (iv) Illegal obligations are not protected by law, and the parties' claims are not supported.

As of the Risks Announcements, judicial decisions have undergone a significant change. In the contract dispute between Zhou Zhenmei and Jinan Manvi Information Technology Co., Ltd., the Intermediate Court of Jinan held that “the creditors' rights generated by Bitcoin are illegal and are not protected by law. Accordingly, the plaintiff must assume risks arising from storing bitcoin in bitcoin platforms. As such, the court rejected plaintiff's claim for returning Bitcoin. In another case involving Jinan Manvi Information Technology Co., Ltd. ((2018) Lu 01 No. 4975), the Intermediate Court of Jinan also dismissed the plaintiff Zhang Haichao's request for returning 37 bitcoins by the same reason. .

These decisions indicate that, although e-coins are not absolutely prohibited as same as “gambling,” they cannot be protected laws even if the investor's interests in e-coins are compromised.

A study of legal status of “E-coins” under PRC Law**III. Conclusion**

The current legal and regulatory regime has many restrictions on the issuance, trading and circulation of e-coins. In general, direct issuance and exchange of e-coins is illegal. However, the judicial practice also recognizes that e-coins have actual economic value. Even from based on the strictest regulatory and judicial position, the laws do not prohibit Chinese individuals and companies from buying and holding virtual currency issued, traded, and circulated outside of China, participating in or providing services to the virtual currency outside of China. . Therefore, participating in the offshore virtual currency in China is a possible option.

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