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Mid-Atlantic Bankruptcy Workshop

Updates in Cryptocurrency Bankruptcies: What We've Learned and What to Expect

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The Aftermath of the Crypto Winter



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But first, a refresher on the basics.



Blockchain Technology

“Blockchain is a distributed database or ledger shared among a computer network’s nodes.” Adam Hayes, *Blockchain Facts*, INVESTOPEDIA (Apr. 23, 2023)



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Blockchain Technology

- Ledger to record transactions
 - Each “block” is like a cell in a spreadsheet
 - Also acts like a database; all possible keys included
- Decentralized
 - “Nodes” (computers) makes copies of ledger, which are used to validate transactions
 - Fully automated
- Immutable
 - “One way math” used to generate keys
- Anonymous
 - Users identifiable only through public keys



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Cryptocurrency

- Best known use of blockchain technology
- Each “coin” is a record of value (e.g., represents purchasing power of one coin)
- Value based on demand in market
 - Compare to artwork
 - Hypothetical: ABI Coin
- Valuable also because anonymous



Cryptocurrency Business Models

- **Trading and Exchange Services:** establish platform for cryptocurrency trading
- **Custodial or “Wallet” Services:** provide storage for cryptocurrency, can be interest-bearing or not
- **Lending Services:** provide lending and borrowing services
- **Mining:** validate transactions in exchange for new cryptocurrency



Cryptocurrency Business Models

| | Trading and Exchange Services | Custody and Wallet Services | Lending Services | Mining |
|-----------------|-------------------------------|-----------------------------|------------------|--------|
| Celsius | | x | x | |
| Voyager | x | x | x | |
| 3AC | x | | | |
| FTX | x | | | |
| BlockFi | x | x | x | |
| Core Scientific | | | | x |
| Genesis | x | x | x | |
| Bittrex | x | x | x | |
| Binance | x | x | x | |
| Coinbase | x | x | x | |
| Ripple | x | | x | |



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Regulators Mount Up (or Not)



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Regulatory Oversight - Purposes

- **Licensing and Registration:** require cryptocurrency-related businesses to obtain licenses or register with financial regulator
- **Anti-Money Laundering (AML) and Know Your Customer (KYC) Rules:** require adherence with AML/KYC regulations to prevent illicit activities and ensure customer identification
- **Consumer Protection:** protect consumers from scams, fraudulent schemes and misleading information related to cryptocurrencies
- **Taxation:** require investors to pay taxes on cryptocurrency gains



Regulatory Oversight - Overview

| Regulator | Jurisdiction | Primary sources of authority | Characterization of cryptocurrency |
|---|---|--|------------------------------------|
| Securities Exchange Commission (SEC) | Oversight of securities markets | Section 2(a)(1) of Securities Act; section 3(a)(10) of Securities Exchange Act | security |
| Commodities Futures Trading Commission (CFTC) | Oversight over futures, options, and derivative contracts involving commodities | Section 9(1) of Commodities Exchange Act | commodity |
| Financial Crimes Enforcement Network (FinCEN) | Agency of U.S. Treasury Dep't; anti-money laundering enforcement | Section 5312(a)(2) of Bank Secrecy Act | currency |
| Internal Revenue Service (IRS) | Oversight over taxation | Internal Revenue Code | property |



Regulatory Oversight - Overview

- **Congress:** no overarching legislation
- **SEC:** *Shavers* (2013); DAO Report (2017); ICO enforcement actions
- **CFTC:** *Coinflip* (2015); *McDonnell* (2018); *My Big Coin Pay* (2018)
- **IRS:** 2014 guidelines; *Coinbase* (2017); 2018 press release
- **FinCEN:** 2013 guidelines; *Ripple* (2015); *BTC-E* (2017)
- **DOJ:** various enforcement actions



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Regulatory Oversight - SEC

- *SEC v. Shavers*, No. 4:13-CV-416, 2014 WL 12622292 (E.D. Tex. Aug 26, 2014)
 - Enforcement action against individual
 - Court found Bitcoin tokens were “investment contracts” and “securities” for purposes of court’s subject-matter jurisdiction only
- DAO Report (July 2017)
 - Confirms SEC will apply traditional *Howley* test to determine if cryptocurrency is an “investment contract” and thus a “security”
 - Authority under Securities Act and Securities Exchange Act
 - *S.E.C. v. W.J. Howley Co.*, 540 U.S. 389 (2004): contract whereby “[1] person invests his money, [2] in a common enterprise and [3] is led to expect profits [4] solely from the efforts of the promoter or third party”
 - Flexible test intended to cover future, innovative products
- 2017 SEC Chairman statement: focus on Initial Coin Offerings (ICO) to raise capital; must be registered with SEC or satisfy an exemption
- *Munchee* Order: ICO coins were investment contracts and thus securities
- Various successful enforcement actions



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Regulatory Oversight - CFTC

- *In re Coinflip Inc.*, CFTC No. 15-29, 2015 WL 5535736
 - Administrative decision
 - Bitcoin was “commodity” under Commodity Exchange Act
 - CEA defines “commodities” broadly to include “all services, rights and interests in which contracts for future delivery are . . . dealt in”
 - Includes “derivatives” – financial contract that derives value from underlying asset
 - Bitcoin fell under “derivatives” because value based on number of individuals transacting on the Bitcoin blockchain
 - Cryptocurrency markets are subject to CFTC jurisdiction
- *BFXNA Inc.*, CFTC No. 16-19 (June 2, 2016)
 - Cryptocurrency platform engaged in illegal retail commodities transactions by not registering with CFTC
- *CFTC v. McDonnell*, 287 F.Supp.3d 213 (E.D.N.Y. 2018)
 - District Court ruled CFTC can regulate cryptocurrencies as a “commodity” because they act as “goods exchanged in a market for a uniform quality and value”
 - Interpreted CEA sec. 9(1) to hold that CFTC has jurisdiction over individuals exchange in manipulation using commodities transactions
- *CFTC v. My Big Coin Pty, Inc.*, 334 F.Supp. 3d 492 (D. Mass. 2018)
 - Section 9(1) prohibition against manipulation violated given misrepresentations including that cryptocurrency was backed by gold
- Since 2015, over a dozen other enforcement actions



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Regulatory Oversight - FinCEN

- Governs “money service businesses” and “money transmitters”
 - “Money transmitter” defined as any person that accepts “currency, funds, or other value that substitutes for currency” from one person and gives it to another person
- FinCEN Guidance No. FIN-2013-G001 (Mar 18, 2013)
 - Guidelines describing how FinCEN will regulate cryptocurrency based on existing regulations governing money service businesses
 - Cryptocurrency exchanges must register with FinCEN and create anti-money laundering programs
- *In Matter of Ripple Labs Inc*, FinCEN No. 2015-05 (May 5, 2015) (cryptocurrency exchange fined for selling token without registration)
- *In Matter of BTC-E*, FinCEN No. 2017-03 (July 26, 2017) (cryptocurrency exchange violated anti-money laundering program requirements)
- Only a handful of enforcement actions



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Regulatory Oversight - IRS

- *IRS Virtual Currency Guidance*, Notice, 2014-16 I.R.B. 938 (2014)
 - Identified tax procedures for virtual currencies
 - Virtual currencies will be treated as “property” and thus must be declared when filing for taxes
- *U.S. v. Coinbase, Inc.*, No. 17-CV-01431 (N.D. Cal. July 18, 2017)
 - IRS requested and received certain customer records
- 2018 Press Release: taxes are owed on all realized gains of cryptocurrency exchanged for cash, for the purchase of goods or services, or exchanged for other cryptocurrencies

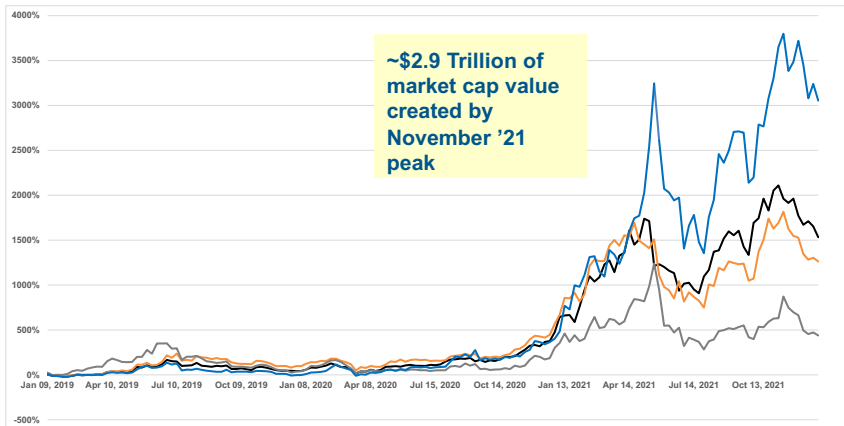


What happened in this unregulated environment?



Global Cryptocurrency Market Explodes

Weekly Market capitalization % change from January 1, 2019; shown through December 2021



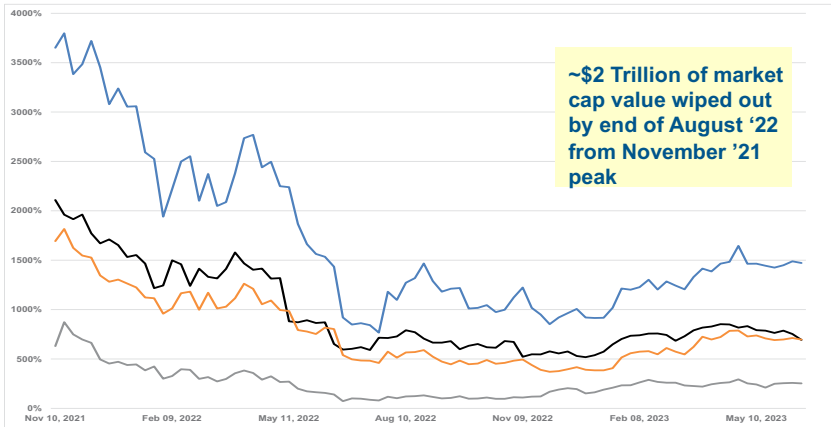
-  Global Market
-  Bitcoin (BTC)
-  Ethereum (ETH)
-  Litecoin (LTC)





Source: CoinGecko; BitInfoCharts



Global Cryptocurrency Market Implodes

Weekly Market capitalization % change from January 1, 2019; shown Nov. 10, 2021 – June 14, 2023



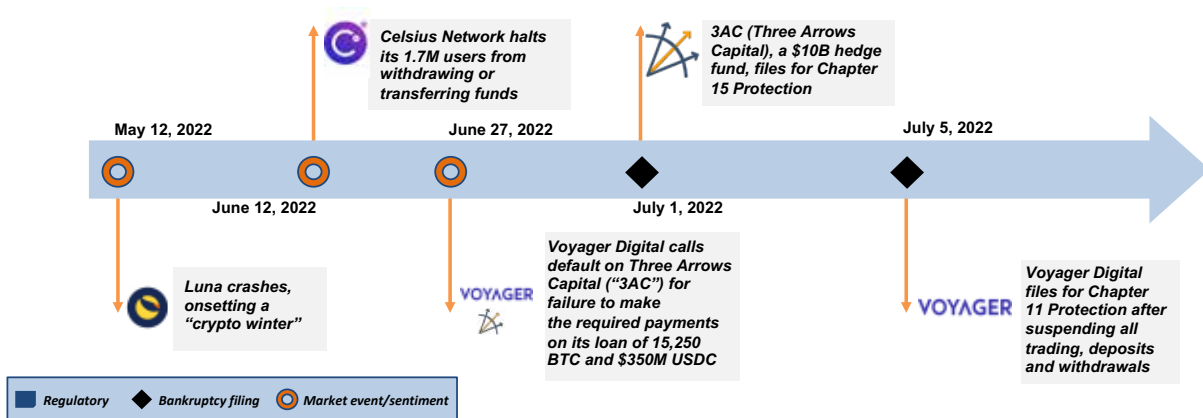
-  Global Market
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Recent Cryptocurrency Market Events

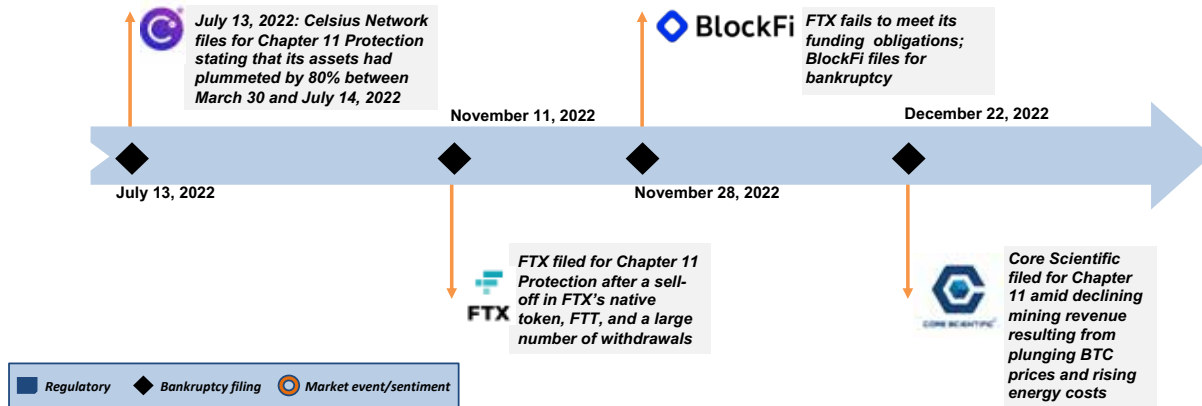
Luna Crashes....winter comes....bankruptcies begin.





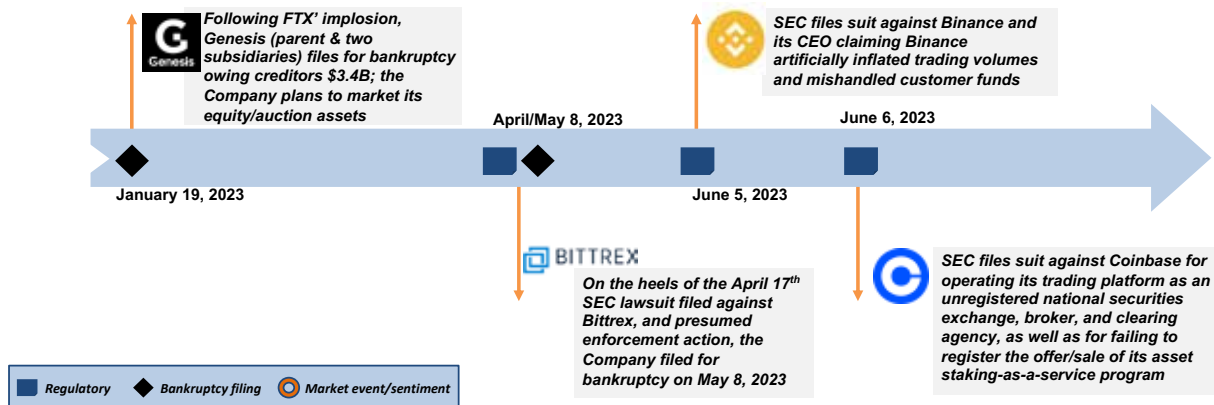
Recent Cryptocurrency Market Events

FTX entanglement...dominoes fall....bankruptcy filings continue.



Recent Cryptocurrency Market Events

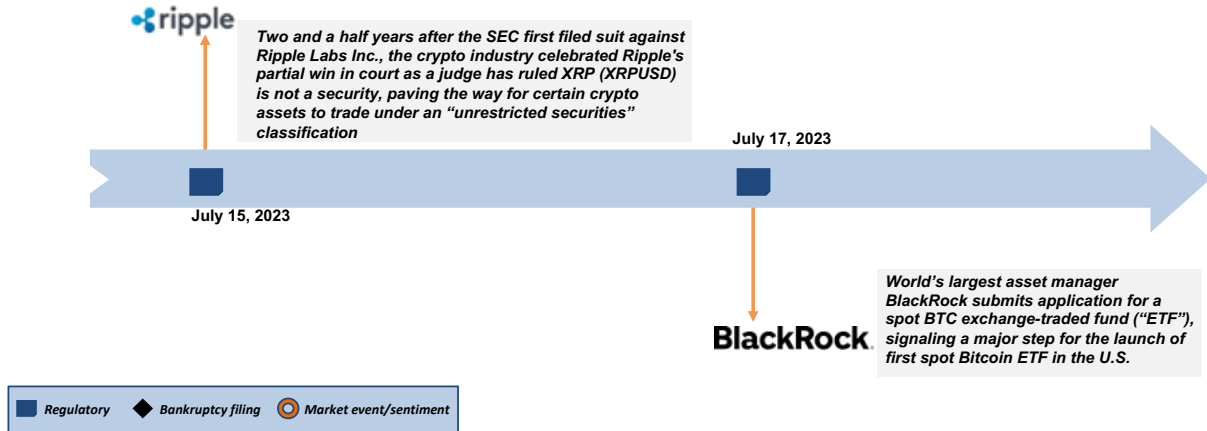
Bankruptcy filings continue....lawsuits ensue....SEC engages.





Recent Cryptocurrency Market Events

Regulatory issues continue...July developments bring positive potential.



Key Issues In the Aftermath of the Crypto Winter



Issue 1: Creditor Anonymity

Bankruptcy's Fishbowl Policy & Crypto Anonymity Collide



Sealing Customer Information

Issue: Tension between public right to access and crypto customer's expectation of anonymity

Bankruptcy Code § 107(a) codifies common law right of public access to documents

v.

Anonymity is fundamental tenet of cryptocurrency transactions



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Sealing Customer Information (cont.)

Exceptions to 107(a)'s Right to Public Access

- Section 107(b) allows court to protect a debtor's trade secrets or confidential research, development, or information.
- Section 107(c) authorizes court, for cause, to protect an individual's identifying information to the extent disclosure of that information would lead to identity theft or unlawful harm.



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Sealing Customer Information (cont.)

Relevant Non-Bankruptcy Law

- **California Consumer Privacy Rights Act (CCPRA):** permits consumers to prevent businesses from sharing their personal information, to correct inaccurate personal information, and to limit businesses' usage of sensitive information, including race, sexual orientation, and health data.
- **The General Data Protection Regulation (GDPR):** European Union and the United Kingdom regulatory scheme governing certain companies' and organizations' storage, usage, and transmission of individual customer data.



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Sealing Customer Information (cont.)

Court Decisions Permitting Sealing of Customer Information

- *In re Cred, Inc.*, No. 20-12836 (JTD) (Bankr. D. Del. Dec. 21, 2020) [D.I. 264] (seal individual customer names)
- *In re Voyager Holdings, Inc.*, No. 22-10943 (MEW) (Bankr. S.D.N.Y. July 08, 2022) [D.I. 54] (seal names of any natural personal subject to UK GDPR and EU GDPR regulations)
- *In re BlockFi, Inc.*, No. 22-19361 (MBK) (Bankr. D.N.J. Feb. 13, 2023) [D.I. 53] (seal individual customer names on an interim basis);
- *In re Genesis Global Holdco, LLC*, No. 23-10063 (SHL) (Bankr. S.D.N.Y. Jan. 20, 2023) [D.I. 14] (seal individual customer names; motion remains *sub judice*);
- *In re FTX Trading*, No. 22-11068 (JTD) (Bankr. D. Del. June 15, 2023) [D.I. 1643] (seal individual customer names)
- *In re Desolation Holdings LLC, et al.*, No. 23-10597 (BLS) (Del. Bankr. D. Del. June 8, 2023) [D.I. 116] (seal customer information)



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Sealing Customer Information (cont.)

Court Decision Denying Sealing of Customer Information

- *In re Celsius Network LLC*, No. 22-10964 (MG) (Bankr. S.D.N.Y. Sept. 28, 2022) [D.I. 910] (order denying motion to seal individual customer names)



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Sealing Customer Information (cont.)

Aftermath of Celsius

Disclosure of customer names resulted in numerous phishing attempts, including one sophisticated attempt where a malefactor emailed Celsius customers a modified court order that required customers to submit their cryptocurrency wallet address and contact information and pay a filing fee. Notices of Phishing Attempts, *In re Celsius Network LLC, et al.*, No. 22-10964 (MG) (Bankr. S.D.N.Y.) [D.I. 1527, 1681, 1904, 1992, 2082].

Judge Glenn ordered a prompt investigation into the phishing attempts, referring the matter to the Federal Marshal's Office, which coordinated with the FBI, given that the incident involved the modification of a court order.



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Issue 2: Asset Forfeiture

Knock Knock... Those Assets Are Being Seized



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Background: Asset Forfeiture Issues

Upon the filing of a petition:

- Section 541 creates an “estate” comprised of all of the debtor’s assets
- Section 362 imposes an injunction known as the “automatic stay” pausing any existing lawsuits and preventing any future lawsuits against a debtor or its estate during the pendency of the bankruptcy, with limited exceptions.



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Background: Asset Forfeiture Issues

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Relevant Exceptions to the Automatic Stay Concerning Forfeiture

- Criminal Actions (section 363(b)(1))
- Police Power Exception (section 363(b)(4))



Criminal Forfeiture

- Post conviction sanction imposed on a convicted defendant
- Generally requires tracing assets to the criminal activity



Civil (“Judicial”) Forfeiture

- In rem actions brought against property itself and does not require a conviction or charges be brought
- Relation Back Doctrine: Once property is subject to forfeiture, title vests in the United States at the moment when the criminal conduct occurred



Examples of Crypto Cases with Asset Forfeiture Issues





FTX Forfeiture Issues

- United States Department of Justice seized certain assets, including shares of Robinhood Markets, Inc. and approximately \$150mm held in FTX accounts at Moonstone Bank and Silvergate Bank
- The DOJ also seized a number of cash deposits and other assets as a result of the criminal indictment of Samuel Bankman-Fried



BlockFi Forfeiture Issues

- United States Department of Justice filed a notice of asset seizure, specifying that Robinhood shares and \$20,746,713.67 were seized pursuant to criminal and civil asset seizure statutes, arguing that the automatic stay does not apply because of (i) the relation back doctrine, and (ii) the police power exception.



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Issue 3: Valuation

Many uncertainties exist with respect to valuing cryptocurrencies in bankruptcy cases



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Asset vs. Commodity

Courts have disagreed on whether to classify certain cryptocurrency assets as currencies or commodities for the purpose of bankruptcy proceedings.

- If treated as currency, it is necessary to attribute a dollar value to the assets for the purpose of claims and recovery actions.
- If treated as commodities (or securities), the assets themselves or the value of the assets may be sought by creditors and litigants.



How to value crypto assets?

Cryptocurrency assets are difficult to value, with the value resulting almost entirely from demand

- Crypto assets are volatile, making it difficult to determine a value as of a particular date.
 - For example, on December 13, 2020, Bitcoin was trading at \$19.1k. On January 10, 2021 (less than a month later), Bitcoin was trading at \$38.3k.
- Crypto assets trade on multiple exchanges, and the price of the same crypto asset can vary between exchanges.



When to value crypto assets?

The Bankruptcy Code does not prescribe when crypto assets should be valued.

- Courts have used:
 - Petition Date
 - Date on which debtor transferred the assets
 - Date of recovery action



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Why valuation matters

The value of the cryptocurrency assets is relevant to many aspects of crypto bankruptcy cases, including:

- Claims administration
- Avoidance actions
- Funding the estate
- Sale proceedings



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What other issues are on the horizon
in the aftermath of the crypto winter?



Questions?

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 co-director of programming 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.

Hon. Michael B. Kaplan is Chief U.S. Bankruptcy Judge for the District of New Jersey in Trenton, initially appointed on Oct. 3, 2006, and named Chief Judge on May 1, 2020. Prior to taking the bench, Judge Kaplan served as a standing chapter 13 bankruptcy trustee, as well as a member of the chapter 7 panel of bankruptcy trustees, where he received case appointments as both a chapter 11 and chapter 12 trustee. His private practice included the representation of institutional lenders consumer debtors (under both chapters 7 and 13), business debtors and individuals undergoing reorganization pursuant to chapter 11. Judge Kaplan is a Fellow of the American College of Bankruptcy and has been appointed by the director of the Administrative Office of the U.S. Courts (AOUSC) to a term as the Third Circuit representative to the Bankruptcy Judges Advisory Group, in addition to appointments as the bankruptcy judge representative for the Risk and Finance Management Advisory Council, Human Resources Advisory Council and Budget & Finance Advisory Council to the AOUSC. As a member of the National Conference of Bankruptcy Judges, Judge Kaplan has served as treasurer and executive board member. He serves currently as a member of the Judiciary Advisory Council for the Rabiej Litigation Law Center. Over the past 30 years, he has spoken to numerous bar associations and business organizations, and since 2009 he has taught as an adjunct professor at Rutgers University School of Law. Judge Kaplan has authored several articles relating to bankruptcy issues and is a co-author of West's *Consumer Bankruptcy Manual* and *Consumer Bankruptcy Handbook*. He received the NCBJ President's Award for Excellence, the Conrad B. Duberstein Memorial Award given by the New York Institute of Credit, the Judicial Service Award from the Association of Insolvency and Restructuring Advisors, the National Association of Chapter 13 Trustees' 2006 Distinguished Service Award and New Jersey State Bar Association's 1999 Legislative Recognition Award. Prior to taking

the bench, Judge Kaplan served as mayor and councilman for the Borough of Norwood, N.J., and as a member of the Norwood Planning Board. He received his A.B. from Georgetown University in 1984 and his J.D. from Fordham University School of Law in 1987.

Ferve E. Khan is a full-service bankruptcy and restructuring attorney in the New York office of BakerHostetler LLP, where her practice includes both plaintiff and defense-side litigation and transactional work. She has particular experience in the financial services, energy and health care industries. She also has represented creditors, committees and fiduciaries in cases of mass torts, the recovery of the proceeds of fraud, and chapter 11. In 2020, Ms. Kahn was named one of ABI's "40 Under 40." In addition, she co-chairs ABI's Legislative Committee. Ms. Khan received her B.A. in political science magna cum laude in 2005 from Brown University, and her J.D. in 2008 from Cornell University Law School, where she served as articles editor for the *Cornell International Law Journal* and managing editor of the *Legal Information Institute Bulletin*.

Timothy J. Martin, CIRA, CFE, CTP, CCFI is a managing director at Huron Consulting Group in Boston and leads its Corporate Dispute Advisory practice. He focuses his practice on providing forensic, investigative and financial advisory consulting services, primarily related to distressed situations. Mr. Martin has advised secured lenders, creditors' committees, debtors, shareholders, trustees, receivers and examiners in cases throughout the U.S. He has been involved in many high-profile investigations, including investigating the failures at HealthSouth, the Kmart Stewardship investigation, the Thomas Petters and TelexFree Ponzi schemes, the Residential Capital examiner report and advising parties in the Purdue Pharma opioid litigation. Mr. Martin recently served as financial advisor to the court appointed Examiner in the Celsius Networks LLC Chapter 11 case. He previously held positions with KPMG, LLP and Arthur Andersen, LLP. Mr. Martin received his B.A. in accounting in 1997 from the Isenberg School of Management at the University of Massachusetts at Amherst.

Eric J. Monzo is a partner with Morris James LLP in Wilmington, Del., where he focuses on issues relating to business restructuring and insolvency. He regularly represents a wide range of stakeholders with a focus on official and unofficial committees, indenture trustees, commercial creditors and lender groups, in addition to corporate debtors and their independent and special committee management. Mr. Monzo handles matters relating to the restructuring and liquidation of companies in a broad range of industries with experience in health care, construction, energy, finance, food and beverage, pharmaceuticals, technology, transportation, real estate and retail. While many of the matters pertain to matters pending in courts located in Delaware and involve issues of Delaware law, he also represents clients in multi-jurisdictional and international insolvency proceedings and litigation outside of Delaware. Mr. Monzo is a member of the American Bar Association's Business Law Section and chairs its Chapter 11 Subcommittee, and he is a former Education Director for ABI's Unsecured Trade Creditors Committee. He also is a member of the Delaware Bankruptcy American Inn of Court, Delaware State Bar Association, Federal Bar Association and the Turnaround Management Association. Mr. Monzo is admitted to practice in Delaware, Maryland, New Jersey and Pennsylvania, before the U.S. District Courts for the Districts of Delaware, New Jersey and Maryland, as well as the Eastern and Western Districts of Pennsylvania, and before the U.S. Bankruptcy Court for the District of Delaware. He received his B.A. in psychology and business administration with a concentration in finance in 1999 from Washington & Jefferson College, and his J.D. with honors from Widener University Delaware Law School.