AMERICAN BANKRUPTCY INSTITUTE

2023 Caribbean Insolvency Symposium

Cryptocurrency

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2023

Intro to Blockchain

A blockchain is a cryptographically secured transaction network and ledger that is shared among and verified by all computer nodes participating in a distributed system.

Key Characteristics of Blockchain Include:

1. **Distributed Network.** Multiple independent computer nodes support the network and verify updates.
2. **Cryptography.** The integrity of information stored on a blockchain is secured by advanced public-private key cryptography.
3. **Immutability.** Every "block" of transactions is linked to the previous "block" of transactions, making it (practically) impossible to alter network data.
4. **Disintermediation.** Characteristics 1-3 enable trusted peer-to-peer transactions, without using a central authority as intermediary.

Intro to Blockchain

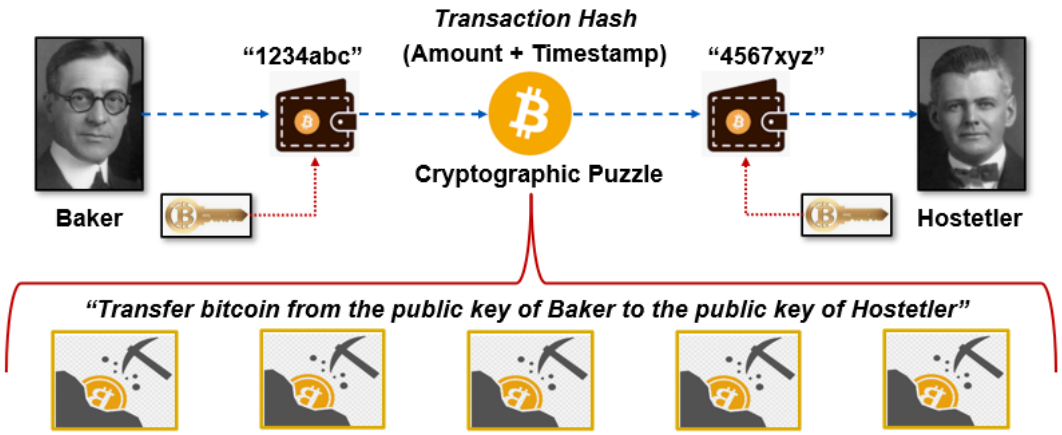
1. **Distributed Network.** Multiple independent computer nodes support the network and verify updates.

Traditional Centralized Network

Distributed Network

Intro to Blockchain

2. **Cryptography.** The integrity of information stored on a blockchain is secured by advanced public-private key cryptography.



Intro to Blockchain

2. **Cryptography.** The integrity of information stored on a blockchain is secured by advanced public-private key cryptography.

Bitcoin Network Example

- Every 10 minutes, all transactions broadcast to the network are aggregated in a new "block" that is verified by the winning miner.
- Once 51% of all miners verify the "block," the transactions are time-stamped and posted to the public ledger network.
- Each fully verified "block" is linked to the previous block, such that the only way to alter a transaction would be to alter the entire blockchain.
- Each miner retains their own copy of the full blockchain ledger, making it arguably the most secure network the world has ever seen.

Intro to Blockchain

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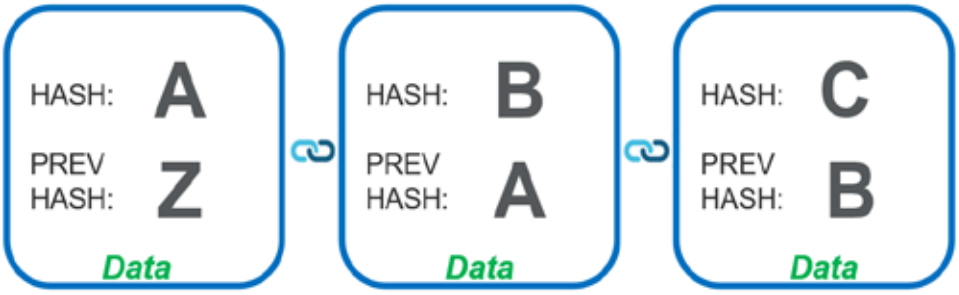
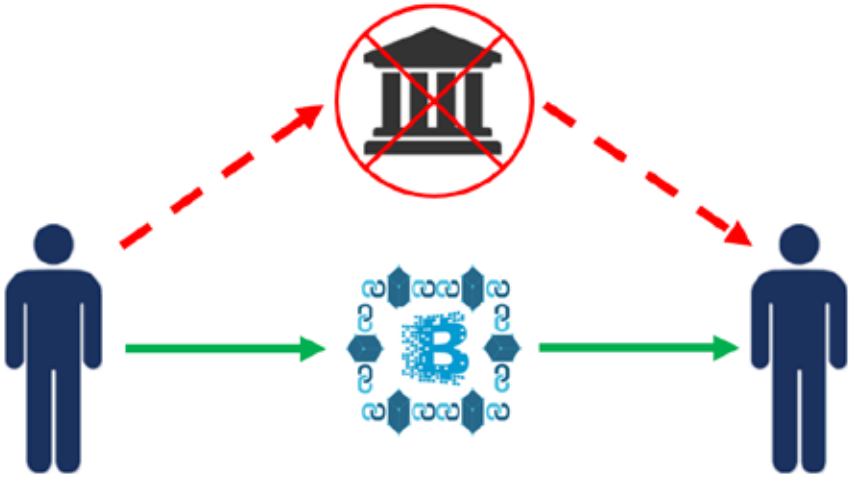


Sample Hash From the Bitcoin Blockchain:
00000000000000000098983c6e67bec9488da5f55f2842e2f01cf7188f33912

Intro to Blockchain

1. **Disintermediation.** Characteristics 1-3 enable trusted peer-to-peer transactions, without using a central authority as intermediary.



Cryptocurrency Regulatory Issues

In the U.S., various federal agencies and courts have defined cryptocurrencies as falling into a variety of legal asset classes, depending on the situation. Similarly, international legal frameworks are inconsistent and constantly evolving.

1. **FinCEN** – Cryptocurrencies are **"money"**
2. **IRS** – Cryptocurrencies are **"property"**
3. **CFTC** – Cryptocurrencies are **"commodities"**
4. **SEC** – Cryptocurrencies are **"securities"**

Cryptocurrency Regulatory Issues

March 9, 2022, "Executive Order on Ensuring Responsible Development of Digital Assets"

- Orders interagency reports addressing **CBDCs**, **economic opportunities and risks** of digital assets, and **approaches to illicit activity**.
- The EO also provides definitions of the following terms: **blockchain**, **central bank digital currency**, **cryptocurrencies**, **digital assets** and **stablecoins**.
- **Cryptocurrencies** refers to a digital asset, which may be a *medium of exchange*, for which generation or ownership records are supported through a distributed ledger technology that relies on cryptography, such as a blockchain.
- **Digital Assets** refers to all CBDCs, regardless of the technology used, and to other representations of value, financial assets and instruments, or claims that are used to make payments or investments, or to transmit or exchange funds or the equivalent thereof, that are issued or represented in digital form through the use of distributed ledger technology. For example, *digital assets include cryptocurrencies, stablecoins, and CBDCs*. Regardless of the label used, *a digital asset may be, among other things, a security, a commodity, a derivative, or other financial product*.

Blockchain Resources

Blockchain University Podcast Series:

https://www.bakerlaw.com/podcasts?SeriesID=181632

Blockchain Monitor Weekly Blog:

https://www.theblockchainmonitor.com/

Cryptocurrency: Property of the Estate

What is "Property of the Estate"

- The Bankruptcy Code defines "property of the estate" as "all legal or equitable interests of the debtor in property as of the commencement of the case" "wherever located and by whomever held"
  - This definition is intended to sweep broadly to include all kinds of property, including tangible or intangible property.
  - The term "property" is construed generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed.
- If an asset is property of the bankruptcy estate, the automatic stay precludes creditors from trying to recover those assets during the pendency of the bankruptcy case.
- "Property of the estate" does not include assets that the Debtor holds solely for the benefit of another party (e.g., assets that the Debtor holds in trust).
  - The Supreme Court in *United States v. Whiting Pools, Inc.* commented in a footnote that "Congress plainly excluded [from "property of the estate"] property of others held by the debtor in trust at the time of the filing of the petition."

What Qualifies as a Property Interest of the Debtor

- The Bankruptcy Code does not provide guidance on what constitutes a legal or equitable interest of the debtor in property. Bankruptcy courts generally look to state law.

Cryptocurrency

- Determining whether cryptocurrency or any other digital asset is property of the estate is determined on a case-by-case basis. There are a number of variables that will be examined, including
  - Relevant state law
  - Whether a trust (or "custodial") relationship has been formed
  - Whether the assets have been commingled

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Identifying a Viable Transaction

Valuation

- Valuing cryptocurrency firms in a chapter 11 is complex.
- 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 sale scenario), how active the customers will be in future trading, etc.

Reorganization vs. 363

- Initial restructurings in the cryptocurrency space have focused, generally, on asset sales under Section 363.
- Consolidation in the industry, coupled with faster cases, may facilitate reorganizations where the company emerges from chapter 11 and continues to operate in the ordinary course.
  - Rapid development of applicable caselaw will enhance predictability of restructurings.
  - Reorganizations will likely require significant outside capital infusion to ensure feasibility and confirmability of any plan of reorganization.

Running a "Crypto Auction"

- Auctions for cryptocurrency companies present unique challenges
  - Varying structure of bids, diversity among bidders, and execution risk can complicate bid evaluation.
  - Potential for several successive auctions due to varying interest in acquiring different pieces of the business.
- In current environment, most auction participants have been strategic investors.
  - Financial sponsor engagement may shift auction dynamics in future cases.

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Dollarization Considerations

- There are issues core to cryptocurrency that conflict with general bankruptcy practice.
- Although cryptocurrency is valued in U.S. dollars, holders have an interest in holding and recovering cryptocurrency—not its U.S. dollar equivalent.
  - A common theme in cryptocurrency is that 1 BTC is 1 BTC.
- This creates an issue as to how to value or consider crypto claims in bankruptcy.
  - For example: a creditor with a 1 BTC claim does not want to recover the value of the BTC on any given day, but rather the BTC itself.
- Bankruptcy Code section 502(b) provides that the court "shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the [bankruptcy] petition."
  - Thus, the general rule is that all claims are valued in U.S. dollars as of the date of the bankruptcy filing.
- Given the volatility of cryptocurrency and the amount of time a bankruptcy case takes from filing to completion, if crypto claims are valued as of the petition date, customers could recover considerably less cryptocurrency than they are owed (or can receive more)
  - For example: a creditor with a 1 BTC claim. On the petition date, 1 BTC is valued at $20,000. On the distribution date, 1 BTC is valued at $40,000. If distributions are paid in kind, the creditor will receive .5 BTC.
    - However, if on the distribution date, 1 BTC is valued at $10,000, the creditor will receive 2 BTC.
- Other dollarization considerations include:
  - Potential taxable events if distributions are made in fiat.
  - A bankruptcy estate becoming solvent if crypto prices increase during the case.

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Faculty

Jeffrey S. Ainsworth is an attorney with BransonLaw PLLC in Orlando, Fla., where he practices primarily in the areas of bankruptcy, creditors' rights and dischargeability issues, and has represented individual debtors, corporate debtors, unsecured creditors, committees, secured creditors and trustees. He is a member of ABI, the Orange County Bar Association and the Central Florida Bankruptcy Law Association. Mr. Ainsworth is admitted to practice in all Florida courts and the U.S. District Courts for the Northern, Middle and Southern Districts of Florida. He received his B.A. in political science in 2004 from the University of Central Florida and his J.D. in 2008 from Florida State University, where he also received a Certificate in Environmental and Land Use Law.

Robert A. Musiala, Jr. is the co-leader of the Blockchain Practice at BakerHostetler in Columbus, Ohio. He has been working in the blockchain and cryptocurrency market since 2012 and has extensive experience in cryptocurrency investigations and regulatory compliance, including having worked with a U.S. national security community client, advising blockchain clients on compliance with the Bank Secrecy Act, GDPR, SEC and CFTC regulations, alternative trading system applications, and as the court-appointed receiver to investigate and secure assets related to a cryptocurrency fraud scheme. Mr. Musiala invented one granted blockchain patent and another pending blockchain patent. In his practice, he works directly with technical teams to design solutions that meet legal and regulatory requirements. Mr. Musiala received his B.A. in creative writing (with honors) and international studies from Northwestern University in 2000, his J.D. from Notre Dame Law School in 2003 and his M.S.A. from the University of Illinois at Chicago Liautaud Graduate School of Business in 2011.

Alan R. Rosenberg is 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 bankruptcy. 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.

Gregg A. Steinman is a partner with McDermott Will & Emery in Miami and focuses his practice on corporate and transactional matters, particularly chapter 7 and 11 bankruptcy cases. He also is a member of firm's FinTech & Blockchain team and works closely with the firm's dedicated team of crypto lawyers who work exclusively on cryptocurrency and blockchain matters. Mr. Steinman advises and represents clients on all stages of both in- and out-of-court restructurings, and his experience includes the representation of corporate debtors, receivers, trustees, creditor committees and creditors. He has

restructuring experience in a variety of fields, including energy, cryptocurrency, health care, retail, manufacturing, telecommunications and transportation. He also has distinct experience investigating insolvent entities for the purpose of recovering assets lost as a result of fraud, pursuing avoidance actions, and related matters. Mr. Steinman's experience includes representing the Official Committee of Unsecured Creditors of Cred, Inc., the first chapter 11 cryptocurrency case of its kind, and Voyager Digital Holdings, Inc., a publicly traded cryptocurrency company and one of the largest cryptocurrency platforms in the world. He regularly advises cryptocurrency exchanges and related companies on regulatory matters pertaining to cryptocurrency and FinTech. Mr. Steinman received his B.A. in 2012 from Moravian College and his J.D. *cum laude* in 2016 from the University of Miami School of Law.