

Digital assets in insolvency and restructuring

Emmanuelle Inacio takes a closer look at the impact of the protection and recovery of digital assets on insolvency and restructuring practice



EMMANUELLE INACIO
INSOL Europe Technical Officer

Cryptocurrencies, tokens and ICOs

Cryptocurrencies such as Bitcoin, Ethereum or Ripple, use **blockchain** (see box right) to transfer economic value. Bitcoin is a technology that was first proposed in 2008 in a whitepaper written by Satoshi Nakamoto. The term Bitcoin refers both to a private currency and the network of computers that runs the currency. However, governments do not issue Bitcoins, but instead a decentralised network of computers does so³. There are more than nine hundred cryptocurrencies today and the entire cryptocurrency market will reach a total value of \$1 trillion this year⁴.

Blockchain is not limited to cryptocurrencies and can also store, transfer and record tokens of values. The token is a digital asset personalised by its author, emitted and exchangeable via blockchain and which has all the characteristics of a cryptocurrency.

Recently promoters have been selling virtual coins or tokens in **Initial Coin Offerings** (ICOs) or token sales which are a new form of crowdfunding. Purchasers may use fiat currency (e.g., U.S. dollars) or virtual currencies to buy these virtual coins or tokens. Promoters may tell purchasers that the capital raised from the sales will be used to fund development of a digital platform, software, or other projects and that the virtual tokens or coins may be used to access the platform, use the software, or otherwise participate in the project. Some promoters

and initial sellers may lead buyers of the virtual coins or tokens to expect a return on their investment or to participate in a share of the returns provided by the project. After they are issued, the virtual coins or tokens may be resold to others in a secondary market on virtual currency exchanges or other platforms⁵.

Legal qualification

The first question which arises is that of the legal qualification of the cryptocurrencies.

In France, Article L. 111-1 of the French Monetary and Financial Code states that the currency of France is Euro. Therefore, cryptocurrencies cannot be qualified as currencies in France.

Similarly, in the US, the US Bankruptcy Court of the Northern District of California, in the case *Hashfast v/ Mark Lowe*, stated on 22 January 2016, that “*Bitcoin is property, not currency*”⁶.

What about the legal qualification of the token and its value? Is it a currency? A personal property?

Many values can be transposed on a token: a property title, a copyright, means of payment, miles, credits, etc. which makes its legal qualification impossible. The hybrid nature of many tokens will defy the clear categories within which the law is typically structured. In France, by default, the legal qualification of a token could be that it is a personal property.

Another question is that of the legal qualification of the ICO. In France, no clear legal

framework has been laid down so far. The French *Autorité des Marchés Financiers* launched a public consultation on the question of the regulation of the ICOs, which ended on 22 December 2017⁷.

In the US, depending on the facts and circumstances of each individual ICO, the virtual coins or tokens that are offered or sold may be securities. If they are securities, the offer and sale of these virtual coins or tokens in an ICO are subject to the federal securities laws.

As for China and South Korea, the decision was taken of prohibiting the organisation of ICOs⁸.

Digital assets and insolvency

Therefore, if a company becomes insolvent, and if this company has digital assets, the question arises whether a creditor can lodge its claim e.g. in Bitcoins.

According to Article L. 622-25 of the French commercial code, the lodging of a claim consists in stating the amount of the claim due on the date of the judgement opening the insolvency proceedings and where the claim is expressed in a foreign currency, the conversion to euros shall be made at the exchange rate prevailing at the same date.

As we have seen above, Bitcoin is not a currency according to Article L. 111-1 of the French Monetary and Financial Code and cannot be considered as a foreign currency as it does not belong to a country. Therefore, the French insolvency judge would not recognise the



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Blockchain technology

To quote former IBM IOT Division head Paul Brody, Blockchain is “the glue that is going to drive a productivity revolution across the globe on par with what Henry Ford did with the automobile”.

Blockchain is a distributed register made up of digitally recorded and encrypted data in the form of blocks, which when connected via the distributed network of computers storing the blocks, forms the blockchain.

Each computer holds all or part of the entire blockchain and applies the particular blockchain’s computational algorithm to verify a block and permit it to be added to the chain. Since each instance of the data is held in many places

simultaneously, and a block may be verified and added to the chain by any number of computers, the chain is hack-resistant.

Data added to the chain is cryptographically “hashed” which means that a short digest of the data is created and not a complete record. This hash of data is stored simultaneously in a block across multiple computers and transferred in encrypted form via the blockchain and not the actual, underlying data itself. As a digest, the hashed data can’t be decrypted to reproduce the full underlying document or transaction data. However, within the chain, the hash can verify a copy of the underlying document or transaction existing outside of the blockchain¹.

Therefore, blockchain is not based on the trust of powerful intermediaries such as governments and banks, but on a proof system.

To sum up, the blockchain is an incorruptible digital register of economic transactions that can be programmed to record not just financial transactions but virtually everything of value. Melanie Swan, the founder of the Institute for Blockchain Studies explains: “Think about the blockchain as another class of thing like the Internet - as a comprehensive information technology with tiered technical levels and multiple classes of application for any form of asset registry, inventory, and exchange, including every area of finance, economics, and money; hard assets, and intangible assets”².



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lodging of claim in Bitcoins.

In the US, in the above-mentioned case, Hashfast v/ Mark Lowe, the US Bankruptcy Court of the Northern District of California ruled that Bitcoin should be classified as “intangible personal property”. Therefore, the trustee was allowed to recover this property for the benefit of the estate, or the value of the property, at \$1.3 million. Indeed, the judge ultimately agreed with the trustee’s citation of the Commodity Futures Trading Commission (CFTC) and the Internal Revenue Service (IRS) which characterise Bitcoin as a property or commodity.

Thus, if Bitcoin is not currency but property, it can be the subject of an action for recovery of the digital assets⁹. And as Bitcoin is fungible, it lacks a stable value and significant problems will arise. Bitcoin will also defy the rules of private international law¹⁰.

However, Moscow’s Arbitration Court ruled on March 2018 that the laws of the Russian Federation do not recognise the cryptocurrency as property. Indeed, the Russian legislation does not provide a definition of cryptocurrency and there are no requirements for its circulation. There is no way to tell

if it is property, information or “surrogate”, the court notes, stating that it is impossible to regulate the relations involving cryptocurrency. It was also noted that the use of cryptocurrency presents a potential danger, including a risk of being prosecuted for money laundering or financing terrorism. The court had, therefore, refused to include cryptocurrency discovered on the accounts of the insolvent debtor in the bankruptcy estate even if the insolvency practitioner argued that if the court refused to include it, this would enable some debtors to hide their property in Bitcoin¹¹.

As a result, digital assets create even more complex issues for insolvency professionals and it is difficult to predict outcomes in insolvency scenarios.

In response to recent illegal activities facilitated by Bitcoin use, the states are beginning to propose cryptocurrency regulations. Moreover, it is not by accident that the Central Bank Governors and Finance Ministers of France and Germany have written to the Argentinian Finance Minister requesting the inclusion of cryptocurrency regulations on the G20 Summit Agenda¹². If 2017 was the year of the ICOs, it seems that 2018 is

destined to become the year of regulation.

These challenging questions of the impact on insolvency and restructuring practice of protection and recovering of digital assets will be debated during the Annual Congress of INSOL Europe from 4 to 7 October 2018 in Athens, whose main theme is “Breaking the Chains”. We look forward to meeting you all in Athens! ■

Footnotes

- 1 <http://www.legalalignment.com/blog/blockchain-for-lawyers-101-part-i#http://scet.berkeley.edu/wp-content/uploads/BlockchainPaper.pdf>
- 2 <http://www.blockchainstudies.org/>
- 3 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2620309
- 4 <https://coinmarketcap.com/>
- 5 https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_coinofferings
- 6 <https://www.davispolk.com/files/bitcoin-def-brief.pdf>
- 7 <http://assaslegalinnovation.com/2018/03/26/la-reglementation-des-icos-un-defi-crucial-pour-le-legislateur-francais/>
- 8 <https://medium.com/@wulfkaal/initial-coin-offerings-the-top-25-jurisdictions-and-their-comparative-regulatory-responses-4b8c9ae7e8e8>
- 9 <http://www.fusions-acquisitions.fr/article/dossiers-5/blockchain-et-procedure-collective-du-partage-aux-interrogations-2743>
- 10 <http://leidenlawblog.nl/articles/the-end-of-comi-as-we-know-it-insolvency-rules-in-the-era-of-decentralisati>
- 11 <https://news.bitcoin.com/russian-bankruptcy-court-orders-debtor-disclose-cryptocurrency-holdings/>
- 12 http://www.rapsinews.com/judicial_news/20180312/282170768.html
- 13 <http://www.djcapital.com/single-post/2018/02/15/Crypto-Regulation-France-and-Germany-Want-Issue-Included-in-G20-Summit-Agenda>

