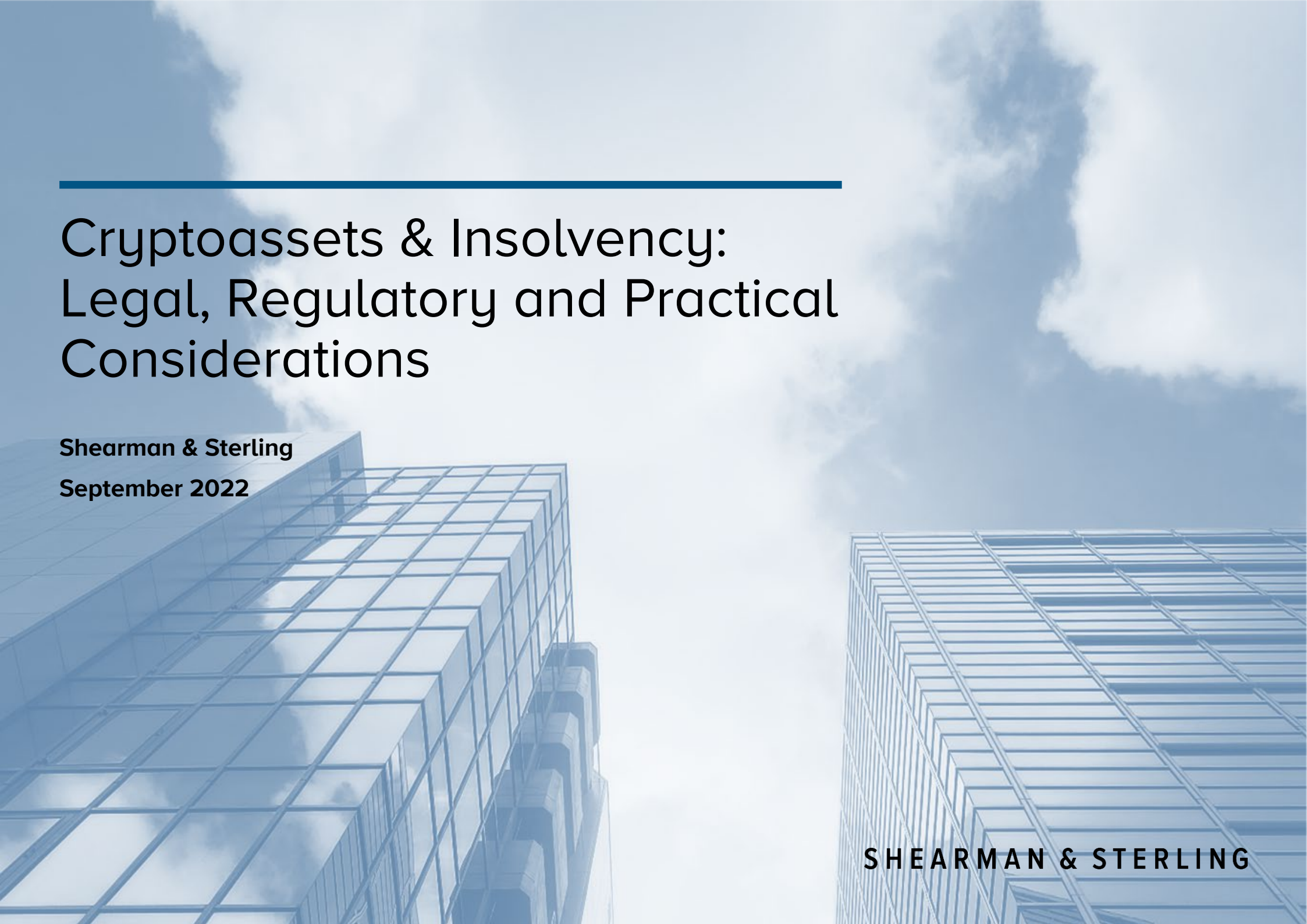

Cryptoassets & Insolvency: Legal, Regulatory and Practical Considerations

Shearman & Sterling

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SHEARMAN & STERLING

Part I: Introduction and Background

Introduction

Cryptoassets have emerged from relative obscurity to become an increasingly significant and mainstream presence: in just five years the global market cap for cryptocurrencies rose from around $15bn to over $3tn at its peak in November of last year. This has fueled a prolific expansion of crypto-focused businesses (e.g., cryptocurrency exchanges, crypto payment gateways, custodian wallet providers) and has led to increasing numbers of businesses accepting crypto as a form of payment and/or holding it on their balance sheets.

In this context, it is clear that "cryptoasset insolvencies" (for the purposes of this paper, we use this term loosely to refer to insolvencies / bankruptcies involving cryptoassets) will be an increasingly regular occurrence. However, the rapid growth of the asset class has left governments, lawmakers and regulators struggling to determine if and how existing legal and regulatory frameworks apply, or to the extent they do not, what additional laws and regulations may be needed.

Therefore, it is important for insolvency practitioners (**IPs**), debtors-in-possession (**DIPs**), debtors, trustees, investors, financial institutions and intermediaries, businesses and their advisers to understand the technologies underlying cryptoassets and the evolving legal and regulatory framework (including any potential deficiencies).

There have already been a number of high-profile insolvencies of crypto exchange platforms, and insolvencies involving other crypto-focused businesses (including those holding them as an asset, using them to pay creditors or accepting them as payment for goods / services) should rise in line with the growth of the asset class.

As highlighted in this paper, the insolvency of such businesses will present unique challenges, testing "tried and trusted" operational processes, laws and jurisprudence.

However, while the challenges are significant, so are the opportunities. Practitioners and advisers that allocate the time and resource to develop expertise in the sector will be well placed to secure key mandates and lay the foundations for future growth.

Note: This paper focuses on the U.K. and U.S. position and references to IPs are to IPs acting in respect of collective insolvency proceedings (e.g., administration, liquidation), whereas references to DIPs and trustees are to DIPs and trustees acting in bankruptcy and insolvency proceedings.

"Regulators in some jurisdictions will try to curtail activity in this space, but because of its nature as a peer-to-peer technology, that's a very difficult thing to do. It's far wiser for regulators to spend their time thinking about allowing crypto to interact with our traditional legacy financial system. That's a much better way for regulators then to get to know the technology and to get to know this asset class."
HESTER PEIRCE
COMMISSIONER, U.S. SECURITIES AND EXCHANGE COMMISSION

"What's going to happen to Bitcoin? It's really unclear. The price is not just driven by the money-supply rule, it's driven by other speculative forces. That's why it's multiple times more volatile than the stock market."
CAM HARVEY
SENIOR ADVISER, RESEARCH AFFILIATES

Emergence and Trajectory

In their infancy, cryptocurrencies were not commonly accepted as a form of payment, being most commonly used to make purchases through illicit sites on the dark web, such as the now defunct Silk Road. However, as cryptocurrencies and other cryptoassets have gained traction in mainstream society, an increasing number of institutions have begun to accept cryptocurrencies (in particular, Bitcoin) as a form of payment, including AXA Insurance (in Switzerland), Microsoft, Starbucks and Tesla (although the latter subsequently put Bitcoin transactions on hold).

On March 9, 2022, President Biden signed an Executive Order on Ensuring Responsible Development of Digital Assets. According to an accompanying fact sheet, it is the "first ever, whole-of-government approach" to regulating cryptocurrency activities. Although the order does not prescribe a regulatory framework itself or require the issuance of new rules, it directs various parts of the federal government to issue reports and recommendations on potential regulatory or legislative actions concerning digital assets. In addition, several bills have been introduced in Congress that would regulate cryptoasset activity at the federal level.

The U.K. government is also focused on updating its crypto legislation and is moving forward with various crypto initiatives. In January 2021, HM Treasury (**HMT**) launched a Consultation and Call for Evidence on the regulatory approach to cryptoassets and published its Response on April 4, 2022, (the **Cryptoasset Consultation Response**), which confirmed that issuing or facilitating the use of stablecoins used for payment would become regulated. In a separate consultation paper published on May 31, 2022 (the **FMI SAR Consultation**), HMT set out its proposals for a modified Financial Market Infrastructure Special Administration Regime (**FMI SAR**) as the primary legal framework to address the failure of systemic digital settlement asset (**DSA**) firms which are not banks. That consultation is ongoing.

On July 20, 2022, the U.K. Government introduced in Parliament the Financial Services and Markets Bill (**FSMB**), which, among (many) other things, contains significant provisions to amend the regulation of cryptoassets. The Cryptoasset Consultation Response, FMI SAR Consultation and FSMB are discussed further on slide 25.

In recent times, a number of blue-chip financial institutions have begun trading in cryptoassets or exploring ways to offer clients access to cryptoassets. In October 2021, a Bitcoin ETF launched on the New York Stock Exchange, signaling a significant milestone for the integration of such assets into the mainstream financial system. Perhaps most notably, certain countries have begun to positively support their use—in Costa Rica employment law allows workers to be paid a portion of their wages in the form of cryptocurrency, while in June 2021 El Salvador officially developed and launched a free government administered crypto wallet to encourage and enable widespread cryptocurrency use (i.e., the "Chivo Wallet").

Emergence and Trajectory (cont.)

There are a number of benefits to the use of cryptocurrencies in day-to-day transactions. For example, their peer-to-peer nature means that, in theory, intermediary / processing fees can be eliminated (or significantly reduced), and transactions completed almost instantaneously. Transactions are also secure, because the underpinning distributed ledger technology (**DLT**) prevents people from spending coins they do not own or undoing transactions.

However, cryptoassets also come with risk and remain highly volatile as shown recently by the influx of digital asset companies freezing assets, seeking to restructure liabilities and/or filing for insolvency / bankruptcy proceedings. Notable examples include (i) Voyager Digital, which at its height boasted 3.5m users and $5.9bn in assets, freezing customer funds at the beginning of July and a few days later filing for bankruptcy protection in New York; (ii) ThreeArrows Capital, which as recently as March managed c.$10 billion in assets (making it one of the most prominent crypto hedge funds in the world) filing for bankruptcy in June; and (iii) Celsius Network, one of the world's largest cryptocurrency lenders, recently filing for bankruptcy and listing its liabilities and assets between $1bn and $10bn, highlighting the volatility of cryptoasset value. These cases swiftly follow the failure of the TerraUSD stablecoin and the Tether stablecoin (which underpins much of the trading in cryptocurrencies), which fell below their $1 peg and resulted in investors facing losses of $1.3 trillion, as estimated by the European Central Bank in Q2 2022.

Due to the absence of intermediaries, cryptocurrencies also lack many of the protections that come with institutional involvement and regulatory oversight. For example, when someone loses access to a traditional bank account (e.g., loses their bank card, internet banking password, etc.), a bank can generally restore access once the customer's identity is confirmed. By contrast, where someone loses access to their crypto wallet, the wallet (and the funds held within) can be lost forever. While some of this risk may be mitigated by using a wallet hosted by a third party (e.g., an exchange), there may still be a risk of loss if those third parties become insolvent (since there is no deposit protection equivalent for cryptocurrencies) or are targeted by cyberattacks or theft.

The Financial Policy Committee of the British central bank, the Bank of England, has said that "extreme volatility" in crypto prices in recent months underscores vulnerabilities in the crypto market. Citing a $2tn reduction in the total market capitalization of crypto assets to $1tn, the Bank of England has stressed the need for tougher law enforcement and regulation for the crypto sector.

While noting that the volatility in the crypto market is not currently posing a risk to the stability of the U.K. financial system, the Bank of England cautioned that systemic risks would emerge if crypto activity and its interconnectedness with the traditional financial system continues to grow.

In June of this year, the president of the European Central Bank, Christine Lagarde, similarly said: "Crypto assets and decentralized finance (defi) have the potential to pose real risks to financial stability."

What are Cryptoassets?

The most commonly known form of cryptoassets are cryptocurrencies, but others, such as non-fungible tokens (**NFTs**) (a means of recording the ownership of digital assets such as digital artwork), will also fall within the asset class.

Although there is no single recognized definition, cryptoassets can be seen as a digital representation of value or contractual rights that can be stored, transferred, or traded electronically. Cryptoassets may utilize cryptography (secure communications techniques which use computer science and mathematical theory), DLT or similar. While Central Bank Digital Currencies (**CBDCs**) are issued by a central bank, work alongside sovereign cash and bank deposits and have the same security as cash, cryptoassets are often privately issued and can fluctuate drastically in value. One type of cryptocurrency—the stablecoin—attempts to manage that problem by backing the "currency" with assets.

Cryptoassets can be used to make transactions for speculative investments or to diversify an investment portfolio and afford a degree of anonymity to those owning or using them.

The individual tradable units which comprise a cryptoasset (e.g., a Bitcoin or an NFT) are typically referred to as "tokens." In turn, these are sometimes subdivided into: (i) "native" tokens—which do not derive their value from another underlying asset (e.g., Bitcoin); and (ii) "non-native" tokens—which derive their value from some other underlying asset (e.g., stablecoins, which are typically pegged to a fiat currency or a commodity, such as gold). Depending on their structure, native or non-native tokens may fall within the definition of "securities."

Native tokens give rise to significant investment risk, as the value of the investment is simply the value in holding that native token (and is completely dependent on the infrastructure maintaining that token). Non-native tokens are more likely to carry the value of the underlying asset. That said, they do not necessarily carry the right to the underlying asset itself but may help to constitute evidence of such right to ownership, and if the asset itself is another token, may be the only manner in which that asset can be handled. Non-native tokens are likely to be of interest to financial institutions, including clearing banks, in that they can provide a form by which other assets can be traded (including for central banks, fiat currencies, where the non-native token wraps a central bank obligation to pay a currency).

THE THREE KEY CATEGORIES OF CRYPTOASSET ARE:

01 Exchange Tokens

Often referred to as cryptocurrencies, they use DLT platforms and are not issued or backed by a central bank. They are used as a means of exchange or for investment—examples include Bitcoin and Litecoin.

02 Security Tokens

In the U.K., Security Tokens qualify as "specified investments" for the purposes of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. They may provide rights such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits.

03 Utility Tokens

Utility Tokens can be redeemed for access to a specific product or service that is typically provided using a DLT platform.

Key Features

The U.K. Jurisdiction Taskforce (**UKJT**) is one of the six taskforces of the Law Tech Delivery Panel, and its objective is to demonstrate that English law and the jurisdiction of England and Wales together provide a state-of-the-art foundation for the development of DLT, smart contracts and associated technologies. In the United States, at the federal level, most of the focus on cryptocurrencies has been at the administrative agency level, including the Securities and Exchange Commission (**SEC**), the Commodity Futures Trading Commission (**CFTC**), the Internal Revenue Service (**IRS**), and others. In November 2019 the UKJT provided guidance (**UKJT Statement**) which, among other things, identified cryptocurrencies (the best-known category of cryptoassets) as possessing the below characteristics.

01 INTANGIBLE

Typically represented by a pair of data parameters (identifiers or keys). The public parameter is disclosed to all the participants in the particular cryptoasset system (or even to the world at large) and contains encoded information about the asset. The private parameter (or "key") allows dealings in the cryptoasset to be cryptographically authenticated by a digital signature and is available only to person(s) entitled to the key. Knowledge of the private key confers control over the asset. Some complex cryptoassets might have multiple private keys with control over the asset shared among the key holders.

02 AUTHENTICATED BY CRYPTOGRAPHY

A process which guarantees the security of a transaction and the participants, independence of operations from a central authority, and protection from double-spending.

03 BASED ON A DISTRIBUTED LEDGER TECHNOLOGY

Dealings in cryptoassets are recorded via a digital ledger to keep a reliable history of transactions. The most common form of DLT, Blockchain, comprises blocks of transactions linked together sequentially and was originally invented to support Bitcoin.

04 DECENTRALIZED

Unlike traditional currencies, cryptocurrencies and other cryptoassets are not controlled by a centralized authority, such as a government or central bank. Instead, the task of managing and maintaining the value of the cryptocurrency is decentralized via a peer-to-peer network, in which no centralized intermediary is required for clearance.

05 RULED BY CONSENSUS

The rules governing dealings in a cryptoasset network are often established by the practice and consensus of participants rather than by contract or another legally binding way. Those rules are self-enforcing because only transactions made in compliance with them and duly entered in the ledger will be accepted by participants as valid.

Key Features (cont.)

LAW COMMISSION CONSULTATION

The Law Commission (a statutory independent body that keeps the law of England and Wales under review and recommends reform where it is needed) published a consultation on digital assets in July 2022 (**Law Commission Consultation**) which draws on the conclusions of the UKJT Statement. The Law Commission Consultation looks at (and makes proposals in relation to) whether, and if so, how, the law of England and Wales should be reformed to cater for cryptoassets.

In general, the Law Commission agrees with the UKJT Statement and finds that English law has, to some extent, proven to be sufficiently resilient, flexible and iterative to accommodate cryptoassets as objects of property rights. However, it considers that certain aspects of English law require reform to ensure consistent legal recognition and to acknowledge the nuanced features of cryptoassets. Of particular note, the Law Commission considers that cryptoassets cannot be properly categorized as "things in possession" or "things in action" (the two existing categories of personal property), as they are neither tangible (at least in the ordinary sense), nor are they only claimable or enforceable by legal action or proceedings. Consequently, the Law Commission proposes that digital assets should be categorized as a third category of personal property, known as "data objects."

The Law Commission Consultation aligns with international law reform in relation to cryptoassets, including work being carried out by the American Law Institute and Uniform Law Commission's Uniform Commercial Code and Emerging Technologies Committee in the United States, and by the International Institute for the Unification of Private Law (UNIDROIT) Digital Assets Working Group.

The Law Commission Consultation closes in November 2022. It will be interesting to see if the proposal to categorize cryptoassets as a separate category of personal property is supported (both in England and Wales and internationally).

Part II: Overarching Considerations

Ownership Issues

DO CRYPTOASSETS QUALIFY AS PROPERTY?

Given the rapid growth and complexity of the asset class, it is not surprising that cryptoassets and their core underlying technology are not completely understood. This is made more acute by the lack of legislation directly focused on cryptoassets and the relatively thin body of case law dealing with disputes in relation to them.

Despite the intangible nature of cryptoassets, the English Courts have held that they can be characterized as "property" (although to date, such findings have only been on an interim basis). In the 2019 case of *AA v. Persons Unknown*, the Court confirmed that cryptoassets were a form of property (and therefore capable of being subject to a proprietary order) on the basis they met the four criteria of property established in *National Provincial Bank v. Ainsworth [1965]*, namely definable, identifiable by third parties, capable in their nature of assumption by third parties and having some degree of permanence.

In 2019, the UKJT provided guidance through the UKJT Statement that cryptoassets are to be treated "in principle as property" on the basis that they have "all the indicia of property" and their intangible nature "does not disqualify them from being property." The UKJT Statement also concluded that cryptoassets fall within the definition of property for the purposes of s426(1) of the Insolvency Act 1986 (**IA86**). As such, IPs will have a duty to realize the value of any cryptoassets owned by the estate wherever possible. In order to do this, they will need to be able to identify, access, preserve, value and then distribute the assets. Cryptocurrencies are not recognized as legal tender in the U.K., but as noted on slide 6, security tokens are classified as "specified investments" for the purposes of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

In the U.S., in 2014, the IRS issued Notice 2014-21, 2014-16 I.R.B. 938, explaining that virtual currency is treated as property for Federal income tax purposes. The CFTC has classified cryptocurrencies as commodities as opposed to currencies. In the 2018 case *Commodities Futures Trading Commission v. My Big Coin Pay, Inc.*, the U.S. District Court of Massachusetts held that the CFTC could regulate the cryptocurrency in question because it qualified as a commodity. The SEC has stated the view that many cryptoassets are securities.

The legal status in the U.S. of whether cryptocurrencies are currencies or commodities poses complex challenges for bankruptcy courts, particularly in the context of asset valuation. In *Hashfast Technologies LLC v. Lowe* (*In re Hashfast Technologies LLC*), a 2016 case decided by the Bankruptcy Court for the Northern District of California, the court had to determine whether the debtor had fraudulently transferred its Bitcoin assets to another party, and if so, whether the transferee had to return the coins themselves or their value to the bankruptcy estate. If the court classified Bitcoin as a currency, the transferee would have been required to return the cash value of the Bitcoins, rather than the coins themselves. The court did not decide the issue but did make clear that Bitcoins are distinct from U.S. dollars.

Ownership Issues (cont.)

HOW DO YOU ESTABLISH OWNERSHIP?

In its 2019 guidance, the UKJT concluded that ownership of a cryptoasset will generally be attributed to the person who acquires knowledge and control of the private key, subject to the rules of the particular cryptoasset system (e.g., the position may differ for cryptoassets with multiple private keys or a person holding a key on behalf of another etc.). This is supported by the Law Commission Consultation, which suggests the concept of "control," as opposed to "possession," is the most suitable concept to apply to cryptoassets (although noting that control may not necessarily denote legal ownership, e.g., in the case of a custodial arrangement).

In the U.S. context, depending on the manner in which the cryptoasset is held, it may be unclear who "owns" the cryptoasset itself, to what extent, and in the context of a crypto exchange, what (if any) custodial relationship exists between the exchange and its customers that may impact that "ownership." Whether cryptoassets are held in trust for an exchange's customers is an issue discussed later in this paper.

01 The UKJT and Law Commission consider the cryptoasset itself, rather than the private key, as the property (i.e., the private key is information and as such is not capable of being property).

02 Given that the cryptoasset constitutes property, ownership of the legal title to that asset should of course be capable of being treated in the same way as other personal property, meaning that it may be capable of being held in trust for others and should be capable of being conveyed both legally (i.e., by transferring control of the key) and in equity (where such transfer does not take place).

Private keys are stored in a "wallet" which defines and gives control over each cryptoasset. Wallets can take various forms, including "hard" wallets, physical devices capable of storing the information (an imperfect analogy would be a USB drive), "soft" wallets, in the form of a program downloaded to a computer or a device which securely stores such data, and "hot" wallets which store keys online and require access to the internet.

The ability to access keys and gain control over the cryptoasset may be one of the key challenges in relation to cryptoasset insolvencies.

Ownership Issues (cont.)

HOW IS OWNERSHIP FULLY TRANSFERRED?

There is no single prescribed method for transferring cryptoassets. The ability to transfer (or purportedly transfer) will depend on the nature of the cryptoasset and the requirements of its supporting infrastructure. Even the concept of "transferring" cryptoassets can be seen as somewhat imprecise since, as noted in the Law Commission Consultation, transfers of cryptoasset transfers "will typically involve the replacing, modifying, destroying, cancelling, or eliminating of a pre-transfer crypto-token and the resulting and corresponding causal creation of a new, modified or causally-related crypto-token"—i.e., the property changes as a result of the "transfer."

However, it is generally accepted that rights to cryptoassets are transferable. For example, a holder of a cryptoasset can transfer it to any other wallet address, in the same way that a person might send money to a specified bank account. The most common means of acquiring and selling cryptoassets is now via cryptocurrency exchanges. The transfer is typically made by modifying the public parameter, or generating a new one, to create a record of the transfer (which includes the details of the transferee). The transferor then authenticates the record by digitally signing with their private key, at which point the asset comes under the control of the transferee, and no further transactions with the asset by the transferor will be accepted by the consensus (those validating the transaction on the public parameter). This type of transfer is known as "on-chain." However, it is also possible to make an "off-chain" transfer, which is not recorded on the ledger but agreed to by two parties, with the transferor or a third party retaining control of the asset.

As an asset, it is also possible that beneficial interests may be capable of being held or conveyed without requiring a full transfer in the manner described above, provided evidence of such interest can be established in accordance with normal property and trust principles. The fact that cryptoassets are capable of constituting property does not therefore displace the application of orthodox principles of personal property law and trust law. That the cryptoasset can be transferred in accordance with its own rules in a particular and unique manner does not necessarily mean that the asset's legal or equitable title passes solely in accordance with those rules—who controls the key and whether a transfer was actually made may be part of the evidence but may not be conclusive as a matter of law. If a person is able to demonstrate that they have an equitable interest in the asset, then the holder of the key may be subject to that equitable interest and such interest may, in certain circumstances, be capable of being traced through to subsequent holders (in the same way that interests in other assets, including money, can be). This means that the infrastructure affecting who controls the key and how the asset is transferred is a relevant factor in determining ownership of the asset, but that does not displace other principles of personal property and trust law from applying. Conversely, a person that can show an equitable interest in a cryptoasset will not be able to exercise rights in relation to the cryptoasset unless it is able to exercise control over it (e.g., through the private key).

Some exchanges (e.g., Coinbase, Binance, etc.) are large enterprises that in many ways mirror common online securities exchanges, such as Hargreaves Lansdown or eToro (indeed, Coinbase is now listed with the New York Stock Exchange). Parties set up trading accounts with the exchange and the exchange holds funds on behalf of customers. Others, such as PancakeSwap, are simply automated market makers, streamlined systems for facilitating peer-to-peer exchange, which in many cases do not even require users to create an account. Parties simply link their wallets to the exchange through a simple prompt in their web browser and confirm the details of the proposed exchange. The exchange then automatically pairs them with a corresponding trade.

Identifying and Accessing Cryptoassets

The defining characteristics of cryptoassets can make it very difficult to establish their existence in the first place. Once identified, acquiring the private key and accessing the wallet may prove even more challenging. Finally, understanding the applicable legal and regulatory position will determine which cryptoassets fall within a bankrupt / insolvent estate and the obligations of the DIP/IP in relation to them.

Cryptoassets may be practically impossible to trace without their private key. A DIP/IP will be unable to access, safeguard, transfer, or convert a company's cryptoassets without cooperation from the entity / individual responsible for storing a company's digital cryptoasset credentials. Digital credentials stored offline are at greater risk of loss and destruction and can prove more challenging for DIPs/IPs to locate.

Where a cryptoasset holder (or suspected cryptoasset holder) refuses to co-operate, DIPs/IPs should take steps to freeze any identified cryptoassets to minimize the risk of the estate being dissipated. While (at least at this stage) there will be no bank to receive service of the order, it could be served on cryptocurrency exchanges.

While third parties (e.g., banks and accountants) in "orthodox" insolvencies will usually cooperate with DIPs/IPs due to regulatory or reputational reasons or existing contractual relationships with the company, cryptoasset insolvencies (and the absence of certain pressure points) may not induce the same level of cooperation.

Bankruptcy courts in the U.S. and IPs in the U.K. have a duty to consider the factors that contributed to an insolvent entity being unable to pay its debts, in particular the conduct and actions of directors or *de facto* directors. DIPs and IPs also have the power to set aside transactions and return assets / value to the insolvent estate. However, the makeup of blockchain transactions can make it nearly impossible to look back and track transaction sequences. Where necessary expertise to identify or locate cryptoassets is needed, a cybersecurity or tracing expert may be engaged to search for the digital wallet.

01 ***Dooga Ltd (t/a Cubits) (Dooga) (2018)***

Administrators for the U.K.-headquartered cryptoasset exchange and storage facility confirmed in their progress report in June 2019 that although they had:

i. located the digital wallet containing the company's cryptoassets; and
ii. visibility on all transactions,

they could not access the cryptoassets because they did not have access to the private keys.

The currently appointed liquidators may require the assistance of the English Courts to secure access to the private keys so as to take control of the cryptoassets.

02 ***Philip Stephen Wallace (as liquidator of Carna Meats (UK) Limited) v. George Wallace [2009] EWHC 2503 (Ch)***

The High Court held that liquidators' powers of discovery under s236 IA86 can be used extraterritorially. Combined with the UKJT Statement, this decision may assist officeholders seeking to compel directors or others who might hold a private key to hand it over, even if such individuals are residents outside the U.K. The UKJT considers that private keys should be treated as information and as such s.236 IA86 (i.e., the ability to compel an individual to deliver up company books, papers or other records) will apply.

Part III: Key U.K. Insolvency Considerations

Determining Jurisdiction in the U.K.

Determining the law applicable to cryptoassets and transactions involving them will be an important consideration for any party seeking to submit a claim to such assets. However, linking a cryptoasset transaction to a particular applicable law is problematic—cryptoassets are not tangible and due to their decentralized nature operate with customers through software in different jurisdictions minute-by-minute. It is notable that similar issues concerning the law(s) applicable to de-materialized securities—a much more established and ubiquitous type of financial asset than cryptoassets—remain uncertain and controversial in English law.

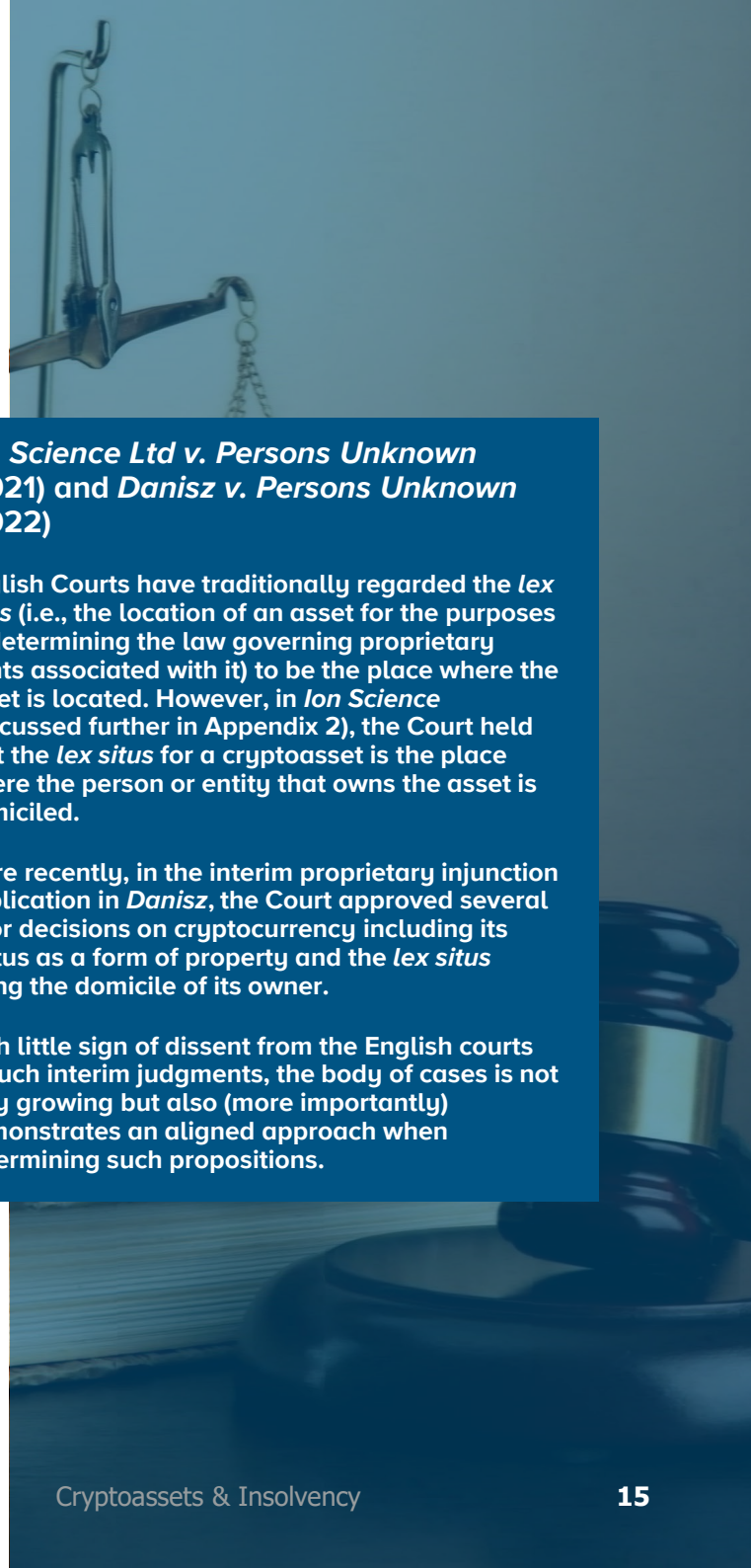
A party might seek to argue that cryptoassets are located wherever the wallets containing them are located. In the case of software or hardware-based wallets (i.e., those which physically store the relevant keys on a computer or other device in a party's possession), this may be the location of the relevant device. For a hot wallet, provided by a third party via the internet, it could be the location at which the wallets are hosted (i.e., the site of the relevant servers). Alternatively, a party may assert that the Hague PRIMA Convention applies, such that (at least certain) cryptoassets should be treated as securities and any cross-border transaction in relation to them be governed by the laws of the jurisdiction where the intermediary maintaining an account to which the securities are credited is located.

The Law Tech Delivery Panel has suggested that the following factors might be particularly relevant in determining whether English and Welsh law governs the proprietary aspects of dealings in cryptoassets (although it does not provide guidance as to the significance of each factor and/or whether these should be considered as standalone or collective):

i. whether any relevant "off-chain" asset is located in England and Wales;
ii. whether there is any centralized control in England and Wales;
iii. whether a particular cryptoasset is controlled by a particular participant in England and Wales (because a private key is stored there);
iv. whether the law applicable to the relevant transfer (perhaps by reason of the parties' choice) is English law.

On the other hand, the UKJT has stated "*there is very little reason to try to allocate a location to an asset which is specifically designed to have none because it is wholly decentralized*."

Without a legally binding global framework, this legal uncertainty will apply across jurisdictions, meaning complex and contentious cross-border issues are likely to feature in many cryptoasset insolvencies.



***Ion Science Ltd v. Persons Unknown* (2021) and *Danisz v. Persons Unknown* (2022)**

English Courts have traditionally regarded the *lex situs* (i.e., the location of an asset for the purposes of determining the law governing proprietary rights associated with it) to be the place where the asset is located. However, in *Ion Science* (discussed further in Appendix 2), the Court held that the *lex situs* for a cryptoasset is the place where the person or entity that owns the asset is domiciled.

More recently, in the interim proprietary injunction application in *Danisz*, the Court approved several prior decisions on cryptocurrency including its status as a form of property and the *lex situs* being the domicile of its owner.

With little sign of dissent from the English courts in such interim judgments, the body of cases is not only growing but also (more importantly) demonstrates an aligned approach when determining such propositions.

Key Legal Issues for U.K. Insolvency Proceedings

While IPs often face an obstacle course of considerations, the complexities may be even more acute when dealing with a relatively niche asset class with minimal legal and regulatory safeguards (including judicial precedent) on which to rely. Similar to a case before a U.S. Bankruptcy Court (for which, see corresponding U.S. analysis on slides 27 – 32), the following issues may require determination in U.K. crypto-insolvencies:

- whether the cryptoassets are property of the estate;
- whether to realize the cryptoassets and distribute the fiat currency proceeds, or to distribute the cryptoassets themselves to creditors;
- how to value claims linked to cryptoassets; and
- whether there is scope to challenge transactions or actions taken in relation to cryptoassets prior to the commencement of the insolvency proceedings.

PROPERTY OF THE ESTATE: Where a crypto exchange or platform enters insolvency proceedings, a key consideration will be whether the cryptoassets are property of the insolvent estate under r.1.2 Insolvency (England and Wales) Rules 2016, such that the customer is an unsecured creditor, or whether the cryptoassets are held on trust for the customer.

DISTRIBUTING CRYPOASSETS / CRYPTOASSET PROCEEDS: If the cryptoassets form part of the insolvent estate, a further consideration will be whether creditors should receive the value of their admitted claim (or their lower entitlement based on estate realizations) in cash, or through a dividend-in-specie of the cryptoassets.

CLAIM ASSESSMENT: Particularly where a cryptoasset class has been subject to significant price volatility, determining the appropriate value for a claim based on that cryptoasset will be a key consideration for an IP.

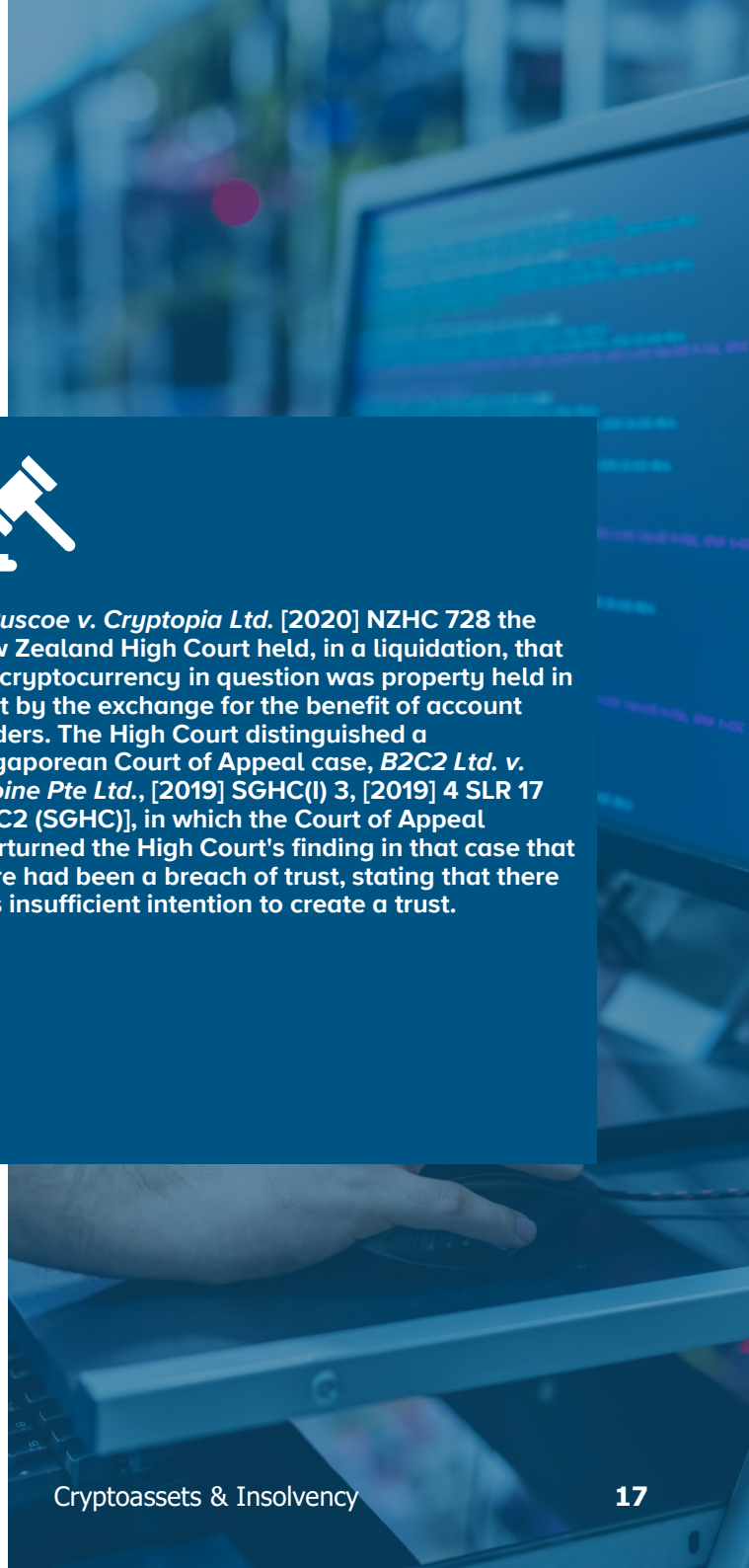
AVOIDANCE POWERS: Liquidators and administrators have significant powers under the IA86 to challenge transactions effected in certain periods prior to insolvency (e.g., transactions at undervalue under s.238 and preferences under s.239). The officeholder will need to assess if there may be grounds to use such powers, and if so, the utility of doing so if the cryptoassets may be difficult to recover and/or the transaction counterparty difficult to trace.

Property of the Insolvent Estate

English common law and legislation recognizes that assets held on trust for a third party remain the property of that third party, and thus should not be made available for distribution to other parties (e.g., creditors in an insolvency). Therefore, whether assets are held on trust for third parties can affect the amount / value of assets falling within an insolvent estate, which can be particularly significant in the case of businesses such as crypto exchanges. Whether cryptoassets are *in fact* held on trust will require analysis of the terms on which they are held.

Under English law, trusts can be expressly created or implied by the general law. For example, a crypto exchange could hold cryptoassets on behalf of its customers under an express trust created through the exchange's terms and conditions. Alternatively, the exchange could hold those cryptoassets under a constructive trust (a category of implied trust) if, for example, the cryptoassets were legally owned by the crypto exchange but it is shown that the exchange should really own the property on behalf of the customer (i.e., such that the customer retains the beneficial interest). The wider intricacies of trust law are beyond the scope of this paper, but unless an express trust relationship can be evidenced through documentation between the exchange and the customer, an IP managing insolvency proceedings in relation to that exchange could face difficult legal issues, some of which could potentially lead to litigation (see Lehman, MF Global, etc.).

It also remains unclear whether cryptoassets held by an exchange platform on behalf of a beneficial creditor in an insolvency situation would be classified as client assets or segregated assets; the distinction can create significantly different outcomes for customers and will need to be considered on a case-by-case basis. If the cryptoassets are classified as client assets under the FCA's Client Assets Sourcebook (CASS) rules, they will be subject to an automatic statutory trust in favor of the customer from the time the exchange receives the assets. Furthermore, where assets are deemed segregated liquid assets, the IP will usually hold those assets until distribution is necessary, whereas non-segregated funds will be put into an "asset pool," and the IP will look to liquidate the cryptoassets and distribute in a fiat currency to all creditors (trade and customers etc.). It should also be noted that certain special administration regimes have different administration objectives to those prescribed by paragraph 3(1) IA86 and the categorization of assets as "client assets" can be significant in that context (for example, one of the administration objectives of The Investment Bank Special Administration Regulations 2011 is to ensure "the return of client assets as soon as reasonably practicable").



In *Ruscoe v. Cryptopia Ltd.* [2020] NZHC 728 the New Zealand High Court held, in a liquidation, that the cryptocurrency in question was property held in trust by the exchange for the benefit of account holders. The High Court distinguished a Singaporean Court of Appeal case, *B2C2 Ltd. v. Quoine Pte Ltd.*, [2019] SGHC(I) 3, [2019] 4 SLR 17 [B2C2 (SGHC)], in which the Court of Appeal overturned the High Court's finding in that case that there had been a breach of trust, stating that there was insufficient intention to create a trust.

Valuation, Realization and Distribution

While there is no certainty that an IP will acquire sufficient control over the digital assets and systems required to transfer, trade and subsequently make realizations in respect of cryptoassets, there is also a question of how creditors with accepted claims deriving from cryptoasset holdings should receive their distribution, e.g., should the distribution be in the form of the relevant cryptoasset or converted into the fiat currency applicable in the jurisdiction governing the proceedings (and if so, when would such conversion rate be determined)?

Rule 14.21 of the Insolvency (England and Wales) Rules 2016 provides that a liquidator, administrator or bankruptcy trustee must convert all proofs of debt incurred or payable in a foreign currency into sterling at the applicable exchange rates prevailing on the date on which the relevant insolvency proceedings commenced. However, this will not apply to cryptocurrencies (or for that matter, other forms of cryptoasset) since they are not recognized as legal tender (the one exception being El Salvador, but since El Salvador allows automatic convertibility of Bitcoin into the U.S. Dollar, the U.S. Dollar could be used to determine the appropriate FX conversion rate for the purposes of the claim). In the absence of a Rule 14.21 equivalent, valuing claims linked to cryptoassets could present challenges for an IP.

IPs will likely require external expertise to assist in helping them identify, collect in and preserve cryptoassets identified as property (or potential property) of the insolvent estate. Furthermore, realizing and/or distributing cryptoassets (or the legal tender proceeds derived from their sale) may be costly, complex and time-consuming. Care should also be taken when transferring cryptoassets. In the liquidation of Canadian currency exchange Quadriaga, cryptoassets were allegedly transferred to the wrong cold wallet, resulting in significant losses because the asset could not simply be returned. IPs should therefore take control of the cryptoasset immediately and transfer it to a devoted cold wallet.

Finally, IPs will be cautious to avoid flooding the market when seeking to sell cryptoassets as their relative illiquidity, particularly at a time of heightened market volatility, could decrease the cryptoassets' value and negatively impact returns to the estate. An administrator or liquidator could therefore choose to seek creditors' permission under rule 14.21 of the Insolvency (England and Wales) Rules 2016 to divide cryptoassets in their existing form among the company's creditors according to their estimated value. Whether or not creditors elect to accept a dividend in specie of the cryptoassets, offering creditors this option could help protect the IP against claims that they sold the cryptoassets at a time or in a manner that resulted in lesser returns for creditors than might otherwise have been achieved (although the Court will always be slow to find against an IP, provided they took a reasonable approach in the circumstances).

Where an insolvent entity has dealt in both traditional currency and cryptoassets, disputes relating to creditor entitlements, valuation, exchange rates and methodology of realization are likely to be exacerbated. An IP will also need to study the state of the market for the particular cryptoasset it is holding since:

01 **Not all cryptoassets are liquid, and as a result, they are subject to volatile deviations in market price; therefore, mistiming a liquidation / sale of a cryptoasset holding could expose the IP to criticism.**

02 **Were an IP to "flood the market" with a certain cryptoasset (with the objective to exchange it for traditional currency and subsequently distribute the proceeds), the value of that cryptoasset could be diminished.**

Avoidance Powers

The Insolvency Act provides liquidators and administrators with powers to challenge transactions or actions by or on behalf of a company prior to its insolvency. The value of assets transferred by or otherwise removed from a company's possession (or control) is often crucial in this regard. Take two examples:

- A company enters a transaction at an undervalue for the purposes of s.238 IA86 if, among other things, it "enters into a transaction with a person for a consideration, the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company."
- A company gives a preference for the purposes of s.239 IA86 if, in relation to one of its creditors or surety or guarantor for its debts or liabilities, the company "does anything or suffers anything to be done which…has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done."

Where such transactions are shown, the court can make such order as it thinks fit for restoring the position of the company to the position if the transaction at an undervalue or preference had not been given.

The price volatility of certain cryptoassets could make it difficult to show that a TUV or preference had occurred in the first place or to determine what should be required to unwind the transaction. For example, if the cryptoasset had risen and fallen in price significantly since the date of the relevant transaction, a question may arise as to whether the company should be entitled to the cash equivalent of the cryptoasset at its highest valuation since the date of the transaction, the value of the cryptoasset at the date of the court order, or at some other point in time. The English courts have a huge body of jurisprudence on which to rely and will be able to rule on such matters, but the novel characteristics of cryptoassets are likely to present some complex legal issues in the coming years.

Security, Netting and Enforcement

As cryptoassets constitute property they can be used as security, such as to support a loan or other financial transaction. We expect to see an increasing use of cryptoassets as security as crypto products become more established and the sector becomes more regulated.

The type of cryptoasset will determine the security options available, but the fact that they are all intangible assets has a significant bearing.

- **Charge**: similar to other intangible assets such as bank accounts or shares, cryptoassets can be secured by way of a charge.
- **Mortgage**: technically possible where a cryptoasset represents bearer securities (or other assets that can be secured by way of a mortgage).
- **Pledge**: not possible because cryptoassets are not capable of being transferred by delivery of possession.
- **Lien**: as with the case of pledges, the English Court of Appeal concluded that a lien could not be taken over intangible assets in *Your Response Ltd v. Datateam Business Media Ltd*.

As with any lending arrangement, those financing or facilitating cryptoasset transactions will often look to protect their investment by taking some form of collateral over assets of the borrower. However, there are a number of considerations (and potential challenges) in relation to taking and enforcing cryptoasset collateral. A particular focus will be whether a transaction may fall within the scope of the Financial Collateral (No 2) Regulations 2003 (**FCA Regs**), either as a security financial collateral arrangement or title transfer financial collateral arrangement, such that it would benefit from the disapplication of certain statutory formalities in relation to the taking of security and the modification of insolvency law provisions. Certain cryptoassets (in particular, cryptocurrencies) could be viewed to fall within the definition of "financial instruments" in the FCA Regs and therefore be eligible financial collateral.

However, the legal position is currently unclear. For example, in the context of security financial collateral arrangements, the requirement for the financial collateral to "be in the possession or under the control of the collateral taker or of a person acting on the collateral taker's behalf," could prove difficult to show within a DLT framework (in particular, note the discussion above regarding the unsuitability of the concept of "possession" to cryptoassets). Furthermore, in instances of enforcement, crypto creditors will frequently need to rely on the actions of others (e.g., where private keys held by different parties are required to transfer an instrument). As such, there is uncertainty as to whether (and if so, in what circumstances) the FCA Regs apply. We highlight some potential implications on the following slides.

Security, Netting and Enforcement (cont.)

Prevention of Enforcement: When a company is subject to administration proceedings, a secured creditor cannot enforce against their security without the permission of the court or consent of the administrator. Similarly, where a company is subject to a Part A1 moratorium, a secured creditor cannot take steps to enforce security without the permission of the court. However, if a cryptoasset transaction constitutes a financial collateral arrangement, the collateral holder will be able to enforce its security notwithstanding the moratoria.

Void Dispositions: In a winding up by the court, any disposition of the company's property after the commencement of the winding up (the time at which the winding-up petition is served) will be void without sanction of the court (s.127 IA 86). However, this will not apply to a disposition of property or a security interest arising under a financial collateral arrangement (including a close-out netting provision, subject to certain conditions).

Registration: Security given by an English company or LLP which is not registered in 21 days will generally be void as against an administrator, liquidator or other creditors. However, registering security would de-anonymize the transacting parties and consequently undermine what is considered to be one of the key attractions in using cryptoassets. If the FCA Regs apply, there is no requirement to register a charge, nor will unregistered security be viewed as void against such persons.

Foreclosure: English law will generally not permit a creditor to "foreclose" on their security without a court order, i.e., to claim ownership of a secured asset in satisfaction of their debt without having to sell the secured asset. However, if security falls within the ambit of the FCA Regs, the collateral-taker may appropriate the collateral (subject to the terms of the security financial collateral arrangement) without any order of foreclosure from the courts. Contractual terms that allow for effective foreclosure against cryptoasset collateral will be at risk of challenge if the FCA Regs exemption does not apply.

Close-out Netting Provisions: A close-out netting provision (such as a contractual setoff or netting provision) that relates to a financial collateral arrangement or an arrangement of which a financial collateral arrangement forms part will take effect even though the collateral-provider or the collateral-taker is subject to winding-up proceedings or reorganization measures.

Security, Netting and Enforcement (cont.)

Expenses and Preferences: Where a company has gone into an administration or winding-up process, the IP will ordinarily be able to pay its remuneration and any expenses incurred during their tenure (subject to certain restrictions) out of the property under its control and in priority to the rights of the holder of a floating charge. Given the level of specialist expertise that may be required by IPs (and their delegates) in managing cryptoassets insolvencies, costs could be significant (as discussed later in this paper), which could impact recoveries for floating charge holders and unsecured creditors. Furthermore, in certain circumstances, an IP is required to set aside a part of the company's property subject to a floating charge (known as the "prescribed part") and make it available to unsecured creditors. However, these insolvency law provisions will not apply to a security interest over a cryptoasset under a financial collateral arrangement and consequently, a floating charge holder should be able to ring-fence their collateral from such claims.

Avoidance of Contracts: An IP has the power to disclaim property it considers unprofitable or too onerous to retain which, given their complex nature and volatile valuation, could feasibly apply to cryptoassets. However, this will not apply to a financial collateral arrangement where the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings. In addition, a floating charge created for insufficient value in a prescribed time before a company goes into administration or liquidation will be deemed invalid against an administrator or a liquidator. However, no such qualifications would apply to a charge created or otherwise arising under a financial collateral arrangement.

Security, Netting and Enforcement (cont.)

Similar considerations apply in relation to other pieces of legislation which, like the FCA Regs, seek to regulate the plumbing of financial markets by (among other things) disapplying certain provisions of insolvency law. As cryptoassets and the platforms and businesses that support them become increasingly intertwined with mainstream financial markets, we expect these questions to become increasingly pertinent.

One example is Part VII of the Companies Act 1989 (**Part VII**) which is designed to ensure that English insolvency law does not disrupt the rules that regulate the operation of the financial markets. It does so by disapplying insolvency law where provisions would conflict with contractual remedies agreed between market participants and their counterparties. In particular, Part VII disapplies "the law relating to the distribution of assets" of an insolvent entity to the extent that it would render invalid any of the following:

- market contracts (broadly, contracts entered into by a Recognized Investment Exchange (**RIE**), recognized central counterparty (**CCP**), recognized clearing house (**RCH**) or recognized central securities depository (**CSD**), or their members or designated non-members, with respect to transactions conducted on, cleared by, or settled by, those recognized bodies);
- qualifying property transfers (certain transactions cleared through a recognized central counterparty);
- the default rules of a RCH, a CCP, a RIE or a CSD;
- transfers or settlements of contracts by a recognized CCP and the transfer or settlement of related trades and qualifying collateral arrangements; and
- any other rules of an RCH, an RIE or a CSD relating to the settlement of market contracts.

Similarly, the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (**Settlement Finality Regs**), aim to minimize systemic risk associated with, and to ensure the stability of, payment and securities settlement systems. Among other things, the Settlement Finality Regs provide that transfer orders entered into such systems cannot be revoked or invalidated, even if a system participant is subject to insolvency proceedings.

The application of Part VII and/or the Settlement Finality Regs to certain crypto businesses or transactions would give greater legal certainty to transactions by those businesses and/or in those assets. However, for Part VII to apply, a crypto business would need to be recognized by the Financial Conduct Authority as an RIE, RCH, CCP or CSD and for the Settlement Finality Regs to apply, a crypto business would need to be declared a "designated system" by the Financial Conduct Authority or the Bank of England. While certain crypto exchanges are FCA registered, we are not aware of any such recognition orders or designations in relation to crypto businesses to date.

Funding Considerations for IPs

The challenges involved in locating and realizing cryptoassets assets may be significant. IPs will need to weigh these challenges (including the time, cost and risk implications) against potential realization value and the likelihood of being able to deliver that value to creditors. We set out below some factors that may be relevant to this assessment.

The expenses of an insolvency rank above unsecured claims, but as in all insolvencies, an IP considering a cryptoasset appointment will need comfort that there are sufficient assets in the estate to cover likely expenses.

When deciding the best approach, IPs may need to engage with creditors and/or claimants and seek their approval where necessary. They may also need to provide such parties with reports or other documentation to evidence / rationalize any allocation or steps taken.

Where cryptoassets are held on trust, an IP may be able to rely on a Berkley Applegate trust order, which can provide that an officeholder's fees and expenses are paid from the sale proceeds of the trust assets.

When assessing potential actions against third parties, an IP may consider litigation funding options. Although it can be costly, litigation funding could be used to hedge the IP's (and estate's) risk in pursuing actions to, e.g., collect / preserve assets or investigate prior transactions. However, a key factor will be time, since assessing the merits of potential actions and engaging and reaching agreement with liquidation funders can be a protracted process. This may reduce the attractiveness of the option when dealing with assets which allow for low levels of control and are at risk of dissipation and/or price volatility.

The U.K. Regulatory Perimeter for Digital Assets

HMT's FMI SAR Consultation (discussed on slide 4) proposes to implement a modified FMI SAR as the primary legal framework to address the failure of systemic DSA firms which are not banks. The adapted FMI SAR would cover stablecoins used for payment and other digital assets used for payments or settlement. The primary objective of the framework is to allow a firm's services to continue ahead of the interests of its creditors and allow administrators to consider the return of customer funds and private keys. The proposal includes an additional objective covering the return or transfer of funds and custody assets, including the transfer of coins to another stablecoin issuer, which may only be considered when the FMI SAR is applied in relation to systemic DSA firms. Stablecoin firms that are deemed systemically important will also be subject to supervision by the Bank of England, meaning that they will be authorized by the FCA and recognized by the Bank of England, and the Bank will be the lead prudential regulator, including in the administration of a systemic DSA firm. The Bank of England would be given the power to direct administrators as to which objectives should take precedence in an administration (continuity of service or return / transfer of funds and custody assets) but would be required to consult the FCA before a special administration order was sought for stablecoin issuers. The FMI SAR would take precedence over the Payment and E-Money Special Administration Regime (**PESAR**), where both the FMI SAR and the PESAR apply to a firm. The consultation closes on August 2, 2022, after which HMT will review submissions and publish its own response.

HMT's separate Cryptoasset Consultation Response resolved that the U.K. Government should introduce a regulatory regime for stablecoins. On July 20, 2022, the U.K. Government published the FSMB which, among other things, provides for the regulation of digital settlement assets (DSAs) which it defines as "*a digital representation of value or rights, whether or not cryptographically secured, that (a) can be used for the settlement of payment obligations, (b) can be transferred, stored or traded electronically, and (c) uses technology supporting the recording or storage of data (which may include distributed ledger technology).*"

As anticipated in the Cryptoasset Consultation Response, the FSMB provisions in relation to DSAs largely apply to stablecoins. Sections 21 and 22 of Schedule 6 of the FSMB propose amendments to the Bank of England's oversight of payment systems established under the U.K. Banking Act 2009 and to extend a section of the existing Financial Services (Banking Reform) Act 2013 to payment systems involving DSAs. The FSMB also provides that the Treasury will retain the power to make and modify regulations as it considers appropriate in connection with (among other things) (i) payments that include DSAs; (ii) recognized payment systems that include arrangements using DSAs, recognized DSA providers and service providers connected with or in relation to such systems and providers and (iii) insolvency arrangements in respect of the systems and providers mentioned in (ii). However, the Treasury will be required to consult the FCA, the Bank of England and other applicable payments regulatory bodies before making such regulations.

As the FSMB has just been introduced to Parliament, it will undergo examination and consultation before becoming law. The bill's progression (including any amendments made to it) will be keenly monitored by those working in or advising in this area.

Part IV: Key U.S. Bankruptcy Considerations

Key Legal Issues Critical to the Outcome of a Case Before a U.S. Bankruptcy Court

In bankruptcy proceedings in the U.S. there will likely be certain key legal issues that will arise in a case involving crypto assets:

- Is the cryptoasset property of the estate?
- Are customers (in the event the debtor is the exchange) entitled to the return of crypto-in-kind?
- As of what date is the amount of the crypto claim determined?
- Can the debtor (assuming the debtor is the exchange) recover customer withdrawals or loan liquidations completed in the 90 days before filing as preferences?

PROPERTY OF THE ESTATE: A key consideration is whether the crypto assets are property of the debtor's bankruptcy estate under Section 541 of the Bankruptcy Code, and therefore, not recoverable by the customer, who would then likely be an unsecured claimholder of the debtor exchange. Common law, existing provisions of Article 8 of the UCC, and proposed amendments to the UCC recognize that if the arrangement and relationship between the exchange and its customers is one that is characterized as "custodial," the crypto assets held by the exchange should remain property of the customer, and thus not be made available for distribution to other creditors.

RETURN OF CRYPTO-IN-KIND: A major consideration is whether customers entitled to a distribution from the bankruptcy estate should receive the value of such currency in cash as of a specified date, or the crypto asset itself.

DATE OF THE CLAIM: When the crypto claim in question arises will be extremely important, especially given the volatility in the price of such assets. The Bankruptcy Code does not mandate the date on which the court should value property recovered, and whether the crypto assets are deemed currency or commodities, the date on which the court determines the value could significantly impact creditor and/or customer claims.

AVOIDING TRANSFERS: Section 547 of the Bankruptcy Code provides that the trustee can avoid and recover transfers made within 90 days prior to the petition date and one year prior to the petition date if the transfer was to an "insider." If customers withdraw their cryptoassets within the 90-day period, can the trustee avoid such transfer?

Property of the Bankruptcy Estate

When a cryptocurrency exchange declares bankruptcy, it may be unclear who "owns" the crypto assets and whether they are merely held in trust or a custodial capacity by the exchange for the benefit of its customers. If held in trust, then it is unlikely that the cryptoassets will be classified as property of the estate available for distribution to general unsecured creditors. The legal characterization of custodial arrangements in the world of crypto lacks legal clarity and will likely result in litigation regarding who "owns" the custodially held cryptocurrency and in what capacity.

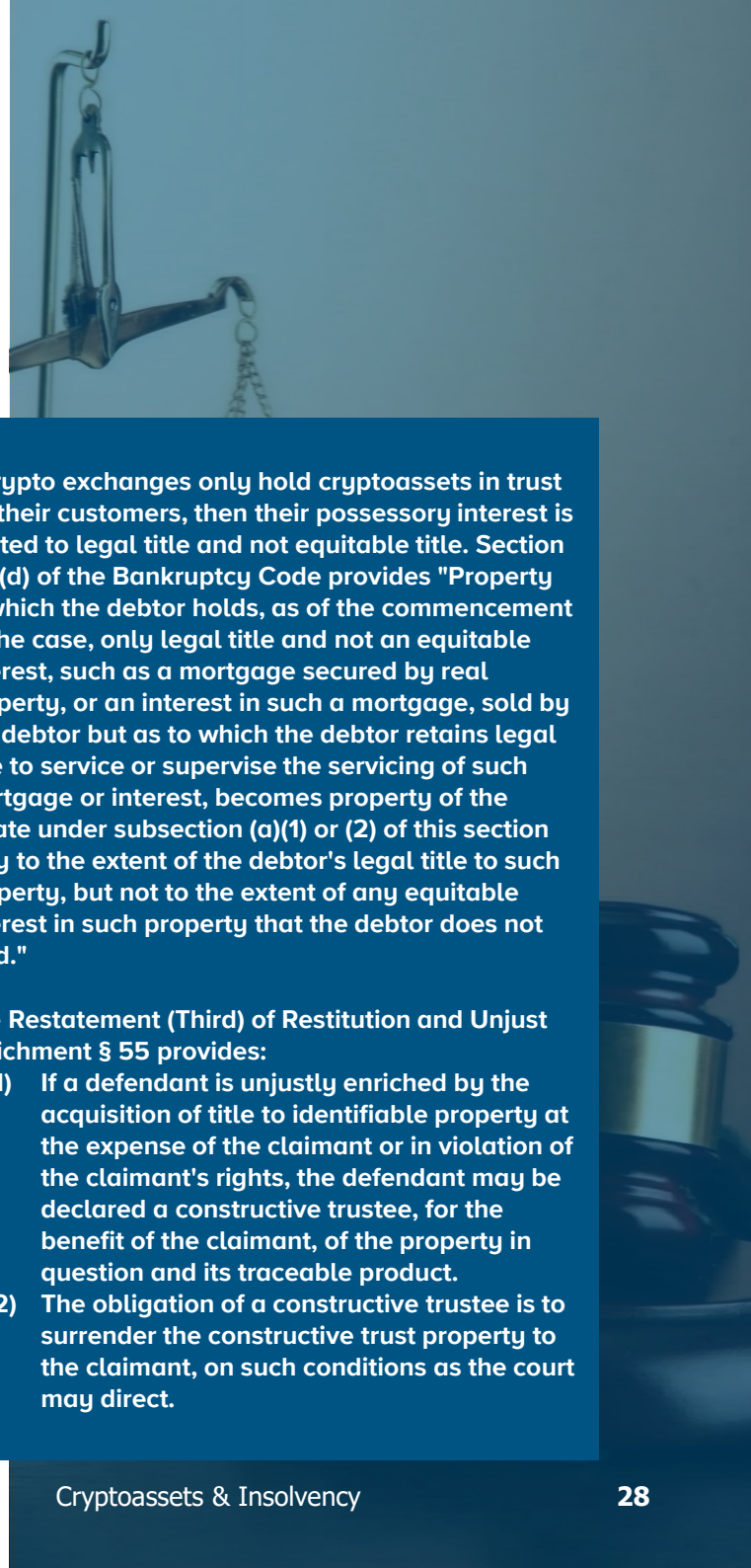
Creation of an **express trust** requires a writing that manifests the intent to place certain assets in trust for the benefit of identifiable beneficiaries. Restatement (3d) of Trusts § 10. In cryptocurrency arrangements, a trust can be created by direct entrustment or an intermediated entrustment. The difference is significant in terms of bankruptcy because it changes whether the exchange is the trustee or the trust beneficiary.

- **Direct entrustment**: the custodial funds are placed in trust for the exchange's customers. In a scenario involving a direct entrustment, where the exchange itself holds the cryptocurrency in trust for the individual customers, the exchange's bankruptcy would not change the customer's beneficial interest in the cryptocurrency, and the bankruptcy estate's interest would be limited to legal title only.

- **Intermediated entrustment**: the custodial funds are placed in trust for the exchange itself. This arrangement provides little protection for an exchange's customers in the event the exchange declares bankruptcy, because it suggests the economic interest belongs to the exchange rather than the customers. Intermediated trusts require the exchange, however, to alienate the cryptocurrency by placing it in trust for itself. If the exchange alienates the cryptocurrency in trust for itself, it could argue that the customer is nothing more than a creditor of the exchange without a claim to any particular asset.

A **constructive trust** is a kind of implied trust that is usually judicially created as a remedy when a party is unjustly enriched by the acquisition of title to identifiable property at the expense of another or in violation of another's rights. Constructive trusts are governed by state law, and a constructive trust is an equitable remedy. As an equitable remedy, bankruptcy courts are able to consider different equities than a state court. *Ades and Berg Group Investors v. Breeden (In re Ades and Berg Group Investors)*, 550 F.3d 240, 245 (2d Cir.2008). Depending on the state law and the federal court's view of the particular constructive trust and its interaction with bankruptcy law, there is no guaranty that a constructive trust would survive in bankruptcy.

- Importantly, constructive trusts would only protect exchange customers to the extent that the exchange still has its cryptocurrency or the traceable proceeds thereof. Because cryptoassets are commingled, the use of a constructive trust could be severely limited or destroyed depending on how tracing rules apply.



If crypto exchanges only hold cryptoassets in trust for their customers, then their possessory interest is limited to legal title and not equitable title. Section 541(d) of the Bankruptcy Code provides "Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold."

The Restatement (Third) of Restitution and Unjust Enrichment § 55 provides:

1) **If a defendant is unjustly enriched by the acquisition of title to identifiable property at the expense of the claimant or in violation of the claimant's rights, the defendant may be declared a constructive trustee, for the benefit of the claimant, of the property in question and its traceable product.**
2) **The obligation of a constructive trustee is to surrender the constructive trust property to the claimant, on such conditions as the court may direct.**

Property of the Bankruptcy Estate (cont.)

Some crypto exchanges may provide that their relationship with their customers is merely a bailment. A bailment is a delivery of property from one person to another for a specific purpose under a contract providing that the property will be returned when that purpose has been accomplished or the bailor reclaims the property. Examples of common bailments would be parking valets and coat checks.

- Courts may sometimes refer to bailed property as being held in "trust," but a bailment is neither a fiduciary relationship nor an entrustment because a bailment does not transfer title to property.
- A bailment bifurcates ownership from possession where general ownership remains with the bailor while the bailee has lawful, but limited, possession.
- In the context of bankruptcy, mere possessory interests (bailments) are not sufficient to convey ownership to a bailee and, as such, bailed goods are not "property of the estate" of a bankruptcy bailee.

When crypto exchanges transfer holdings into omnibus wallets controlled by the exchange, the custodial assets are commingled. The commingling of assets complicates the situation, and in some cases, the commingling of fungible assets can destroy a bailment and constitute conversion by the bailee. Courts analyzing the issue will typically look at whether the customer had an expectation of getting back the specific asset in question (which is typically a bailment) or the value of the asset or a like-kind good. However, commingling of fungible assets can make it difficult, if not impossible, to trace the specific asset.

That said, the commingling of assets does not, in and of itself, prevent the assets from remaining the property of the customer. Restatement (Third) of Restitution and Unjust Enrichment § 59 provides that property interests in an asset continue even when commingled, when the interests can be traced.

Property of the Bankruptcy Estate (cont.)

Cryptocurrencies may also be characterized as "financial assets" subject to Article 8 of the UCC. Part 5 of Article 8 created a system of indirect securities holding based upon immobilization of legal title to securities: the physical securities certificates are deposited at issuance with a central securities depository (usually the Depository Trust Company), which maintains the physical certificates in its vaults. The depository (called a "securities intermediary") then tracks the beneficial interest in the securities (or more precisely the broker for the beneficial owner), which is called a "securities entitlement," on its electronic books and records.

So, what is the effect of being classified as a "financial asset" under the UCC?

If cryptocurrencies can be deemed "financial assets" and crypto exchanges deemed "securities intermediaries" under the UCC, then "all interests in that financial asset held by the securities intermediary will be held by the securities intermediary for the entitlement holders, will not be property of the securities intermediary, and [will not] be subject to claims of creditors of the securities intermediary (except as provided in Section 8-511, which provides certain exceptions for secured creditors). See UCC § 8-503(a). As a result, customers could receive treatment ahead of general unsecured creditors with respect to the cryptoassets such customers have an interest in (shared on a pro rata basis).

UCC Definitions:

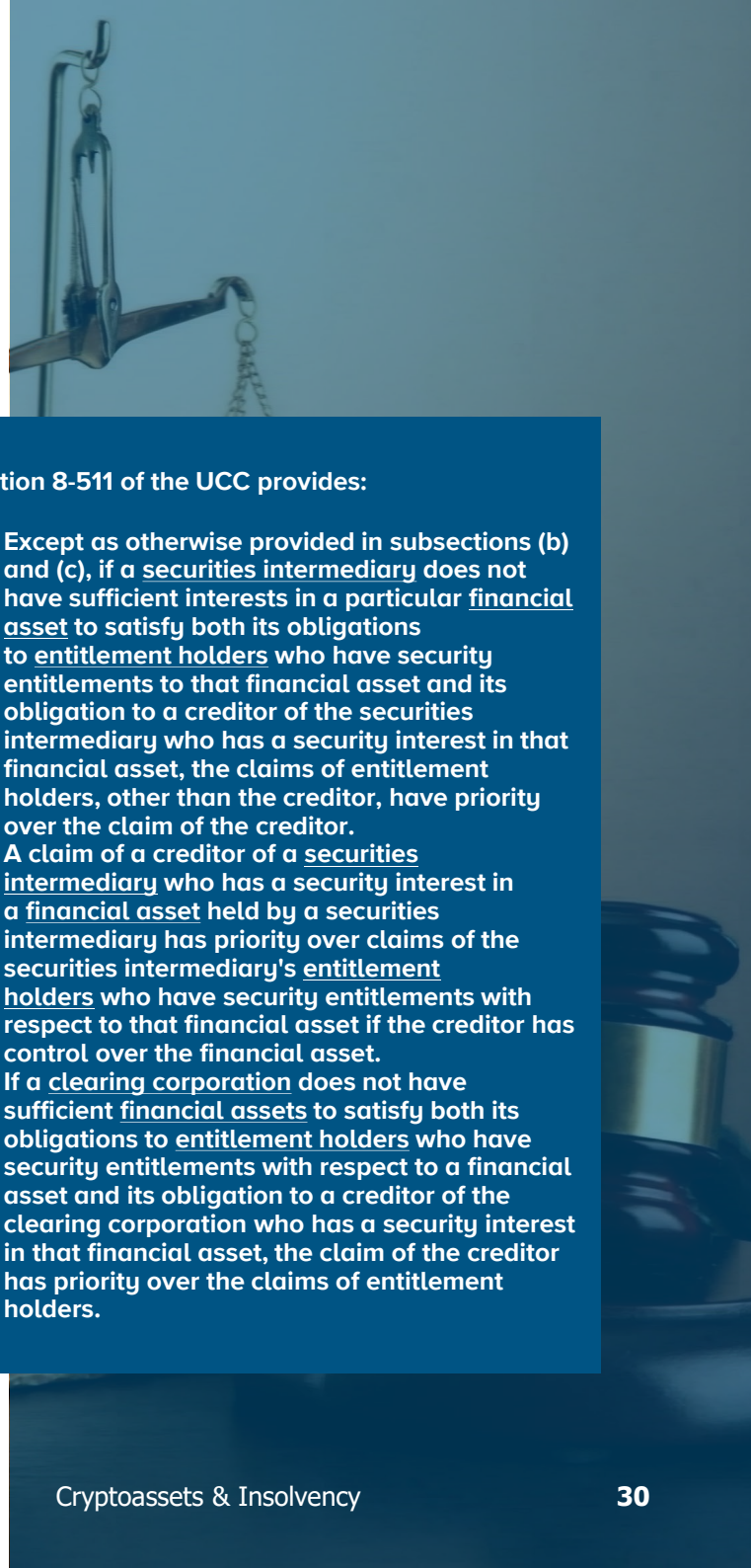
"Entitlement holder" means a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary.

"Financial asset," means:

i. a security;
ii. an obligation of a person or a share, participation, or other interest in a person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on financial markets, or which is recognized in any area in which it is issued or dealt in as a medium for investment; or
iii. any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this Article.

"Securities intermediary" means:

i. a clearing corporation; or
ii. a person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity.



Section 8-511 of the UCC provides:

a) Except as otherwise provided in subsections (b) and (c), if a securities intermediary does not have sufficient interests in a particular financial asset to satisfy both its obligations to entitlement holders who have security entitlements to that financial asset and its obligation to a creditor of the securities intermediary who has a security interest in that financial asset, the claims of entitlement holders, other than the creditor, have priority over the claim of the creditor.

b) A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset.

c) If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders.

Valuation, Realization and Distribution

Other issues that bankruptcy courts will have to grapple with include the value of the cryptoassets, whether customer claims should be paid according to that value as of the petition date or a later date, and whether customer recoveries should be in kind or based on the value of the cryptoassets as of that date. For instance, should a bankrupt exchange be required to convert cryptoassets into U.S. dollars or make customer distributions in kind? The answers to these issues can significantly impact creditor recoveries in a crypto exchange bankruptcy because the value of the cryptocurrency is volatile and can change significantly in a short period of time.

Voyager, for example, has indicated that it will not convert cryptoasset holdings as part of its plan of reorganization, but instead will (pursuant to its chapter 11 plan of reorganization) seek to make customer distributions in kind. A significant portion of Voyager's cryptoassets ($307mm of its $4.3bn) are Voyager Tokens or VGX. VGX has fallen in price to $0.48 as of July 19 from $1.81 as of March 31. A further decline could significantly reduce customer claimant recoveries.

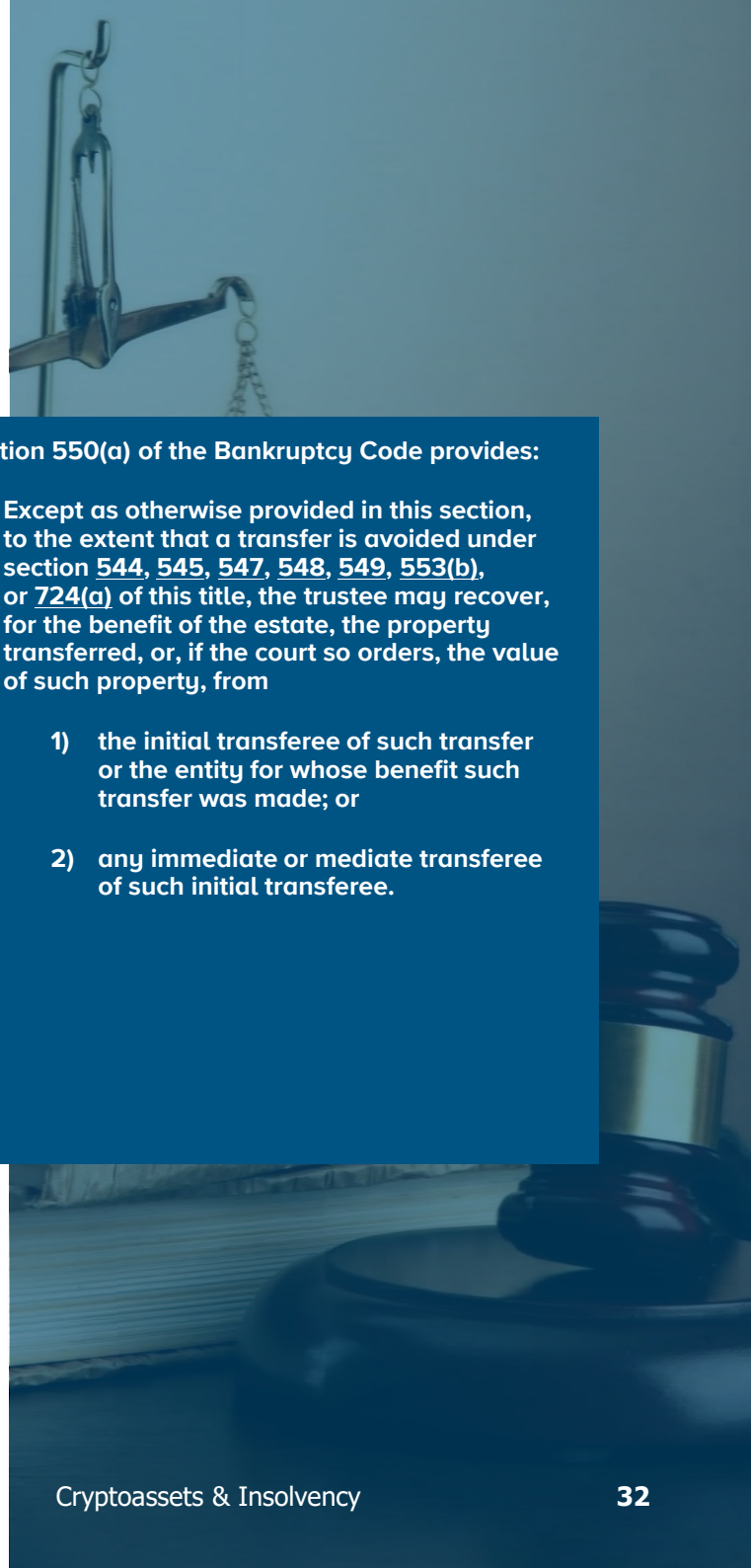
The value of the cryptoasset could be vastly different at the start of a crypto bankruptcy as compared to the end. If, by the end of a case the value of certain crypto currencies increases significantly, many creditors would want their claims paid in kind to reap the benefit of such increased value.

Avoidance Powers

The value of an asset plays an essential role in the context of fraudulent and preferential transfers. Transfers of assets of the bankrupt estate that are fraudulent or that prefer one creditor over another can be avoided and recovered by the trustee to distribute to the debtor's various creditors. Section 550 of the Bankruptcy Code provides that the trustee, in recovering a transfer, may recover the property of the transfer, or if permitted by the bankruptcy court, the cash value of the transferred property rather than the property itself.

Issues with valuation may arise when recovery of the actual cryptocurrency is not possible because the transferee must return the value of the cryptocurrency asset rather than the asset itself (either because it is deemed a currency or because it cannot be recovered due to theft or some other reason).

The value of cryptocurrencies, however, change every day. Thus, the question becomes what date should be used to determine the value of any particular cryptoasset when evaluating the trustee's avoidance powers under the Bankruptcy Code? The Bankruptcy Code does not prescribe a specific valuation date, so some courts have used the date of the fraudulent or preferential transfer, while other courts have used the date the trustee brings the recovery action or the date on which the debtor filed the bankruptcy petition.



Section 550(a) of the Bankruptcy Code provides:

a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from

1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

2) any immediate or mediate transferee of such initial transferee.

Appendix 1: Regulation of Cryptoassets

U.K. Regulation of Cryptoassets

Note: The information in this section is a selective and non-exhaustive summary of existing regulation and regulatory proposals / initiatives in the U.K.

Need for Global Approach to Regulation

In December 2021, the Bank of England announced plans to discuss a global approach to regulating cryptoassets with other members of the Financial Stability Board—a body that unites international central banks (including in Japan, America, Europe and Australia). This mirrors calls of other regulators for a consistent, global approach to the regulation of cryptoassets. Sarah Breeden, executive director for financial strategy and risk at the Bank of England said the Bank faced "challenges" in finding data on cryptocurrency holdings by institutional investors and international co-operation was required to establish the sale of investments by big holders. She went on to say that moves by banks to offer cryptocurrency trading and custody services to clients meant that global regulators needed to design rules to protect the financial system.

The U.K. Regulatory Perimeter for Digital Assets

The current distinction between regulated and unregulated digital assets, according to the FCA, is that:

- regulated tokens are: (i) security tokens and (ii) e-money tokens; and
- unregulated tokens are: any tokens that are not security tokens or e-money tokens, for example, (i) utility tokens and (ii) exchange tokens (like Bitcoin, Litecoin), used as a means of exchange or for investment.

Extending the regulatory perimeter to stablecoins: Under the newly published FSMB, all stablecoins used for payment will become regulated in the U.K., including those that reference fiat currencies (whether a single currency or based on a basket of currencies). It is proposed that regulation will apply to the following if they are established and providing services in the U.K.: stablecoin issuers, wallet providers and custodians. Consumer protection will be provided for by a statutory legal claim against the issuer or third party facing the consumer.

Special Insolvency Regimes

The U.K. has special regimes that apply to certain regulated firms when they are failing or failed, such as the bank resolvability and resolution regime, the investment firm SAR, the FMI SAR and the payment and e-money SAR. These regimes override many aspects of the usual U.K. insolvency regime, and their main aims are to ensure financial stability (by ensuring continuity of service) and consumer protection (by ensuring return of funds / assets).

Proposed SAR for Systemic DSA Firms

A consultation published by HMT on May 31, 2022 proposes to implement a modified FMI SAR to address the failure of systemic DSA firms, including stablecoin firms. The amended FMI SAR will require a firm's services to continue ahead of the interests of its creditors and provide the Bank of England with powers over the administrators and the ability to direct which objectives take precedence in an administration. In addition to the objective of continuity of service, it will also provide an additional objective covering the return or transfer of funds and custody assets (such as private keys).

U.K. Regulation of Cryptoassets (cont.)

Anti-Money Laundering (AML) / Counter Terrorism Financing (CTF) Regime

Since January 2020, cryptoasset exchange providers (cryptoasset ATMs, peer-to-peer providers issuing new cryptoassets by ICO or Initial Exchange Offerings) and custodian wallet providers providing services in the U.K. by way of business have been required to register with the FCA for AML purposes. The FCA's responsibility is limited to AML / CTF registration, supervision and enforcement, and it will adopt a "risk-based approach" to supervision. Subject to Parliamentary approval, from September 1, 2023, cryptoasset exchange providers and custodian wallet providers will need to send and record information on the originator and the beneficiary of a transfer of cryptocurrency worth more than €1,000 (to include multiple linked transfers). The use of euros for the threshold may be changed during the comprehensive review of the MLRs, but at the moment, it is aligned with the FATF threshold.

U.K. Jurisdiction Taskforce

In 2019 the UKJT found that:

- Cryptoassets "are to be treated in principle as property" and have "all of the indicia of property." The fact that cryptoassets are intangible, use cryptographic authentication and distributed transaction ledgers, are decentralized and operate on the basis of rules by consensus as opposed to legal rules, does not "disqualify them from being property."
- Regarding the private key of a cryptoasset, however, the UKJT concluded that a private key "is not in itself to be treated as property because it is information."
- The requirements for formation of a contract are the same for all contracts, whether a conventional contract or a smart contract, i.e., smart contracts can be, or be part of, binding legal contracts.

Advertising Cryptoassets

- The U.K. will bring certain unregulated cryptoassets within scope of the financial promotion restriction (i.e., not into the regulatory perimeter). The financial promotion restriction provides that a firm must not communicate an invitation or inducement to engage in investment activity in the course of business unless that firm is authorized or the communication is approved by an authorized firm. Financial promotions are supervised by the FCA.
- Currently, advertising of cryptoassets is supervised by the Advertising Standards Agency (ASA). The ASA aims to ensure that consumers are protected and companies comply with the U.K. Code of Non-broadcasting Advertising and Direct & Promotional Marketing (the CAP Code). The headline points include: (i) making clear that cryptoassets are unregulated and not protected; (ii) not to take advantage of consumers' inexperience or credulity; (iii) clearly stating that value can go down as well as up; and (iv) the basis used to calculate any projections or forecasts.

The U.K. Law Commission

The U.K. Law Commission considers the existing laws of England and Wales insufficient in providing legal certainty as to the legal status of digital assets. The Law Commission published a consultation in July 2022 (following a call for evidence and interim update in 2021) with the intention that certainty will incentivize the use of English law and England as a jurisdiction in digital asset transactions (see slide 8 for further details).

U.S. Regulation of Cryptoassets

Note: The information in this section is a selective and non-exhaustive summary of existing regulation and regulatory proposals/initiatives in the U.S.

Presidential Executive Order on Development of Digital Assets

Within 180 days of the date of President Bidens March 9, 2022 executive order, the Secretary of the Treasury, in consultation with the Secretary of Labor and the heads of other relevant agencies, including, as appropriate, the heads of independent regulatory agencies such as the FTC, the SEC, the CFTC, Federal banking agencies, and the CFPB, shall submit to the President a report, or section of the report required by section 4 of the executive order, on the implications of developments and adoption of digital assets and changes in financial market and payment system infrastructures for United States consumers, investors, businesses, and for equitable economic growth.

The report will include policy recommendations, including potential regulatory and legislative actions, as appropriate, to protect United States consumers, investors, and businesses, and support expanding access to safe and affordable financial services.

Bank Secrecy Act (BSA)

Cryptocurrency exchanges are regulated in the U.S. under the BSA which requires that cryptocurrency exchanges register with the Financial Crimes Enforcement Network (FinCEN), implement AML / CFT programs, maintain appropriate records, and submit reports to authorities.

The BSA imposes anti-money laundering obligations on various U.S. financial institutions, including "money services businesses" (MSBs). Under the BSA, businesses that transact in cryptocurrencies may qualify as money transmitters, a type of MSB. An MSB must register with FinCEN, implement anti-money laundering controls, and ensure ongoing compliance with recordkeeping and reporting requirements.

UCC Amendments

The Uniform Law Commission ("ULC") and the American Law Institute ("ALI") have proposed certain amendments to the UCC in light of emerging technologies and the purchase and sale of digital assets. The amendments will need to be adopted on a state-by-state basis.

New Article 12, will deal directly with the acquisition and disposition of interests (including security interests) in "controllable electronic records," which would include Bitcoin, Ether, and a variety of other digital assets. Amendments to Article 9 will provide further legal clarity on creating and perfecting security interests in digital currency.

In addition, amended Article 8 serves to make clear that crypto assets can be "financial assets."

U.S. Regulation of Cryptoassets (cont.)

Federal Regulation of Cryptoasset Trading Activity

There is not, as yet, an overriding federal regulatory regime applicable to cryptoassets generally, and a number of federal agencies may have jurisdiction under existing law depending on the particular activity.

The CFTC has determined that certain cryptocurrencies should be treated as commodities for purposes of the U.S. federal commodities laws. As such, derivatives involving such cryptocurrencies are subject to regulation by the CFTC. Although the CFTC does not generally regulate spot transactions in commodities, such transactions are subject to prohibitions on fraud and manipulation under the commodities laws. In addition, leveraged spot transactions involving retail market participants may also be subject to CFTC regulation.

SEC commissioners and staff members have stated the view that many cryptocurrencies and other cryptoassets (excluding certain cryptocurrencies such as Bitcoin) may be securities subject to the U.S. federal securities laws. In such case, offers and sales of such cryptocurrencies or cryptoassets may only be made pursuant to registration or an applicable exemption. Exchange and intermediaries that deal in such assets may also be subject to registration and other requirements under the securities laws.

State Regulation of Cryptoasset Activity

In the absence of an overriding federal framework, various individual states have exercised jurisdiction over cryptoasset trading and other activity. New York, for example, has adopted the “Bitlicense” regime that requires licensing of some virtual currency activity in New York. In addition, in New York and other states, some custodians and other market participants have become licensed as trust companies subject to regulation by state banking authorities. Other market participants may be subject to state money transmitter regulations. States may also seek to enforce state securities laws against some market activity.

Appendix 2: Ownership Issues – Case Studies

U.K. and U.S. Case Studies

01 *Ion Science Ltd v. Persons Unknown (2021)*

The Claimant had been induced into paying £577,000 in cryptocurrency for what it believed to be a legitimate investment in Initial Coin Offerings. However, the Claimant received no profits from the investment, nor did it receive back any of the amounts transferred. Significant portions of the funds were traced to wallets held with the Binance and Kraken exchanges, based in the Cayman islands and U.S., respectively.

The Court granted a freezing injunction in respect of Persons Unknown on the basis that there was a real risk of dissipation. The Court held that the absence of evidence that assets would be caught by the freezing injunction did not prevent an order being granted (and was a common feature in persons unknown cases). When determining whether the Court had jurisdiction to serve parties outside the jurisdiction, the Court reflected the analysis by Professor Andrew Dickinson in his book "*Cryptocurrencies in Public and Private Law*" and took the interim view that the *lex situs* for cryptoassets is the place where the person or entity that owns the asset is domiciled.

02 *AA v. Persons Unknown (2019)*

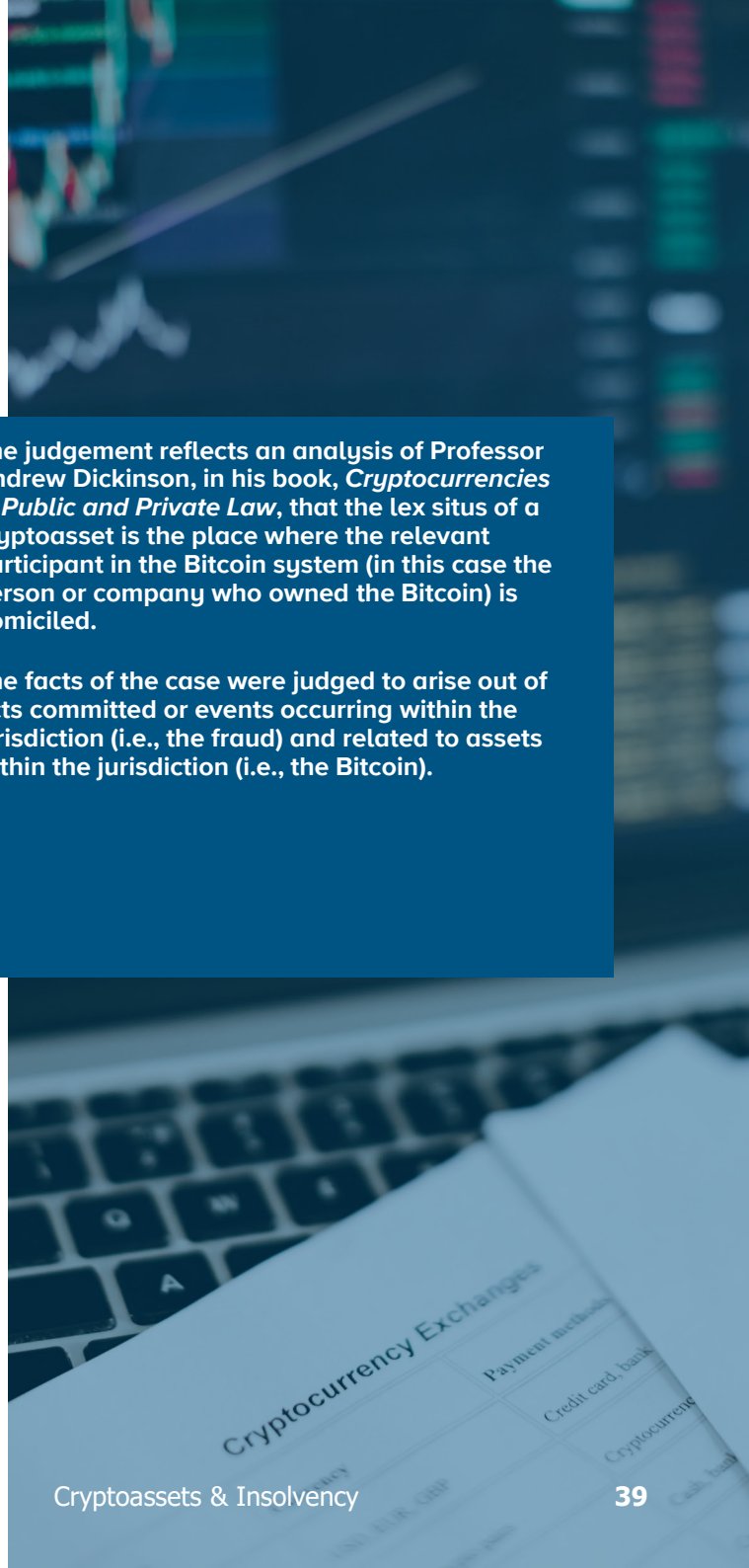
The Claimant insurer sought a proprietary injunction over Bitcoins, which, following a ransomware attack, had been traced to a wallet controlled by the exchange Bitfinex, a BVI based cryptocurrency exchange.

The Claimants initially sought Norwich Pharmacal* and/or Bankers Trust** relief against Bitfinex, to identify the owner of the wallet. However, it was unclear whether the Court had jurisdiction to grant such relief in respect of entities outside the jurisdiction (a question not definitively determined in English law), and the Claimant asked the Court to adjourn its application and proceeded only with its application for a proprietary injunction.

The Court, observing that cryptocurrencies were neither a chose in action nor a chose in possession, held that this did not mean such assets could not be treated as property, as they still satisfied the requisite criteria of property, namely: (i) definable, (ii) identifiable by third parties, (iii) capable by their nature of assumption by third parties, and (iv) having some degree of permanence (*National Provincial Bank v. Ainsworth*). The Court was satisfied, at least to the extent necessary for the purposes of an interim injunction application, that Bitcoin constituted property capable of being the subject of a proprietary injunction.

The judgement reflects an analysis of Professor Andrew Dickinson, in his book, *Cryptocurrencies in Public and Private Law*, that the lex situs of a cryptoasset is the place where the relevant participant in the Bitcoin system (in this case the person or company who owned the Bitcoin) is domiciled.

The facts of the case were judged to arise out of acts committed or events occurring within the jurisdiction (i.e., the fraud) and related to assets within the jurisdiction (i.e., the Bitcoin).



**A Norwich Pharmacal order is a disclosure order available in England and Wales which allows information to be obtained from third parties who have become "mixed up" in wrongdoing, helping victims to investigate, pursue those ultimately responsible and recover their losses.*
*** Bankers Trust orders are usually made against banks or other entities holding misappropriated or stolen funds or through whom such funds have passed. They require financial institutions to provide details ordinarily protected by duties of confidentiality concerning third-party bank accounts and are an effective way of tracing money.*

U.K. and U.S. Case Studies (cont.)

03

Fetch.ai Ltd v. Persons Unknown (2021)

The Claimant's account was hacked and cryptoassets having a value of c.$2.6m were sold at a huge undervalue to wallets believed to be held by those perpetrating the fraud.

Considering the application for a proprietary injunction, the Court found that the assets were a form of property. However, in contrast to *AA* the Court found them a species of chose in action—though provided no reason to support this finding (nor did it refer to *AA*). As such, there are now conflicting decisions on the proprietary categorization of cryptoassets.

Granting a proprietary injunction and worldwide freezing order against the exchange (Binance), the Court followed the decision in *Ion* and concluded the *lex situs* of such assets ought to be the law of the place where the owner is domiciled. Proprietary relief was also drafted to make clear that any cryptoassets otherwise caught by the order but held by innocent purchasers for value would not be caught. The Claimant also sought ancillary information disclosure from Binance in the form of Norwich Pharmacal and Bankers Trust relief. The Court, though appearing to take a critical view of prior authority which established that Norwich Pharmacal relief was not available in respect of entities outside the jurisdiction, granted such relief in respect of the U.K. Binance entity only. However, following *Ion*, the Court distinguished the principles applicable to Bankers Trust relief from those of Norwich Pharmacal relief, although noted that there was a serious issue to be tried as to whether that distinction could properly be maintained.

U.K. and U.S. Case Studies (cont.)

04 ***In re Hashfast Technologies LLC (2016)***

There was a prepetition transfer of 3,000 bitcoins, which were worth $363,861.43 at the time of the transfer but had grown over the case's pendency to reach over $2.3mm. If the bankruptcy trustee could have proven that the transfer qualified as fraudulent or preferential, the trustee would have been entitled to a recovery under section 550 of the Bankruptcy Code.

However, the nature and value of that recovery depended on (i) whether bitcoin is a currency representing U.S. dollars or a commodity for purposes of the Bankruptcy Code; and (ii) what the precise nature of the recovery should be. Section 550 of the Bankruptcy Code allows a bankruptcy court to order the return of either the property or its value to the bankrupt estate. However, the Bankruptcy Code does not state *when* such value should be determined.

The Bankruptcy Court ruled that bitcoin should be classified as intangible personal property, and consequently, the tokens were deemed an asset of the bankruptcy estate, particularly as to avoidable transfers under section 550 of the Bankruptcy Code.

The parties dismissed the case before the bankruptcy court could decide all the issues presented.

International Case Studies

01 ***Mt. Gox (2015)***

Mt. Gox was the largest cryptocurrency exchange (it was responsible for more than 70% of Bitcoin transactions at its peak) until 2014 when it was targeted by hackers who purportedly misappropriated 744,800 Bitcoins. Restructuring proceedings started as an insolvency filing but shifted to a civil rehabilitation proceeding in 2017 when the Tokyo District Court determined that creditors seeking to regain their lost funds in Bitcoin may receive larger amounts of cash than those who sought to be repaid in the fiat currency, thereby allowing the trustee to distribute tranches of Bitcoin to the creditors in its proprietary form.

02 ***Cryptopia (2019)***

Cryptopia was put into liquidation when it lost a substantial amount of its cryptocurrency following a hack. The liquidators sought directions from the New Zealand Court regarding the categorization and distribution of the assets in the liquidation—specifically how to deal with the $170 million of cryptocurrency held in accounts for particular account holders. The Court determined the cryptocurrency was property and that a trust had been created with an associated proprietary interest in the assets held by Cryptopia for its clients i.e., the cryptocurrency was not the property of Cryptopia itself. This meant that the liquidators were not able to distribute the cryptocurrencies held on trust to the general unsecured creditors of Cryptopia.

03 ***Bitgrail (2019)***

The Italian cryptocurrency exchange filed for bankruptcy following a theft of more than 11m Nano XRB coins. The Italian Courts determined that cryptocurrency is both "property…over which rights can be claimed" and a "means of payment." While the cryptoassets were determined to be proprietary, they were treated as commingled by the custodian with other assets, resulting in only a contractual claim being available to clients of the custodian.

Appendix 3: Our Multidisciplinary Team

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Testimonials

"The team has been fully rejuvenated. Their key strengths are anchored in their capital markets/bonds DNA that give them access to key corporates, which is supplemented by a strong network of regional offices giving them enhanced offering."

Legal 500 UK, Corporate Restructuring & Insolvency 2022

"The Shearman team had the expertise, knowledge, and professionalism to advise my client towards a difficult, complex, but best-case outcome. Where other counsel failed to inspire confidence in their recommendations, the Shearman team came across as subject-matter experts."

Legal 500 USA, Corporate Restructuring & Insolvency 2022

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