



AMERICAN
BANKRUPTCY
INSTITUTE

Winter Leadership Conference

WORKSHOP: Cryptocurrency and Bankruptcy

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CRYPTOCURRENCY AND BANKRUPTCY

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What is Cryptocurrency?

- The simplest way to think about cryptocurrency is that it is A DIGITAL MEDIUM OF EXCHANGE
- There are many different types of cryptocurrency
- There are over 23,000 different kinds of cryptocurrency

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- **In terms of utility, cryptocurrency and digital assets have various different uses and functions.**

- Some act like MONEY
- Some function more like STOCK
- Some represent PARTICIPATION in an underlying project
- Some represent OWNERSHIP of digital files
- There is an INFINITE UNIVERSE of use cases for crypto and digital assets

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- **The term “cryptocurrency” comes from the cryptography that is used to secure and verify transactions**

- Cryptography = complex mathematical concepts and rules to secure information
- YOU DO NOT NEED TO UNDERSTAND CRYPTOGRAPHY TO USE CRYPTOCURRENCY!
- Most of the crypto-applications out there are very user friendly

- **What is Blockchain Technology?**

- On its most basic level, a blockchain is a shared, immutable ledger that facilitates the process of recording transactions and tracking assets
- Imagine a giant, consolidated checkbook
- The blockchain not only records every transaction like a checkbook, but also records who engaged in what transaction, and who owns what, at any given time.

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- **Transactions on the blockchain are recorded in chunks, i.e., blocks, in a linear fashion, i.e., like a chain**
 - HENCE THE TERM, BLOCKCHAIN; A CHAIN OF BLOCKS OF DATA
 - You can work backwards on the blockchain to see and verify every transaction conducted
- **Hallmarks of Blockchain Technology**
 - The blockchain is IMMUTABLE
 - The blockchain is DISTRIBUTED and VERIFIABLE
 - The blockchain is DECENTRALIZED
 - The blockchain is governed by CONSENSUS

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- **Public vs. Private Keys**
 - Public key is like a bank account number
 - Private key is like a banking password
- **How to Store Cryptocurrency**
 - Several different ways, but let's focus on two that have the biggest impact in bankruptcy cases
 - Custodial/Centralized Exchange
 - The exchange has your private keys
 - Relationship governed by Terms of Service
 - "not your keys, not your coins"
- **Crypto Wallets**
 - You are responsible for maintaining your private key
 - If you lose your private key, you lose the ability to access your crypto

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Cryptocurrency in Other Countries

- What type of thing is cryptocurrency? The debate continues
 - Singapore: A thing in action capable of being held on trust (*ByBit Fintech Ltd v Ho Kai Xin* and others [2023] SGHC 199)
 - UK: Definitely property (*Tulip Trading Ltd v The Bitcoin Association* and others [2022] EWHC 667 (Ch)) but unclear whether a thing in action, a thing in possession or something else
 - UK: Law Commission of England & Wales publishes a 2023 report on digital assets recommends legislation to recognise digital assets as a third category of things
- Important consequence of England & Wales practitioners can't use tort of conversion to recover crypto – because it's not considered a thing in possession

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- How do English bankruptcy practitioners recover crypto (spoiler alert – like any other class of asset!)
- Regularly used causes of action by English practitioners (and those of equivalent common law jurisdictions):
 - s.234 Insolvency Act 1986 – delivery up of the debtor company's property
 - s.423 Insolvency Act 1986 – transactions in fraud of creditors (like fraudulent transfers)

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- **Practical enforcement tools:**

- s.235 Insolvency Act – duty on directors to cooperate with officeholder
- s.236 Insolvency Act – wide ranging information compulsion powers against third parties holding information – can't resist on the basis of self-incrimination
- *Bankers trust/Norwich Pharmacal* – Applications can be used in support of foreign proceedings.
- Passport orders
- Prison!

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- **Other hot topics:**

- What is the lex situs of the cryptocurrency? So where can I bring my action...
 - Is it where ownership is located?
 - Is it where control is located?
 - What is control for these purposes?
- What's next in the UK for crypto?
 - Legislation?
 - More regulation?

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Prevalent U.S. Bankruptcy Issues in Crypto Cases

- Nothing new with process and issues – just a different type of business or industry
- What are the assets of the estate / what digital assets are there?
- What are the specifics of contractual relationships / what do the agreements provide about title, custody, control, or possession?
- What is the priority of creditors and investors?
- Valuation or estimation and date for determination.
- Are there assets to sell or to pledge for DIP financing so there is sufficient cash flow to operate?

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Prevalent U.S. Bankruptcy Issues in Crypto Cases

- Is a reorganization possible / is the plan feasible?
- What do the real economic interest holders in the case want?
- Are there allegations of fraud / Ponzi scheme, misrepresentations against company and principals?
- Are there avoidance actions for trustee or liquidating trust to pursue / who are the third-party targets?
- Are there regulatory investigations ongoing / can they assist or benefit the estate?

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Celsius Network LLC

Case No. 22-10964 (SDNY)—Filed July 15, 2023 - cases.stretto.com/Celsius

- Judge ruled January 4, 2023 that the Earn Accounts with high interest yield are property of estate and the 600,000 customers in those accounts were unsecured creditors as a matter of contract law (DE 1822).
- User Agreement for Earn Account (version 8) said to customer “in consideration for the rewards payable to you on the eligible Digital Assets using the Earn Service... and the use of our Services, you grant Celsius all right and title to such Eligible Digital Assets, including Ownership rights, and the right without further notice to you, to hold such Digital Assets in Celsius’ own Virtual Wallet or elsewhere, and to pledge...sell, lend or otherwise transfer or use any amount...and to sue or invest such Digital Assets in Celsius’ full discretion.”
- Judge also ruled that Debtor could use funds from Earn Account as collateral or sell the funds and stablecoin of about \$20 million that it owned to finance the operations.

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Celsius Network LLC

- Judge later ruled the Custody Accounts were not property of the estate but crypto belonged to the customer.
- The Withhold Accounts were not yet decided by Judge so not certain it was property of the estate or property of the customer.
- In a settlement the parties agreed to settle the dispute and not litigate it. Under settlement the Custody Account customer had the right to opt-in to receiving 72.5% of its crypto back and give up right to recover from litigation, and the Withhold Account customers agreed to receive cash amount of 70% of claim but no crypto and would have a right to recovery from the litigation proceeds.

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- Additional settlement with the government agencies – Celsius banned from handling consumer assets.
- Under the Plan a new entity was to be formed, to be capitalized and managed by Fahrenheit Group, and the equity in new entity was to be distributed to creditors plus cash distribution plus right to recover litigation proceeds. New entity would focus on Bitcoin mining and staking, with alternative for Orderly Wind Down Toggle if new entity could not operate.
- Disclosure Statement was approved August 14, 2023. Confirmation hearing was held on October 2, 2023.

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QUESTIONS ?

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Faculty

Tal Goldsmith is a partner with Stephenson Harwood LLP in London, where she specializes in all aspects of the recovery of assets into insolvent estates by receivers, liquidators, administrators and trustees in bankruptcy. She also advises international corporate and individual clients on how to best use insolvency processes and powers as part of a wider asset-recovery toolkit. Ms. Goldsmith acts in specialist insolvency proceedings and also has significant experience in shareholder disputes and related Companies Act litigation. In addition to her work for officeholders, she provides advice to corporate and individual clients regarding the implications of insolvency for them and members of their supply chain, on the risks associated with acquisitions of businesses and assets from insolvent companies, and on structuring transactions to ensure that they comply with companies and insolvency legislation. This has recently involved a number of significant board advisory and directors' duties engagements. Early in her career, Ms. Goldsmith spent time working in industry for a market-leading asset-recovery team, and also completed a secondment in the recoveries team of a clearing bank, which gave her a unique understanding of how such clients operate and enabled her to better meet their requirements. A nonpracticing barrister, she went on to cross qualify and was admitted to the Roll in 2009. Ms. Goldsmith was listed in *The Legal 500 UK* for 2023. She received her LL.B. with honors in 2001 from the University of Bristol.

Cathy L. Reece is a director at Fennemore Craig, P.C. in Phoenix and chairs its Financial Restructuring, Bankruptcy and Creditors' Rights Practice Group. She has experience in every aspect of complex corporate workouts and bankruptcies, and works with clients structuring complex transactions and purchasing distressed debt or assets. Ms. Reece has represented lenders in several commercial real estate receiverships, including receiverships involving an operating copper mine and three high-rise commercial office buildings, and she has represented committees and liquidating trusts in the liquidation of assets and distributions to creditors involving allegations of Ponzi schemes and securities fraud. Some of her cases include representing the investors' committee in the bankruptcy of hard money real estate lender Mortgages Ltd., the joint creditors' committee in the Baptist Foundation of Arizona bankruptcies, the secured lender in a publicly traded bankruptcy case involving time shares and resort properties, the municipality that owned the arena where the NHL team played in the Arizona Coyotes hockey bankruptcy cases, a major petroleum-producer and former owner of the El Paso Refinery in litigation over complex environmental claims and restrictive covenants, the debtor-in-possession lender and purchaser of gold mines in cross-border chapter 15 proceedings, and a chapter 11 trustee in several cases involving the sales and operations of health care facilities. Ms. Reece is the president-elect of and serves on the Board of Regents for the American College of Commercial Finance Lawyers. She also is the chair of the American Bar Association Business Law Section's Subcommittee on Loan Workouts. Ms. Reece received her Bachelor's degree in music with high distinction from the University of Arizona and her J.D. from Arizona State University Sandra Day O'Connor College of Law, where she served as managing editor of the *Arizona State University Law Journal*. Following law school, she clerked for Hon. Sandra Day O'Connor at the Arizona Court of Appeals.

Alan R. Rosenberg, CTCE is a partner with Markowitz Ringel Trusty + Hartog in Miami, where he represents chapter 7 and 11 bankruptcy trustees, creditors, debtors and other parties-in-interest in all

aspects of insolvency proceedings and bankruptcy-related litigation. His practice has a particular emphasis on bankruptcy litigation, and he has served as lead or co-counsel to high-net-worth individuals, multinational corporations and nearly every chapter 7 panel trustee in the Southern District of Florida. Mr. Rosenberg has been recognized as a leading authority in the field of cryptocurrency in insolvency proceedings, and he is a Cryptocurrency Tracing Certified Examiner through CipherTrace. He also is an active ABI member, serving on various committees, regularly speaking at conferences and publishing in the *ABI Journal*. In 2020, Mr. Rosenberg was named one of ABI's 40 under 40 insolvency professionals. In addition, he is listed as a *Florida Super Lawyer* "Rising Star" for 2017-21 and a *Florida Legal Elite* "Up and Comer" from 2018-20. Mr. Rosenberg received his B.S.B.A. in finance in 2008 from the University of Florida and his J.D. *cum laude* from the University of Miami in 2011. He is a Cryptocurrency Tracing Certified Examiner through CipherTrace.