

American Bankruptcy Institute Secured Credit Committee  
presents a webinar on:

# Dealing with Digital Assets

## PRESENTERS:

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# Overview

What are “digital assets”? (Overview of payment services, cryptocurrency, and non-fungible tokens (aka NFTs))

How does a creditor get secured and perfected against these types of assets?

What are some bankruptcy issues to be aware of that are unique to these types of assets?

# What is cryptocurrency?

- ▶ Money?
- ▶ Investment Property?
- ▶ Digital Asset?



# What is cryptocurrency? (cont'd)

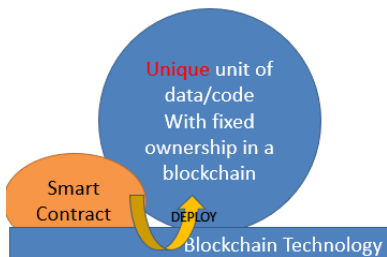
- ▶ The answer is “yes.”
- ▶ Technical definition:
  - ▶ Cryptocurrency is a decentralized digital currency designed to serve as a medium of exchange or store of value.
  - ▶ Cryptocurrency is used to execute transactions on a “blockchain”
  - ▶ Blockchain is a technology that verifies otherwise anonymous transactions through a rigorous mathematical process.
  - ▶ Allows transactions to be permanently recorded without the need for a central authority or trusted third party to clear or verify the transaction, and provides digitally authenticated recordkeeping
  - ▶ Total Market Cap: \$1.0 trillion (up from \$762 billion in June 2022, but down from \$3.0 trillion in November 2021)

# What is cryptocurrency? (cont'd)

- ▶ Money?
  - ▶ El Salvador
  - ▶ Central African Republic
  - ▶ Not in the U.S.

# What are Non-Fungible Tokens?

## NFTs



## CHARACTERISTICS

- ▶ Unique
- ▶ Not exchangeable
- ▶ Does not function as money
- ▶ Has econ and non-economic value
- ▶ Keep track of the holder and Keeps track of trading
- ▶ 90-250 billion market
- ▶ Maximizes value in an insolvent Estate

### Cannot be:

Altered

Asset is in the blockchain itself not in the wallet

Digital representation link to actual assets: - physical or digital.

- Tokenized
- Tracked
- Trade

**Ownership** always transparent and Verifiable

### Used to collect:

Real Estate

Art

Music

Digital cars

Sports memorabilia

Investors

Patent

meme

### Reason to tokenized a

physical object:

Global market exposure

# NFTs as Collateral

- ▶ Bargained for exchange for cryptocurrencies or fiat money
- ▶ Higher returns; higher risk
- ▶ Peer to peer
- ▶ Usually 10-20 APR and 30-90 day duration
- ▶ NFTfi marketplace/JPMorgan at Decentraland blockchain
- ▶ New restrictions and default rate

# What are Payment Services assets?

- ▶ Examples: PayPal, Venmo and eBay balances
- ▶ Venmo, has more than 70 million users in the U.S. who sent nearly \$230 billion to each other in 2021<sup>1</sup>
- ▶ A business PayPal account can transfer out up to \$6 million per year and \$100k per day<sup>2</sup>

<sup>1</sup> <https://www.businessofapps.com/data/venmo-statistics/>

<sup>2</sup> <https://www.jotform.com/paypal-business-account-guide/>

# Getting Secured and Perfected Against Digital Assets

# Cryptocurrency

- ▶ Article 9
  - ▶ Cryptocurrency as personal property/digital assets
  - ▶ Digital assets generally fall within one of two different categories: general intangibles and investment property.
    - ▶ Perfection methods
  - ▶ Filing a UCC-1
  - ▶ Controlling the property
  - ▶ Possessing the property

# Cryptocurrency (cont'd)

- ▶ Control under **new UCC Article 12**
  - ▶ “Controllable electronic records” or “CERS”
  - ▶ The power to enjoy substantially all of the benefits
  - ▶ The exclusive power to prevent others from enjoying substantially all of the benefits
  - ▶ The exclusive power to transfer control
  - ▶ Control > earlier in time UCC-1

# Maximizing Remedies as to Crypto Collateral

- ▶ Concerns:
  - ▶ Ease of transferability of crypto collateral
  - ▶ Proceeds of a collateral sale
  - ▶ Clouds on title
  - ▶ Transfers to a recipient in a remote jurisdiction
    - ▶ Best Practice: Be Proactive!
  - ▶ Consider whether there are prior liens on the collateral
  - ▶ Consider how cryptocurrency is stored
    - ▶ Hot wallets vs. cold wallets

# Non-Fungible Tokens (NFTs)

- ▶ Personal Property
- ▶ General Intangible v. Investment securities
- ▶ Art. 9 - UCC-1
- ▶ Obtain control (lien priority over UCC -1)
- ▶ Acquire private key
- ▶ Secure wallet
- ▶ Subordination letter from other secured creditors
- ▶ Terms completely based on smart contracts
- ▶ Enforceability is questionable

# NFTs

## Default, Collection, Enforcement, Sale

- ▶ New UCC Article 12
- ▶ Replevin action
- ▶ Repossession
  - ▶ Transfer to a different wallet
  - ▶ Smart Contract
    - ▶ Current default term- upon default Borrower transfers to lender the NFT; wallet to wallet.
    - ▶ Does not transfer any copyrights or trademark rights as per smart contract terms, generally.
    - ▶ Currently - No Default rate
- ▶ Judgment
- ▶ Sale
  - ▶ Digital sale
  - ▶ Risk of illiquid intangible

### CHALLENGES

- ▶ Unclear what legal rights are conveyed with the transfer of an NFT.
- ▶ Quiet Title
  - ▶ *Free Holdings Inc. v. McCoy et. al.*, No. 1:22-cv-00881-LGS (S.D. N.Y. Feb. 1, 2022). Chain of title issues between different blockchains
- ▶ Shared Ownership
- ▶ Jurisdiction
  - ▶ where to record UCC -1
  - ▶ Global market
- ▶ Value
- ▶ NFT market influenced by crypto winter - 3AC's hedge fund in BK/Voyager/Celcius
- ▶ M&A - Ethereum Merger - will acquire "Enhanced Store of Value" properties

# Payment Services

- ▶ What are the balances (possibly significant) that are held at the payment services under Article 9?
- ▶ Are they “money”?
  - ▶ No - not authorized or adopted by a government and cannot be perfected by “possession
- ▶ Are they a “deposit account”?
  - ▶ No - it is not maintained by a bank.
- ▶ Are they a “general intangible”?
  - ▶ Yes - while maintained as a balance at the payment servicer

# Payment Services (cont'd)

## ► Perfection

- UCC-1 with appropriate secretary of state
- “All assets” language will cover it but can call out specifically as a category if known to exist and it is a significant asset
- Risk of priority loss if transferred to deposit account without control
- Enforcement - bit of an unknown and changeable
- After default: (i) judicial enforcement; (ii) 9-607; (ii) 9-609; or (iii) wait until transferred or withdrawn and enforce against other collateral

# Bankruptcy Issues Unique to Digital Assets

# Cryptocurrency

- ▶ Whose crypto is it anyway?
  - ▶ *In re Voyager Digital Holdings, Inc.*, 2022 WL 3146796 (Bankr. S.D.N.Y. Aug. 5, 2022)
  - ▶ **Background**: Debtors are a cryptocurrency brokerage, allowing customers to trade and store crypto on their platform
  - ▶ Debtors sought permission to permit customers to w/d funds (“Funds”) from two “for the benefit of” accounts at bank (“Bank”) on the grounds that Funds were not estate property
  - ▶ Customer Agreement differentiates b/w holdings of Customer Funds vs Customer crypto
  - ▶ Funds held in Bank, rendering Customers actually customers of Bank
  - ▶ *Contra* crypto held on Debtors’ platform on Customer’s behalf in Debtors’ name; warns that crypto held for Customer may be estate property but is unsettled at best

## Cryptocurrency (cont'd.)

- ▶ **Ruling:** motion granted.
  - ▶ Court noted that Bank acknowledged FBO accounts generally hold funds that are administered by one entity but belong to someone else
  - ▶ FBO agreement says Debtors cannot hold Customer Funds
  - ▶ “the Debtors do not have either legal title or equitable interests to the funds in the FBO accounts” and thus the “[F]unds held in the FBO accounts therefore are not ‘property of the estate.’”
  - ▶ **Caution:** Court notes that its ruling is guided without any kind of opposition by competing creditors, so it is not necessarily a touchstone for future cases

# Non-Fungible Tokens (NFTs)

- ▶ Property of the estate
- ▶ Adequate protection
- ▶ Automatic Stay and smart contracts
- ▶ Valuation
- ▶ Jurisdiction/Notice
- ▶ 363(f) - **3Acs, Case number: 1:22-bk-10920, SDNY** chapter 15 BK -sold NFTs portfolio as shares
  - ▶ Lien priority
  - ▶ Consent
  - ▶ Co-ownership
  - ▶ Tax fees/copyright royalties and other interests
  - ▶ Bid procedures
  - ▶ Recordation

# Payment Services

- ▶ Bankruptcy Considerations
  - ▶ Disclosure on the schedules and at 341 meeting
  - ▶ Turnover rights of the trustee
  - ▶ Possible claw back actions for transfer to make payments
  - ▶ Intercreditor disputes

Questions?

# Thank You

- ▶ Thank you for attending our webinar. Please keep an eye out for more webinars and educational opportunities from the Secured Credit Committee.
- ▶ Thank you to our presenters:
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## Faculty: Dealing With Digital Assets

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**Christopher (C.J.) Harayda** is a partner with Faegre Drinker Biddle & Reath LLP in Minneapolis and represents clients in bankruptcy and insolvency-related proceedings, transactions and litigation. He advises clients from multiple industries, including financial institutions and retailers, to guide their strategies when they encounter bankruptcy and other restructuring issues. He also represents clients in bankruptcy adversary proceedings and other insolvency-related litigation. Mr. Harayda counsels clients regarding the purchase, sale or restructuring of assets for financially distressed companies in and out of bankruptcy proceedings, including Article 9 foreclosure sales and § 363 sales. He also performs pro bono work with the Volunteer Lawyers Network, and was on Faegre Drinker's Pro Bono Honor Roll from 2017-19. Mr. Harayda received his B.S. in 2005 from the University of Minnesota and his J.D. in 2009 from Indiana University Maurer School of Law.

**Evan T. Miller** is a director at Bayard, P.A. in Wilmington, Del., where he concentrates his practice in the areas of corporate bankruptcy and restructuring, representing debtors (both voluntary and involuntary) and trustees, in addition to asset-purchasers, landlords, official committees of unsecured creditors, secured creditors, vendors, and preference and fraudulent transfer litigants in bankruptcy courts across the country. His clientele stems from a wide range of industries, including aviation, restaurants, insurance, retail, health care, energy and education, among many others. In addition to in-court and out-of-court restructuring matters, Mr. Miller has experience handling commercial litigation in Delaware, New Jersey and Pennsylvania jurisdictions, as well as Delaware Statutory Trust matters. In addition, he is a certified mediator for the U.S. Bankruptcy Court for the District of Delaware and is included on the Register of Mediators and Arbitrators maintained by the court. Since 2016, Mr. Miller has been recognized by Super Lawyers as a Delaware Rising Star in the area of business bankruptcy. He has also been named to Benchmark Litigation's 40 and Under Hot List since 2019 for his nationwide practice in bankruptcy litigation. In

2021, Mr. Miller was named an Emerging Leader by The M&A Advisor, was honored as one of ABI's 40 Under 40, and was named a Top Lawyer in the 2021 Top Lawyers Edition of Delaware Today magazine. He also was named an Americas Rising Star Dealmaker by the Global M&A Network in 2022, and Chambers USA recognized him in 2022 for his work in bankruptcy and restructuring in Delaware. Mr. Miller created and maintains the Avoidance Action Update Blog at [www.bayardlaw.com/blog](http://www.bayardlaw.com/blog), which tracks the latest developments in avoidance action case law and jurisprudence, and he is very active in the local and national restructuring community, currently serving as vice chair of ABI's Real Estate Committee, an executive board member of the Turnaround Management Association Philadelphia/Wilmington (TMA) chapter (which covers the Philadelphia metro area, the state of Delaware and southern New Jersey), treasurer of the Delaware Bankruptcy American Inn of Court and chair of the Business Law Section for the Philadelphia Bar Association, of which he formerly served as vice chair, communications chair, secretary and treasurer. Previously, Mr. Miller served as chairman of TMA NextGen and as co-chair of ABI's Young & New Members Committee, and he served as chairman and treasurer of the Delaware State Bar Association's (DSBA's) Young Lawyer Section, vice chair of the Bankruptcy Committee for the American Bar Association's Young Lawyer Division, and chair of the Philadelphia Bar Association's Bankruptcy Committee. He currently serves as one of two member contacts for Meritas, an invitation-only international alliance of over 175 business law firms located in more than 80 countries. Mr. Miller received his undergraduate degree from Bloomsburg University and his J.D. cum laude from the Delaware Law School and with honors from the Delaware Law School's Institute of Delaware Corporate and Business Law. While in law school, he served as the internal managing editor of the Widener Law Review for the 2008-09 academic year and interned for Hon. Chandlee Kuhn, chief judge of the Family Court of the State of Delaware. In his final year of law school, he served as a judicial extern to Hon. Jane R. Roth of the U.S. Court of Appeals for the Third Circuit.

**Shirley R. Palumbo** is a bankruptcy and insolvency senior counsel in the West Palm Beach, Fla., office of Greenspoon Marder LLP. She has experience in the areas of bankruptcy, debt restructuring, insolvency, creditor's rights, foreclosures, mediation and dischargeability issues, and she has represented unsecured and

secured creditors, institutional lenders and trustees across Florida, Puerto Rico and the U.S. Ms. Palumbo is Board Certified in Consumer Bankruptcy Law by the American Board of Certification and has received Martindale-Hubbell's highest ranking. She is a member of the Florida and Puerto Rico (federal) Bars and is admitted to the Eleventh Circuit Court of Appeals. Ms. Palumbo is a member of ABI and INSOL, and she is a member of the Southern District of Florida Bankruptcy Bar Association and the Judicial Liaison of the Florida Bar's Bankruptcy/UCC and Communications Committee. She received her J.D. from St. Thomas University and her LL.M. in international law from the University of Miami.