



BANKRUPTCY IN CRYPTO

Ownership, Clawbacks, Subsequent
Transferee, Asset Valuation and Creditor
Priority, and Intercreditor Issues

Law Firm Alliance Webinar
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PRESENTED BY

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KEY BANKRUPTCY QUESTIONS

- Ownership
- Clawbacks
- Subsequent Transferee
- Asset Valuation and Creditor Priority
- Intercreditor Issues



OWNERSHIP

- Voyager
- Celsius
- Tracing Ownership

OWNERSHIP

- VOYAGER: Cash held in FBO (“for the benefit of”) accounts when customers of the exchange are beneficiaries is not property of the estate but property of the beneficiary.
 - Pursuant to the customer agreement, the Debtors did not have a legal or equitable interest in funds held in the custodial accounts
- CELSIUS: Based on terms of customer accounts, granting right and title including ownership rights and right to hypothecate, pledge or transfer cryptocurrency, cryptocurrency owned by Celsius, not customer.
 - Account holders formed valid, enforceable contracts through clickwrap agreement
 - Terms of use for rewards program accounts specifically stated that “all right and title ... including ownership rights” were transferred to Celsius
 - Users not barred from asserting individual contract formation defenses or breach of contract claims

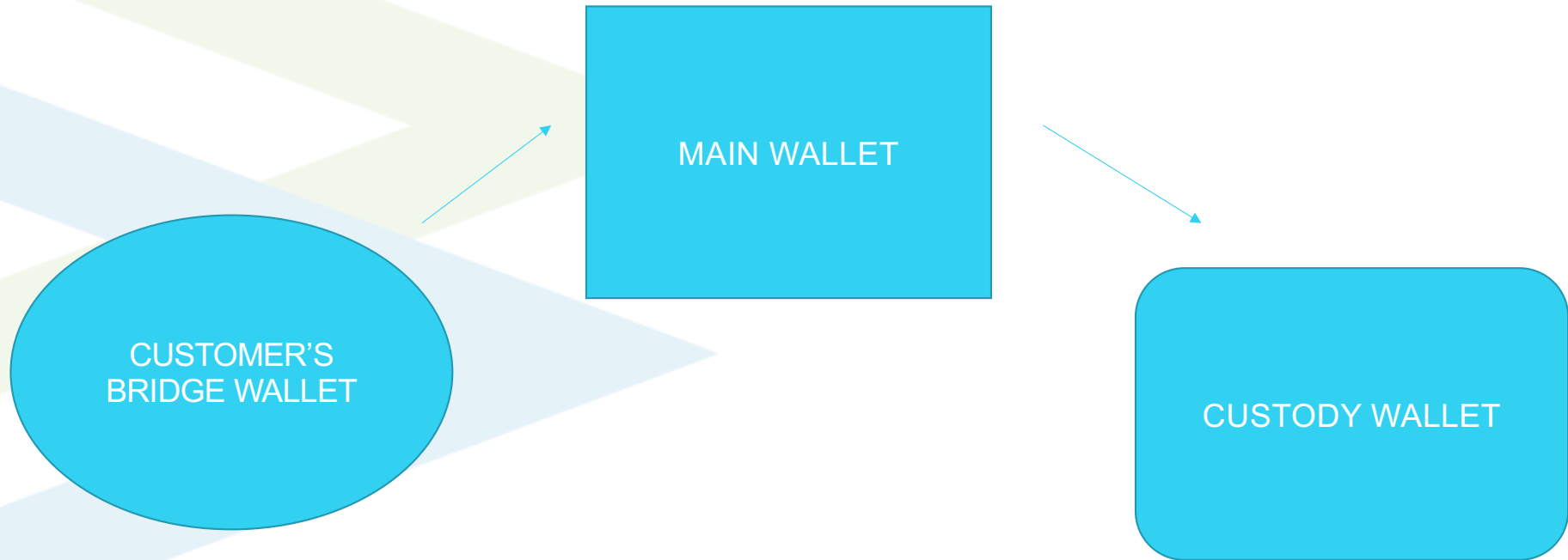
TRACING OWNERSHIP (EACH FINDING SOURCE LINKED TO RECEIVING WALLET BUT IS SEPARATELY IDENTIFIABLE ON BLOCKCHAIN)

- Account based protocol (Ethereum): blockchain mimic transactional information recorded in traditional bank statements (debit sending wallet balance).
- UTXO protocol (Bitcoin): information on the source specifying the unspent amount from prior transactions to fund current transaction. Source of each payment is fungible balance of sending wallet, not specific prior funding sources. Balance of each UTXO wallet is computed from public blockchain data by wallet software.
- Consequence is more transactional record on blockchain than traditional bank statements. Flows in and out of a commingled bitcoin wallet, more traceable than currency transfers.



CLAWBACKS

CLAWBACKS



- If off-chain accounting or tracing can show custody transfers to investment activities, loan repayments or finding other customer withdrawals, may be able to clawback those transfers made within 90 days
- Could order return of cryptocurrency or U.S. dollars
 - Liquidation presents issues as value is volatile
 - Valuation date uncertain: could be value at time of a) withdrawal, b) bankruptcy filing, c) clawback lawsuit, or d) clawback judgment
- Subsequent Transferee Liability
 - Transfer from customer to exchange to lender
- Potential affirmative defenses
 - Ordinary course of business
 - New value (additional deposits)
 - Securities safe harbor provision?



CREDITOR PRIORITY

- Bankruptcy Code creates creditor priority scheme, higher priority status are afforded greater protections
- Treatment depends on how the cryptocurrency is held, or owned, by the exchange platform
 - Customers are secured creditors if they have a valid, perfected security interest
 - Customers are general unsecured creditors if held that the cryptocurrency is property of the estate
 - Customers may be treated as equity security holders and may receive no distribution if cryptocurrency is deemed securities
 - Customers will see a return of their assets if the cryptocurrency is held in custodial accounts



INTERCREDITOR ISSUES

- “Dollarization” – the valuation of cryptocurrency as of the petition date – could lead to intercreditor issues
 - Debtor retains appreciation of value of crypto
 - Incentives quick liquidation at a discounted price, causing fall of crypto prices, causing a pronounced decline in prices to the detriment of the creditors and other holders
- Difference in interests depending on the volatility of cryptocurrency
 - E.g., “stablecoins” vs coins that are fluctuating

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