



AMERICAN
BANKRUPTCY
INSTITUTE

Central States Bankruptcy Workshop

Business Track

The Wild, Wild West of Crypto

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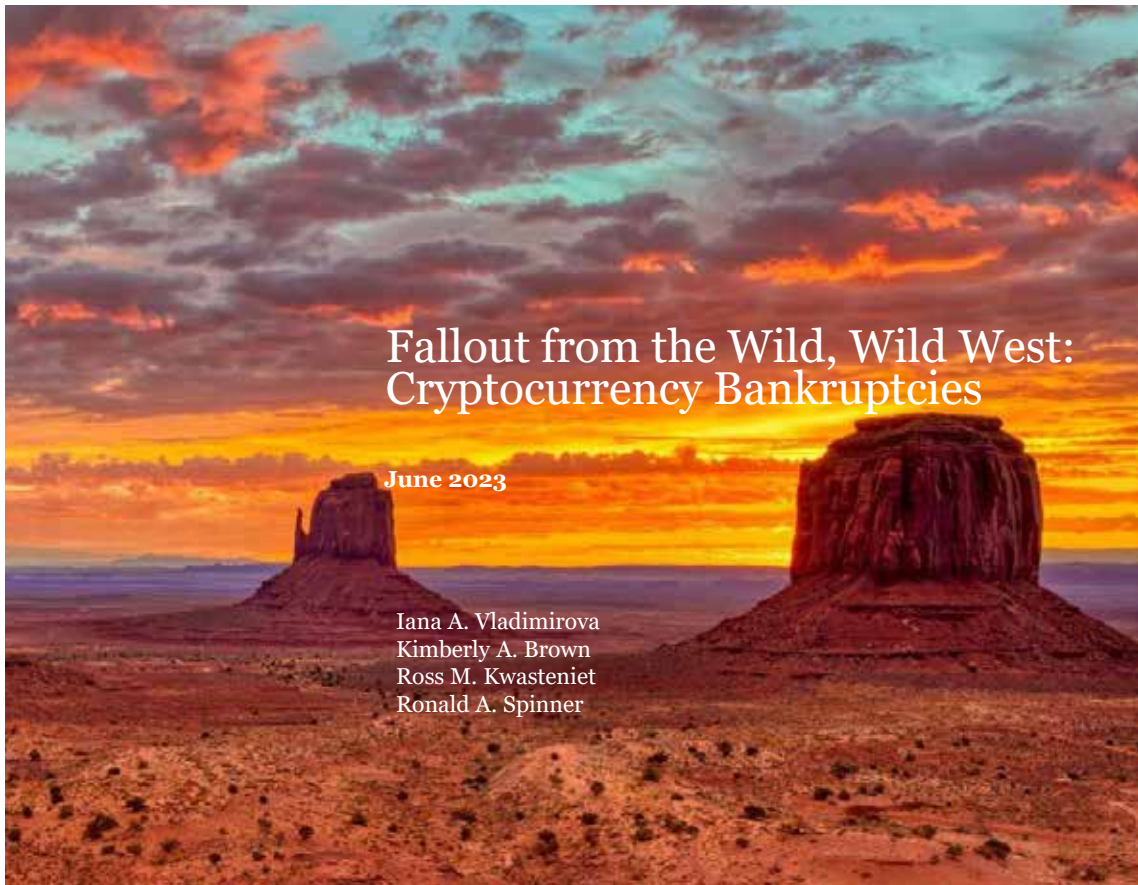
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Fallout from the Wild, Wild West: Cryptocurrency Bankruptcies

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Agenda

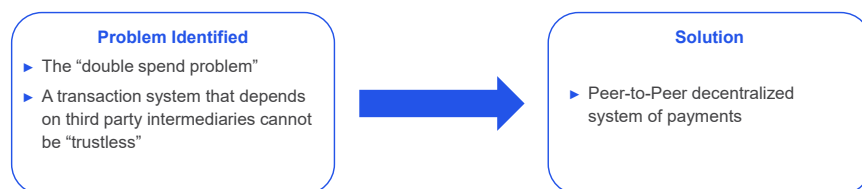
1. Cryptocurrency Overview
2. Cryptocurrency Platforms and Chapter 11
3. Cryptocurrency under the UCC

Cryptocurrency as a Concept // Key Features



Cryptocurrency as a Concept // Key Features

- ▶ Satoshi Nakamoto, Bitcoin: A Peer-to-Peer Electronic Cash System, <https://bitcoin.org/en/bitcoin-paper>



Bitcoin was originally intended as a medium of exchange (e.g., cash) not as an investment (e.g., gold).

- ▶ Bitcoin's goal was to free people from control or interference by governments, middlemen
 - Bitcoin "Genesis Block" (first block in block chain) references a newspaper article on bank bailouts
 - Despite its libertarian minded origins, many today have sought regulation and government action to punish bad actors



Cryptocurrency as a Concept // Key Features

- ▶ Since its first known use to purchase goods, Bitcoin's value and popularity have exploded.
 - In 2010, someone used 10,000 BTC . . . for two large pizzas.



May 2010: \$41.00

May 2023: \$272.3 million*

* Based on value of BTC at closing on May 23, 2023 (i.e., \$27,225.73).



Cryptocurrency as a Concept // Key Features

Crypto never leaves the blockchain—people only transfer ownership or control of the assets

- Similar to land one does not “send” or “receive” a building – one sends or receives a deed

Two key principles underlie blockchains

1. Hashing
 2. Asymmetric cryptography
- ▶ Hashing and asymmetric cryptography can be characterized as “**one way math**” making it difficult to reverse a transaction or change previously recorded information and makes hacking easy to detect.
 - ▶ For Bitcoin (and other crypto), users pick a random private key
 - A key can be any 256-bit number (0 to 2^{256})
 - 2^{256} is roughly 10^{77} , on scale with the number of atoms in the universe – impossible to guess (if truly random)
 - ▶ “One way math” is used to generate a “public key” from the private key, and an “address” from the public key
 - Cannot get private key from these but can use one way math to generate “signatures” from private key that can be confirmed using only public key

Many of the issues regarding crypto today relate to the reliance on third-party intermediaries within the crypto ecosystem (e.g., sharing private keys by holding crypto on an exchange)



Cryptocurrency as a Concept // Key Features

- ▶ Proof of Work (BTC):
 - “The process of verifying transactions on the Bitcoin blockchain by solving mathematical puzzles, for which miners are rewarded with new bitcoin.” –Investopedia
 - Uses massive amounts of electricity
 - Embedded power plants
 - Move toward more sustainable sources such as hydroelectricity, solar and wind
 - Very sensitive to volatility in prices of both energy and BTC
 - Increased energy prices and depressed BTC prices in 2022 led to financial distress and bankruptcies for miners and data centers
- ▶ Proof of Stake (ETH)
 - Different consensus process for validating new blocks on the blockchain – not energy-intensive
 - Validators explicitly stake (lock up) capital in the form of 32 ETH into a smart contract on Ethereum

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Cryptocurrency Business Models



Trading and
Exchange Services



Custody and
Wallet Services



Lending



Mining

Trading and Exchange Services: Facilitate cryptocurrency trading; offer derivative products; execute trades or route to third-party brokers.

Custodial services: Provide “wallet” services for customers to hold their cryptocurrency assets. These accounts generally offered interest or rewards on deposits as consideration for the authority to rehypothecate deposited assets.

Lending: Provide lending and borrowing solutions for retail and institutional clients. Loans were generally originated in dollars and collateralized by cryptocurrency assets.










Mining: Bitcoin mining businesses and related services.

Other: Energy companies, Data Centers, Software companies, Money transmitters, ATMs

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Cryptocurrency Business Models

	 Trading and Exchange Services	 Custody and Wallet Services	 Lending	 Mining
 BlockFi	✓	✓	✓	
		✓	✓	✓
				✓
 FTX	✓			
Genesis	✓	✓	✓	
	✓	✓	✓	

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Industry Headwinds – Cryptocurrency Markets

'The Music Has Stopped': Crypto Firms Quake as Prices Fall

Bitcoin Flirts With Lowest Level Since 2021 as Equities Drop

Bitcoin Plummets Below \$20,000 for First Time Since Late 2020

A \$2 Trillion Free-Fall Rattles Crypto to the Core

A market that has gone through several major downturns in its short life may be facing its biggest test yet.

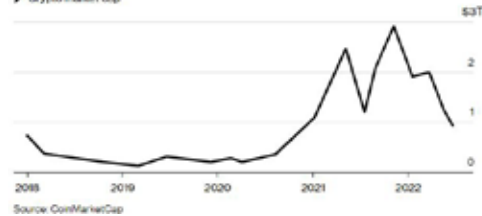
Cryptocurrencies Melt Down in a 'Perfect Storm' of Fear and Panic

The Fall of Terra: A Timeline of the Meteoric Rise and Crash of UST and LUNA

Peaks and Valleys

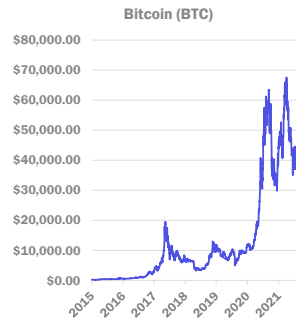
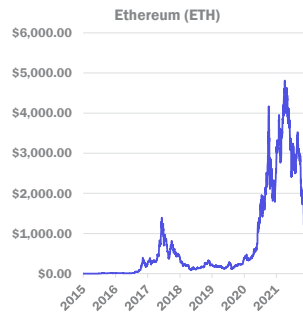
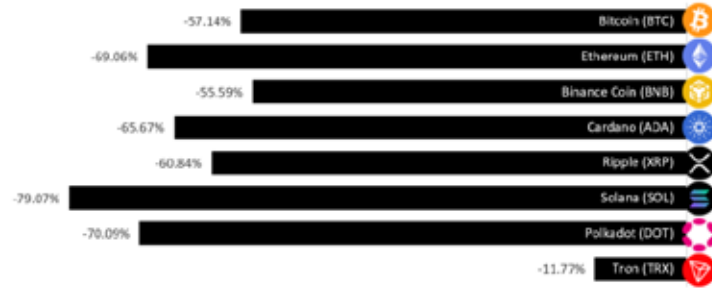
The crypto market is known for its ups and downs, but the latest slide is unprecedented in its magnitude

✓ Crypto market cap



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Industry Headwinds – Coin Values



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Industry Headwinds – Terra (Luna) / Terra USDC

The collapse of Terra (Luna)



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► Industry Headwinds – Three Arrows Capital



From \$10 billion to zero: How a crypto hedge fund collapsed and dragged many investors down with it

The Crypto Geniuses Who Vaporized a Trillion Dollars Everyone trusted the two guys at Three Arrows Capital. They knew what they were doing — right?

3AC: A \$10B hedge fund gone bust with founders on the run

Aftershocks: 3AC's collapse reverberates through crypto ecosystem

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► Pressing Pause: Part 1 (June 2022)

Crypto lender Celsius pauses withdrawals due to 'extreme market conditions'

The Celsius Withdrawal Pause Rattles Crypto World

—
Total value of cryptocurrencies falls below \$1 trillion

Crypto contagion fears spread after Celsius Network freezes withdrawals

Major crypto broker Voyager Digital suspends all trading, deposits and withdrawals

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Pressing Pause: Part 2 (November 2022)

FTX Exchange Halts All Crypto Withdrawals

Crypto exchange FTX saw \$6 bln in withdrawals in 72 hours

FTX Contagion Revives Dreaded 2022 Crypto Knell – the ‘Withdrawal Halt’

The downfall of the FTX exchange has caused a domino effect: a growing list of crypto firms, such as BlockFi and Genesis, halting withdrawals. CoinDesk counted 16 of these announcements just this year.

Binance temporarily halted withdrawals of stablecoin USDC as investor concerns mount after FTX collapse

PUBLISHED THU, DEC 15 2022 AT 07 AM EST | UPDATED MON, DEC 19 2022 AT 09 AM EST

BlockFi says it can no longer operate its business as usual, pausing client withdrawals in the wake of FTX collapse

FTX's \$1.4 Billion Deal for Bankrupt Lender Voyager Is Canceled

- Voyager says FTX meltdown means sale won't go forward
- FTX hasn't said whether it has canceled its Voyager bid

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Regulatory Challenges



CFTC, SEC, DOJ, IRS: These Are the Ongoing Investigations Into Binance

The world's biggest cryptocurrency exchange was sued this week by the CFTC. But a number of cases remain open.

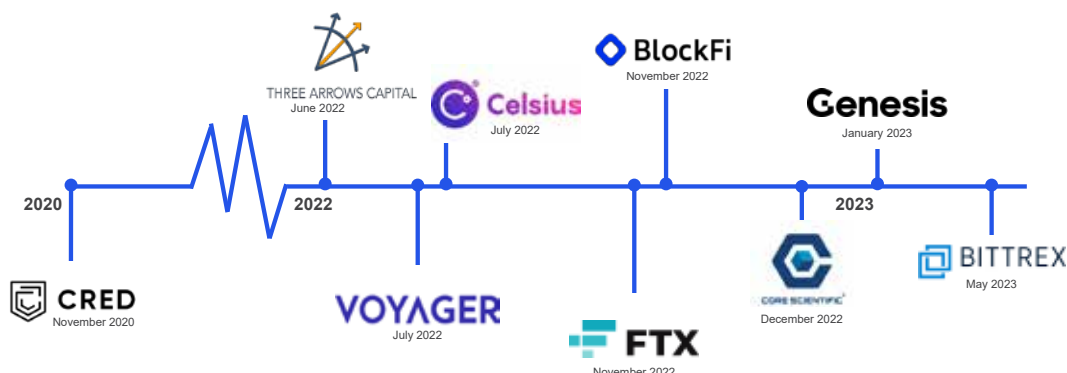
Crypto's 'Crackdown of Epic Proportions' Is Here

Regulators have more resources and the big players are in their sights.






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Timeline of Major Crypto Bankruptcy Filings



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Recent Cryptocurrency Filings

VOYAGER	Voyager has over 3.5 million customers and over \$5.9 billion crypto assets held. It filed for bankruptcy on July 5, 2022 following a short-term "run on the bank" due to the downturn in the cryptocurrency industry generally and the default of a significant loan made to a third party. It sought to emerge from bankruptcy through an acquisition by FTX, which was terminated when FTX filed for bankruptcy. Voyager subsequently entered into an agreement to sell itself to Binance.US for \$1.3 billion. The Binance.US transaction was terminated after confirmation of Voyager's plan was stayed pending appeal. Binance.US said it backed out of the transaction due to the "hostile and uncertain regulatory climate in the United States." Voyager is now in the process of liquidating its estates.
	Celsius has approximately 300,000 active users with account balances of more than \$100 and approximately \$6 billion in assets. It filed for bankruptcy on July 13, 2022. At the time, it was preparing to go forward with an initial public offering of its bitcoin mining business. On March 1, 2023, Celsius executed a plan sponsor agreement with NovaWulf Digital Management, LP and announced its intention to pursue the transactions contemplated therein in a proposed chapter 11 plan. The NovaWulf proposal served as a "stalking horse" bid for Celsius' restructuring plan. Prior to a final bid deadline, Celsius received two additional qualified bids and announced that it would conduct an auction. On May 25, 2023, Celsius announced that Fahrenheit, LLC was the winner of the auction. The company also secured a backup bid from the Blockchain Recovery Investment Consortium. Celsius is now in the process of documenting the contemplated transactions and filing an amended chapter 11 plan.
	FTX filed for bankruptcy on an emergency basis on November 11, 2022. Questions arose regarding Sam Bankman-Fried's (the founder and former CEO) leadership and handling of FTX's complex array of assets and businesses. John J. Ray III was appointed as CEO following Mr. Bankman-Fried's resignation. As of the petition date, FTX's scheduled assets totaled approximately \$4.8 billion and FTX's scheduled claims totaled approximately \$11.6 billion. FTX has estimated that it has over 9 million creditors – the vast majority of which are customers.
 BlockFi	Founded in 2017, BlockFi experienced rapid growth. Total trading volume grew to \$23 billion as of March 2022, while deployable assets grew to \$14.8 billion and gross loan originations expanded to more than \$47 billion. BlockFi originally sought an injection of liquidity to continue operating as a going concern from FTX. FTX, however, failed to meet its obligations, and BlockFi filed for bankruptcy on November 28, 2022. BlockFi filed a plan of reorganization providing for the parallel pursuit of a sale of substantially all assets or a standalone restructuring.
Genesis	Genesis offered qualified individuals and institutional investors a full-service digital currency brokerage platform. Genesis filed for bankruptcy on January 19, 2023. Genesis has been engaged with its creditors, including an ad hoc group of lenders representing more than \$2 billion in outstanding loans, and Digital Currency Group, Inc., Genesis' corporate parent and largest borrower, since prior to the chapter 11 filing. On February 10, 2023, Genesis filed a non-binding term sheet reflecting an agreement in principle among Genesis, DCG, and the ad hoc group, which contemplates Genesis running a marketing and sale process for the equity in, or assets of, the Debtors and certain of their non-Debtor subsidiaries, as well as non-Debtor affiliate Genesis Global Trading, Inc.

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Cryptocurrency Platforms and Chapter 11



Why do Cryptocurrency Exchanges file for Chapter 11?

- ▶ Crypto exchanges are not banks, so there is no FDIC/Federal Reserve receivership process.
- ▶ Rather, they can file for chapter 11 like most other companies.
- ▶ Typically, crypto exchanges have filed chapter 11 cases to stop a “run on the exchange” and prevent users/customers from withdrawing more crypto than the exchanges actually have.
- ▶ Crypto exchanges then propose a plan to distribute cryptocurrency and digital assets—as well as other key assets, such as interests in litigation—to creditors on account of their claims.



Chapter 11 as a Forum

Is Chapter 11 the right forum for a crypto insolvency?

- ▶ Chapter 11 is today the only U.S. legal regime to resolve the failures of cryptocurrency platforms (which are not subject to any bank receivership process at this time).
- ▶ That being said, chapter 11 offers a wealth of benefits, including:
 - breathing room to restructure;
 - broad flexibility to consider value maximizing alternatives;
 - a collective forum for the consideration of stakeholder interests; and
 - closure for management, professionals, and other relevant fiduciaries.
- ▶ Chapter 11's ability to provide better outcomes for cryptocurrency creditors can be enhanced.
 - Regulators should be required to “pick a lane” and provide regulatory guidance so that companies and their creditors know the “rules of the road.”
 - The methods by which debtors and other parties engage with creditors must continue to evolve (social media, etc.).
 - Debtors need to provide independent fiduciary leadership in the face of allegations of potential malfeasance.
 - Courts need to provide oversight of professional fees, timing delays, etc.

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Cryptocurrency and the Code

- ▶ Interpreting and applying the bankruptcy code to non-fiat assets, such as cryptocurrency, raises additional questions, including:
 1. Are digital assets “money” such that section 345 and related cash management requirements apply? E.g., are accounts that hold the crypto assets required to be bonded, with certain institutions, or below a certain amount?
 2. Is cryptocurrency considered a security?
 3. Is cryptocurrency a commodity such that it would be exempt from the automatic stay?
 4. Should different types of cryptocurrency be treated differently?
 5. If the digital assets are property of the estate, are customer withdrawals and transactions in the 90 days leading to a chapter 11 filing preferences and thus avoidable?
 6. Is it permissible to classify all customer claims in a single class or should claims be separately classified by coin type?
 7. When is a customer claim “paid in full”? E.g., if a customer has a claim for 1 BTC, and under a plan receives 0.5 BTC but due to an upswing in the market, the dollar value of the 0.5 BTC is more than the value of 1 BTC at the petition date, is the claim paid in full? Or must the customer receive 1 BTC, regardless of dollar value?
 8. What happens if the crypto market takes a dip after confirmation such that the assets materially depreciate? Must a debtor amend its plan to provide for reduced distributions? Or can it delay distributions and wait for the assets to appreciate?

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Assets of a Cryptocurrency Platform

The assets of cryptocurrency platforms typically consist of:

► **Cryptocurrency and other digital assets**

- Depends on how the platform structures its relationship with account holders.
- Does the exchange hold the cryptocurrency and digital assets in a custodial relationship? In these cases, the cryptocurrency and digital assets are often not considered property of the platform's bankruptcy estate but belong to the account holders.
- Or, alternatively, does the account holder transfer title of cryptocurrency and digital assets to the platform? In these cases, account holders lack a property interest in the cryptocurrency and digital assets and hold merely a claim on account of the relevant assets.

► **Other crypto-related businesses**

- Certain crypto exchanges may operate other crypto-related businesses. For example, Celsius owns a bitcoin "mining" operation where supercomputers process transactions on the blockchain in exchange for bitcoin.
- Celsius, FTX, and other platforms hold interests (such as preferred equity, convertible notes, or other instruments) in other blockchain-related businesses.

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Assets of a Cryptocurrency Platform (*cont'd*)

The assets of cryptocurrency platforms typically consist of:

► **Cash and cash equivalents**

- Cash is still king, even for businesses in the blockchain ecosystem.
- Employees, vendors, and bankruptcy professionals generally must be paid in fiat currency.

► **Causes of action**

- A debtor holds causes of action under chapter 5 of the Bankruptcy Code or applicable state law (such as for breach of duty, preferences, fraudulent conveyances, contract claims, or common law torts).
- A debtor may release those claims under a chapter 11 plan or court-approved settlement.
- Alternatively, the debtor can contribute those claims to a post-confirmation trust or other similar vehicle for pursuit after the bankruptcy case for the benefit of creditors.

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Liabilities of a Cryptocurrency Platform

The liabilities of cryptocurrency platforms typically consist of:

▶ **Account holder claims**

- As noted above, if account holders contribute their cryptocurrency and digital assets to the platform, then the account holder has a claim against the platform for the value of the cryptocurrency or digital assets as of the petition date (even if the value of those assets rises postpetition) under section 502 of the Bankruptcy Code.

▶ **Prepetition vendor and contract claims**

- Cryptocurrency platforms typically do not have third party debt.
- Unlike other complex bankruptcy cases, there is typically no administrative agent for a bank syndicate or a bond trustee for a bond issuance.

▶ **Crypto lenders often have claims for loans made to crypto platforms, either as customers or investors.**

- Preferred equity

▶ **Criminal and regulatory exposure**

- A bankruptcy plan cannot release criminal penalties, such as imprisonment.
- A bankruptcy plan cannot obviate the requirement to comply with regulations.
- But, a bankruptcy plan may be able to discharge certain fines and monetary penalties.

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Liabilities of a Cryptocurrency Platform (cont'd)

How are crypto-backed loans different from other cryptocurrency transactions?

- ▶ Certain platforms, such as Celsius, offer retail lending pursuant to which an account holder may borrow fiat (in USD) or an acceptable stablecoin in exchange for pledging digital assets as collateral.
- ▶ Retail borrowers may contend that they have ongoing ownership of digital assets transferred to the platform as collateral. However, posted collateral is likely deemed property of the estate.
- ▶ Typically, the terms of use provide digital assets posted as collateral shall be the exclusive property of the platform and the borrower grants the platform explicit consent to use such digital assets.
- ▶ Borrowers could argue that the collateral securing the retail loans was held in trust. However, the collateral is likely commingled and not held in a segregated account.
- ▶ Platforms, such as Celsius, are able to deploy the digital assets in their possession and have a right to dispose of and use such assets in their own name.
- ▶ Moreover, such platforms are not required to possess or control a “like” amount of digital assets after deploying them.

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Challenges Associated with Cryptocurrency Platform Cases

- ▶ Disputed questions of ownership of the key assets
- ▶ Disputed questions of priority between different customer segments—loans vs. regular account holders vs. custody
- ▶ Books and records may be poorly maintained because these companies are not fully matured when they file—a problem attendant to other venture capital stage debtors
- ▶ Lack of a bank agent, indenture trustee, or ad hoc group of funded debt creditors means you need to organize individual retail customers, which can be very challenging
- ▶ Crypto cases tend to impact the life savings of individual creditors, which results in an urgency not found in many other cases
- ▶ Overlay of causes of action against D&Os, criminal, regulatory
- ▶ Information deficit among account holders
- ▶ Promise and perils of social media
- ▶ Measuring customer claims in cryptocurrency and making “in-kind” distributions of these assets could lead to creditors within the same class receiving recoveries of disparate USD value due to fluctuation in cryptocurrency prices
- ▶ There is a lack of regulatory guidance in the space, and thus there remains significant uncertainty about whether restructuring solutions will pass regulatory muster

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Property of the Estate

Do account holders own cryptocurrency and digital assets or merely have a claim against the estate for the return of cryptocurrency that has become property of the exchange?

- ▶ The issue is governed by the individual platform’s terms of use, i.e., a contract.
 - In Celsius, the court issued an opinion holding that digital assets held in accounts associated with Celsius’ Earn program constitute property of the estates.
 - The court found that the terms of use were presumed to form a valid, enforceable contract between Celsius and account holders, and those terms of use provided that Celsius held “all right and title to such [assets deposited on the platform], including ownership rights” in the digital assets held in Earn accounts.
 - The digital assets became Celsius’ property upon the transfer by the account holder.
- ▶ Where a platform’s terms of use are ambiguous or silent as to the nature of its relationship with its users, a platform that exercises exclusive control over digital assets is more likely to hold those assets as estate property in bankruptcy.

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“Not your keys, not your coins”



Dollarization of Claims

- ▶ Section 502(b) of the Bankruptcy Code requires that claims must be in “lawful currency of the United States as of the date of the filing of the petition.”
 - However, the intent behind the Bankruptcy Code’s dollarization requirement does not necessarily apply to the unique and novel circumstances associated with cryptocurrency bankruptcies and it is unclear whether section 502(b) actually would require such conversion.
 - Further, obligations under customer contracts may allow for a different result.
 - In *Celsius*, the Debtors and Committee have advocated to not use the petition date price for the platform’s native token due to manipulation.
- ▶ Illustrative example:
 - If an account holder’s portfolio consisted of 0.5 ETH, 30 USDC, 20 APE and 100 ALGO on July 5, 2022, the account holder would have a total claim against the debtors’ estates of \$724.81.

Coin	Customer Claim		
	# of Coins Claimed	7/5 Coin Price	Claim (\$)
ETH	0.50	\$1,131.60	\$565.80
USDC	30.00	1.00	30.00
APE	20.00	4.91	98.27
ALGO	100.00	0.31	30.74
Total			\$724.81

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Dollarization of Claims (*cont’d*)

Advantages

- ▶ All holders of cryptocurrency claims are placed on equal footing to calculate recoveries
- ▶ Recovery can be calculated at a fixed point in time.
- ▶ Administrative convenience in both calculation and messaging.

Disadvantages

- ▶ Holders of claims may not benefit from fluctuations in the cryptocurrency prices (*i.e.* if the price of a coin increases between the petition date and the time of recovery).
- ▶ Potentially difficult to deliver cryptocurrency to customers if types of cryptocurrency on hand do not align with claims outstanding.
- ▶ Clear-cut tax issues.
- ▶ Difficult point to message to customers who, from experience, are most interested in receiving their cryptocurrency back.

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Regulatory Oversight

Cryptocurrency companies face substantial challenges in chapter 11 given the unclear, evolving, and disconnected regulatory landscape, particularly in the below ways:

1. Federal and state regulatory agencies have provided unclear guidance and there is lack of a clear oversight.
 - ▶ There are few, if any, bright-line rules provided by federal agencies with respect to cryptocurrency operations.
 - ▶ CFTC has viewed BTC and ETH as commodities
 - ▶ SEC previously indicated that ETH was not a security but has since reserved judgement; has held that many other cryptocurrencies are securities. See *SEC v. Ripple Labs, Inc.* 20 Civ. 10832 (S.D.N.Y. 2020)
 - ▶ The SEC has been criticized by the crypto community for not creating new rules or providing much guidance and instead relying on the *Howey* framework.
 - ▶ Various federal and state agencies may participate differently, and even inconsistently within their own agencies, in the chapter 11 process, making the bankruptcy process unpredictable for debtors.
2. Disconnected state regulatory schemes.
 - ▶ Having a web of complex state-regulatory schemes means whether or not a company is in compliance with a state's regulations is continually changing.
3. Rapidly shifting regulatory environment.
 - ▶ A quickly evolving regulatory landscape can lead to deal risk, as a change in regulations may jeopardize a buyer's ability to close, impact the purchase price, etc.
 - ▶ Investment by and in cryptocurrency companies may implicate additional regulatory oversight, including issues with CFIUS and Hart-Scott-Rodino review.
 - ▶ Many parties are looking to make their impact on the initial regulation of the cryptocurrency industry, causing noise and mixed messaging from across industries and agencies.
 - ▶ Unclear whether directors and officers may be held liable and if so, to what extent.

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Regulatory Oversight (cont'd)

- ▶ While the landscape continues to evolve, regulators continue to take steps to prevent certain activities of cryptocurrency companies.
- ▶ The mobile app-nature of cryptocurrency and trading platforms also lends to regulatory oversight issues. As most customers transact via a mobile device, they technically can do so anywhere rather than being physically "located" in a single place at all times.
 - ▶ Further, customers self-report their location upon signing up for the apps, potentially creating a loop-hole that a company does not have control over.
 - *E.g.*, a NY customer may want to sign up for a specific app that is not licensed to operate in NY; to get around this, the customer uses a family member's or friend's or other address in a state in which the app is licensed to operate. A regulator may accuse the app itself of operating unlawfully, despite the customer having made the election.
 - ▶ This nuance may ultimately lead to agencies attempting to implement a broader cross-border regime.

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Regulatory Oversight – Voyager Confirmation

Regulatory uncertainty was front and center in the multi-day Voyager confirmation hearing. Judge Wiles of the Bankruptcy Court of the Southern District of New York opened the confirmation hearing with *sua sponte* questioning of the SEC's position:

- ▶ "Good morning. You've submitted an objection that has a couple of parts, and one part is that you think that the contemplated transfers of cryptocurrencies by Voyager may be illegal. I'm sort of unaccustomed to getting objections that something may be wrong as opposed to either it is or it isn't. So what exactly is your position here? Are you saying that it is wrong or that you don't know?" Mar. 2, 2023 Hr'g Tr. at 24:10–17.
- ▶ "You've [] argued that the Debtor has to somehow prove a negative here, has to prove that every one of the transactions, every one of the cryptocurrencies that it might be selling do not involve transactions in securities with no guidance from you at all as to what might constitute a security, which coins they have to do that proof on, why you think any of them are securities, and no indication at all of what legal or factual issues the testimony and argument ought to address. How is that a proper objection?" Mar. 2, 2023 Hr'g Tr. at 26:23–25; 27:1–7.
- ▶ "I'm absolutely shocked, I have to say, that a regulator would come in and say, I'm charged with regulatory authority over these things. These are reasons that I have concerns because they're within my regulatory jurisdiction, but I've done nothing. I have nothing to offer to you except questions, and my excuse for that is that it's somebody else's burden in the context of confirmation. That's incredible. Absolutely incredible. So I'll hear whatever evidence the Debtor has, but you know, I get the feeling that this objection has been made as a kind of cover yourself, so you can say later that well see, we raised these issues, but you haven't really. You've done nothing. You know, I'm trying to do the right thing here. I would like to do the right thing. I don't want to subject customers to any risks. They've already been through a bankruptcy. I don't want to put them through any more issues. But to stand here and tell me, Judge, you know, I'm not going to tell you what we're going to do, but it's your job and the Debtors' job to kind of guess and to make predictions, and you know, you better be right about it; that's really not helpful." Mar. 2, 2023 Hr'g Tr. at 38:10–25, 39: 1–6.

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Regulatory Oversight – Voyager Appeal

U.S. Justice Dept. Appeals New York Judge's Decision to Approve Voyager's Sale to Binance.US

The appeal comes just one day after Judge Michael Wiles gave Voyager Digital the go-ahead to sell its assets to Binance.US.

In addition, the Plan contemplates certain rebalancing transactions and the completion of distributions of cryptocurrencies to creditors. The Exculpated Parties shall have no liability for, and are exculpated from, any claim for fines, penalties, damages, or other liabilities based on their execution and completion of the rebalancing transactions and the distribution of cryptocurrencies to creditors in the manner provided in the Plan.

For the avoidance of doubt, the foregoing paragraph reflects the fact that Confirmation of the Plan requires the Exculpated Parties to engage in certain rebalancing transactions and distributions of cryptocurrencies and the fact that no regulatory authority has taken the position during the Combined Hearing that such conduct would violate applicable laws or regulations. Nothing in this provision shall limit in any way the powers of any Governmental Unit to contend that any rebalancing transaction should be stopped or prevented, or that any other action contemplated by the Plan should be enjoined or prevented from proceeding further. Nor does anything in this provision limit the enforcement of any future regulatory or court order that requires that such activities either cease or be modified, or limit the penalties that may be applicable if such a future regulatory or court order is issued and is violated. Similarly, nothing herein shall limit the authority of the Committee on Foreign Investment of the United States to bar any of the contemplated transactions. Nor does anything in this provision alter the terms of the Plan regarding the compliance of the Purchaser with applicable laws in the Unsupported Jurisdictions before distributions of cryptocurrency occur in those Unsupported Jurisdictions.

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Protection of Personally Identifiable Information of Account Holders

- ▶ The Bankruptcy Rules generally require publication of creditor information.
- ▶ Although this may be unremarkable when creditors are primarily other companies, significant privacy and other issues arise when—as in the case of many crypto exchanges—creditors are individuals.
- ▶ The possible disclosure of personally identifiable information may place account holders at risk of theft, physical violence, or financial extortion.
- ▶ Courts have taken divergent approaches to protecting personally identifiable information of account holders.
- ▶ Voyager was allowed to keep account holder details confidential, but Celsius was forced to disclose that information. In FTX, the Court authorized the debtors to keep the account holder details confidential on an interim basis, subject to the right to seek further extensions. A further extension has been sought and objected to by the Office the United States Trustee. The motion is scheduled to be heard on June 8th.
- ▶ Potential Harm from Disclosure of Customer Information
 - In Celsius, the court required names of individual customers to be disclosed because the court was “unconvinced, beyond speculation, that the disclosure of names alone (without e-mail or physical addresses) presents an imminent risk of harm.” *In re Celsius Network LLC*, 644 B.R. at 295. Thereafter, searchable customer lists were created and posted online. Various criminal attempts were then made to influence and steal from customers, including multiple phishing attempts. *Notices of Phishing Attempts, In re Celsius Network LLC*, No. 22-10964 (MG) (Bankr. S.D.N.Y.) [D.I.s 1527, 1681, 1904, 1992, 2082]. Although some phishing attempts were amateurish and easily detectable, others were more sophisticated and appeared to customers to be legitimate contact from the debtors and their professionals. Indeed, the Celsius bankruptcy court involved the U.S. Marshal when a malefactor criminally modified and emailed to Celsius customers a court order that purported to require Celsius customers to submit personal information, including their cryptocurrency wallet address and contact information, and to pay a “filing fee” and “tax fee.” *Notice of Phishing Attempts, In re Celsius Network LLC*, No. 22-10964 (MG) (Bankr. S.D.N.Y.) [D.I. 1904].

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Rights of Creditors and Equity Holders in Cryptocurrency Cases

- ▶ The Bankruptcy Code provides for a priority waterfall under which secured creditors rank ahead of unsecured creditors, and all debt must be paid before shareholders can retain an interest on account of their existing equity.
- ▶ Where digital assets are not estate property, customers will not be creditors. Instead, they will likely be entitled to withdraw their digital assets from the platform—to the extent there are sufficient digital assets to satisfy the rights of all such customers.
- ▶ Where digital assets are estate property, customers will be unsecured creditors and will share pro rata in distributions.
- ▶ Distributions may be made in kind (i.e. via distributions of digital assets) or claims may be converted to fiat currency (i.e., USD), depending on the terms of the plan of reorganization.

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Preservation of Digital Assets for Account Holders

- ▶ In crypto cases, value is almost entirely dependent upon the value of a platform's crypto and digital assets.
- ▶ In Celsius, the debtors and the creditors' committee developed a robust protocol to ensure the protection of crypto and digital assets by transferring the keys to responsible outside parties, significantly reducing the risk of loss of crypto and digital assets during the bankruptcy case.
- ▶ In cases such as Celsius and FTX, it is important to ensure that former employees, competitors, or criminal elements do not try to steal the most valued assets.

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Cryptocurrency and Preferences

- ▶ The Bankruptcy Code allows a debtor (or trustee) to avoid and recover certain prepetition transfers made to a creditor that increases a creditor's recovery ahead of recovery by other, similarly situated creditors.
- ▶ Under section 547(b) of the Bankruptcy Code, a preferential transfer is "any transfer of an interest of the debtor in property" made: (i) to a creditor; (ii) on account of an antecedent debt; (iii) while the debtor was insolvent; (iv) on or within 90 days of the petition date . . . ; and (v) that enables the creditor to receive more than the creditor would have in a Chapter 7 case if the transfer had not been made."
- ▶ There is a question around whether customer withdrawals and transactions that occurred in the ninety days leading to a cryptocurrency company's filing of chapter 11 (or, for insiders, one year prior to the petition date) are preferences pursuant to the Bankruptcy Code. For example:
 - Is the transaction on account of *antecedent debt*?
 - ▶ **Yes.** The cryptocurrency company has the obligation to return the crypto to users at the time the users deposit the crypto, so the withdrawals are honoring that antecedent debt.
 - ▶ **No.** Customer withdrawals are executed contemporaneously with the request to withdraw, and therefore are not on account of any prior, or antecedent, debt.
 - Are these transactions *ordinary course* transactions, which is a defense to preference claims?
 - ▶ **Yes.** Customers withdrawing funds from the platform occurs regularly in the course of dealings between a cryptocurrency company and its customers. Further, the company does not elect whether or not to honor certain withdrawals and not others, so there is no demonstrated "preference" for payment of one creditor over another.
 - ▶ **No.** Some case law suggests that "run on the bank" scenarios are outside of the ordinary course of business and the defense does not apply. This is a fact-intensive inquiry (when did the "run on the bank" start, and how is it defined?)
- ▶ Additionally, section 547(c)(9) of the Bankruptcy Code exempts transfers below \$7,575 (in the aggregate) from clawbacks as preferences; given the fluctuating value of cryptocurrency, proving whether that threshold has been reached or not may be fact-intensive (as to the price of the cryptocurrency at the time of the transfer).

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Valuation Issues in the Face of Retaining Customers

- ▶ Cryptocurrency companies are uniquely challenged with respect to valuation in a chapter 11 context.
- ▶ The overarching value in a cryptocurrency company is in its customers—including their loyalty, information collected from their trading decisions and personal information used to sign onto the platform, and the funds maintained in their accounts.
- ▶ However, particularly in a sale scenario, the quantum of economic benefit received from acquiring customers is unknown at the time a deal is initiated or signed.
- ▶ For example, it is difficult to predict how many customers will stay on the platform (or migrate, in a sale scenario), how active the customers will be in future trading, etc.
 - Regulatory overhang exacerbates this uncertainty. Customers who WANT to stay may not be permitted to.



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Marketing Process and Sale Issues

- ▶ Conducting an auction of a cryptocurrency company presents several unique challenges that are atypical for a 363 process.
 - ▶ **Evaluating Bids:** Significant differences in structure, valuation, and deal consideration leads to “apples and oranges” bids that are difficult to evaluate against each other.
 - Structural differences also present difficulties in commencing, and completing, an auction on an expedited time frame.
 - ▶ **Industry Dynamics:** Predominantly retail investor base with strong social media presence leads to leaks, while significant discourse online has potential to set the narrative of the auction based on misinformation and outdated news.
 - ▶ **Two-Way KYC Issues:** Nascent state of cryptocurrency industry leads to unfamiliarity with interested bidders and purchasers, while “trad-fi” KYC processes can create unusual difficulties (*i.e.*, obtaining an escrow agent).
 - ▶ **Messaging:** Complicated deal structure can make explaining why deal is “best” for stakeholders difficult, especially in light of online discourse.
 - ▶ **Regulatory Overhang:** Increased regulatory focus on cryptocurrency industry necessitates heavy scrutiny of each bidder’s ability to close, and the impact that closing risk has on the bid’s economics.

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Public Relations Considerations

- ▶ The digital nature of the cryptocurrency industry has brought to light unique avenues of communication with the market's constituency, as well as unique challenges.
- ▶ For example, the Official Committee of Unsecured Creditors in both Celsius and FTX created its own Twitter page to connect with creditors, Celsius developed a series of videos describing the various processes associated with a chapter 11 filing and shared the information on its social media pages, and question and answer sessions between creditors and the Official Committee of Unsecured Creditors have been held via Reddit, YouTube, and Twitter spaces.
- ▶ While such tools have proven beneficial, the dangers and reach of the internet have also been underscored.
- ▶ The ability to communicate with hundreds of thousands of people at the swipe of a finger has provoked creditors to live stream court hearings, "tweet" commentary on secured meetings with parties in interest in real time, and engage in lively discourse on various social media platforms.
 - It has also contributed to widespread dissemination of misinformation, which can be difficult to remedy.
- ▶ As such, the need to be precise, consistent, and succinct in messaging is essential to creating a clear runway to plan confirmation.

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Novel Issues Presented in Celsius



Key Legal Questions

Legal issues critical to the outcome of this case include:

- Are the crypto assets in Celsius' possession property of the estate? Is the answer to this question different for crypto assets held under the Custody vs. the Earn program? What about crypto assets transferred to Celsius to collateralize institutional and retail loans?
- What does it mean to unimpair a crypto claim or to pay a crypto claim in full?
- Are customers entitled to the return of crypto in-kind?
- The amount of a crypto claim is determined as of what date (e.g., as of the petition date, effective date, distribution date)?
- Which Celsius entities do customers have claims against?
- Do retail and institutional borrowers have a setoff right where they (a) borrowed cash, stablecoins, or other crypto from Celsius and (b) transferred crypto to Celsius?
- Can Celsius recover customer withdrawals or loan liquidations completed in the 90 days before filing as preferences?

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Cryptocurrency Under the UCC



Cryptocurrency Under the UCC

Crypto is not money for UCC purposes

- ▶ **Article 9:** Most likely is a "general intangible"
- ▶ Most likely classification: Money, deposit accounts, investment property and general intangibles
 - UCC §1-201(b)(24) defines "money," in part, as "a medium of exchange currently authorized or adopted by a domestic or foreign government"
 - UCC §9-102(a)(29) defines "deposit account" in part as a "demand, time, savings, pass-book, or similar account maintained with a bank"
 - UCC §9-102(a)(49) defines "investment property," in relevant part, as a "security, whether certificated or uncertificated, security entitlement, ... or securities account ..."
 - Most obvious category for virtual currency would be the catchall category of "general intangibles."
 - UCC §9-102(a)(42), a general intangible is essentially any personal property that does not fit within any other specific collateral classification
 - Has included intellectual property and software.
- ▶ This means one must perfect by filing (in theory), however, crypto users are not going to respect a UCC-1 but it can preserve a right to proceeds



Cryptocurrency Under the UCC

Crypto is not money for UCC purposes

► Article 8: Potentially a “financial asset”

- Likely requires parties to agree to this in the user agreements, and most do not (yet)
- Upcoming changes may clarify (for better or worse)
- Perfect by filing has similar pros and cons as under Article 9
- May be safer to describe asset rather than “asset class” in security agreement (“cryptocurrency” rather than “investment property”)

► Section 8-503(a) provides that a customer with a financial asset on an exchange retains ownership of that asset if:

1. the exchange is a securities intermediary
2. the securities intermediary has agreed with the customer to treat the asset as a financial asset; and
3. the securities intermediary has credited the financial asset in a securities account

This retention of ownership prevails even if the securities intermediary holds the financial assets in fungible, or commingled, form

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Cryptocurrency Under the UCC

Article 8 comes with pros and cons

► Comment 2 to UCC § 8-511 shows the issue

The risk that investors who hold through an intermediary will suffer a loss as a result of a wrongful pledge by the intermediary is no different than the risk that the intermediary might fail, and not have the securities that it was supposed to be holding on behalf of its customers, either because the securities were never acquired by the intermediary or because the intermediary wrongfully sold securities that should have been kept to satisfy customers' claims. Investors are protected against that risk by the regulatory regimes under which securities intermediaries operate. Intermediaries are required to maintain custody, through clearing corporation accounts or in other approved locations, of their customers' securities and are prohibited from using customers' securities in their own business activities. . . .

Regulation not in place for cryptocurrencies!

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Cryptocurrency Under the UCC

New Article 12 defines and governs digital assets specifically

- ▶ Uses broad definition—rather than couching Article 12 in familiar technologies, like distributed ledgers, blockchain, and bitcoin—to account for technology not yet developed

▶ Controllable Electric Records (“CERs”) :

- controllable accounts (accounts where the account debtor undertakes to make payment to the person in control of the CER), and
- controllable payment intangibles (payment intangibles where the account debtor undertakes to make payment to the person in control of the CER)

Conceptually similar to “control of deed” = “control of related parcel of land”

▶ CERs exclude:

- any digital assets that are not subject to “control”
- those that are already subject to other commercial laws such as E-SIGN, the Uniform Electronic Transactions Act or other articles of the UCC

Article 12 does not address the regulation of digital assets

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Cryptocurrency Under the UCC

▶ Control of a CER exists if the electronic record:

Gives a person:

- i. the power to avail itself of substantially all the benefit from the electronic record
- ii. the exclusive power to prevent others from doing so
- iii. the exclusive power to transfer control to another person, and
- iv. enables such person to readily identify itself as having these previously enumerated powers (including through the use of a cryptographic key or account number).

▶ Amendments allow for negotiability of CERs

- similar in concept to the negotiability of negotiable instruments

▶ Take Free rule:

- a buyer of a CER can take free of the property claims of others if the buyer obtains control of the CER (e.g., holding the private key), gives value, and does not have notice of the property claims of others
- “take-free” rule applies to the CER but not to other rights tethered to such CER:
 - ▶ NFTs, this might mean that the good faith purchaser might own the NFT free of any claims but would not necessarily enjoy any rights granted under any license to the content associated with the NFT
 - ▶ The rights regarding such tethered rights are governed by law other than Article 12.

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Cryptocurrency Under the UCC

Higher priority for a secured party that perfects its security interest in CERs by control rather than by filing of a UCC financing statement

- ▶ Choice of law:
 - Local law of the CER's jurisdiction governs matters covered by Article 12
 - CER's "jurisdiction" can be specified in the CER
 - If the jurisdiction is not so specified, then the default rule is that the CER's jurisdiction is the District of Columbia
- ▶ Under §12-105(a), a lender will be deemed to have "control" of a CER
 - If "a record attached to or logically associated with the electronic record, or a system in which the electronic money is recorded" gives the lender the "exclusive power" to control its transfer
 - The underlying blockchain—or "system in which the electronic record is recorded"—enables the lender "readily to identify itself" as the party in control (i.e., via "name, identifying number, cryptographic key, office, or account number")
 - Under current blockchain technology, a secured party normally would obtain "control" of a cryptocurrency that is a CER if the secured party has the private key
- ▶ Also, under §12-105(e), a lender can have control of a CER through another party under certain circumstances

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Cryptocurrency Under the UCC

- ▶ **Amendments to other Articles (mainly Article 9)**
 - Reflects new Article 12
 - Under amended § 9-105A, a lender will be deemed to have "control" of electronic money
 - If "a record attached to or logically associated with the electronic money or a system in which the electronic money is recorded" gives the lender the "exclusive power" to control its transfer
 - The underlying blockchain—or "system in which the electronic money is recorded" —enables the lender "readily to identify itself" as the party in control (i.e., via "name, identifying number, cryptographic key, office, or account number").
 - Under current blockchain technology, a secured party normally would obtain "control" of a cryptocurrency that is a CER if the secured party has the private key.
- ▶ **Amendments to Article 8 to allow parties to "opt in" to Article 8 treatment**
 - Article 8 governs treatment of securities
 - Only Coinbase appears to include this provision in agreements

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Faculty

Kimberly A. Brown is a partner with Landis Rath & Cobb LLP in Wilmington, Del., and concentrates her practice in the areas of corporate bankruptcy and restructuring and bankruptcy litigation. She has worked with the Landis Rath & Cobb team representing chapter 11 debtors, official and unofficial committees, financial institutions, secured lenders and other secured creditors, indenture trustees and bondholders, asset-purchasers, liquidation trusts and other significant creditors, chapter 15 foreign representatives, and other parties in interest in a variety of national bankruptcy cases. Ms. Brown represents clients in a wide range of industries, including retail, food and beverage, oil and gas, manufacturing, and cryptocurrency. She was honored in 2019 as one of ABI's "40 Under 40," and she was named one of five finalists for the International Women's Insolvency & Restructuring Confederation's (IWIRC's) 2017 "Rising Star" award. Ms. Brown currently serves IWIRC internationally and regionally as the vice director of Fall Programs and the vice chair of IWIRC at the Shore. She previously served as the *ex-officio* chair, chair, vice chair and social chair of the IWIRC Delaware Network. Ms. Brown is a member of the Delaware State Bar Association, ABI and the Delaware Bankruptcy American Inn of Court. She was selected as one of only 40 bankruptcy practitioners to participate in the National Conference of Bankruptcy Judges (NCBJ) fifth annual Next Generation Program. Before joining Landis Rath & Cobb, Ms. Brown clerked in the Superior Court for the State of Delaware for Hon. Mary M. Johnston and clerked at the Office of Disciplinary Counsel of the Supreme Court of Delaware. Ms. Brown received her B.A. in government and politics with a minor in accounting from Widener University in 2005 and her J.D. in 2008 from Widener University Delaware Law School.

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